



# Form 10-K

AT&T INC. - T

Filed: March 01, 2006 (period: December 31, 2005)

Annual report which provides a comprehensive overview of the company for the past year

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**FORM 10-K**

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934**

☒

**For fiscal year ended December 31, 2005**

**OR**

☐

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to**

Commission File Number: 1-8610

**AT&T INC.**

Incorporated under the laws of the State of Delaware  
I.R.S. Employer Identification Number 43-1301883

175 E. Houston, San Antonio, Texas 78205-2233  
Telephone Number 210-821-4105

Securities registered pursuant to Section 12(b) of the Act: (See attached Schedule A)

Securities registered pursuant to Section 12(g) of the Act: None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12-b2 of the Exchange Act. Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

Based on the closing price of \$23.75 per share on June 30, 2005, the aggregate market value of our voting and non-voting common stock held by non-affiliates was \$78.5 billion.

At January 31, 2006, common shares outstanding were 3,879,759,768.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

- (1) Portions of AT&T Inc.'s Annual Report to Stockholders for the fiscal year ended December 31, 2005 (Parts I and II).
- (2) Portions of AT&T Inc.'s Notice of 2006 Annual Meeting and Proxy Statement dated on or about March 10, 2006 to be filed within the period permitted under General Instruction G(3) (Parts III and IV).

## SCHEDULE A

Securities Registered Pursuant To Section 12(b) Of The Act:

<b><u>Title of each class</u></b>	<b><u>Name of each exchange on which registered</u></b>
Common Shares (Par Value \$1.00 Per Share)	New York Stock Exchanges
7.00% Forty Year SBC Communications Inc. Notes, Due June 1, 2041	New York Stock Exchange

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## PART I

### ITEM 1. BUSINESS

#### GENERAL

AT&T Inc. (“AT&T,” “we” or the “Company”) is a holding company incorporated under the laws of the State of Delaware in 1983 and has its principal executive offices at 175 E. Houston, San Antonio, Texas 78205-2233 (telephone number 210-821-4105). We maintain an internet website at [www.att.com](http://www.att.com). (This website address is for information only and is not intended to be an active link or to incorporate any website information into this document.) We make available, free of charge, on our website our annual report on Form 10-K, our quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports as soon as reasonably practicable after such reports are electronically filed with the Securities and Exchange Commission (SEC). We also make available on that website, and in print, if any stockholder or other person so requests, our code of business conduct and ethics entitled “Code of Ethics” applicable to all employees and Directors, our “Corporate Governance Guidelines,” and the charters for the Audit, Human Resources and Corporate Governance and Nominating Committees of our Board of Directors. Any changes to our Code of Ethics or waiver of our Code of Ethics for senior financial officers, executive officers or Directors will be posted on that website.

#### History

AT&T, formerly known as SBC Communications Inc. (SBC), was formed as one of several regional holding companies created to hold AT&T Corp.’s (ATTC) local telephone companies. On January 1, 1984, we were spun-off from ATTC pursuant to an anti-trust consent decree, becoming an independent publicly traded telecommunications services provider. At formation, we primarily operated in five southwestern states. Our subsidiaries merged with Pacific Telesis Group in 1997, Southern New England Telecommunications Corporation in 1998 and Ameritech Corporation in 1999, thereby expanding our wireline operations as the incumbent local exchange carrier (ILEC) into a total of 13 states. On November 18, 2005, one of our subsidiaries merged with ATTC, creating one of the world’s largest telecommunications providers. In connection with the merger, we changed the name of our company from “SBC Communications Inc.” to “AT&T Inc.” Our services and products are marketed under the AT&T and during a transition period our former name SBC, brand names as well as several other brands including Cingular Wireless (Cingular), through our joint venture with BellSouth Corporation (BellSouth); AT&T Yahoo! through our alliance with Yahoo! Inc.; and prior to the amendment discussed below, AT&T | DISH Network through our agreement with EchoStar Communications Corp. (EchoStar).

#### Scope

We rank among the largest providers of telecommunications services in the United States and the world. Through our subsidiaries and affiliates, we provide communications services and products in the U.S. and in 240 countries. We offer our services and products to consumers in the U.S. and services and products to businesses and other providers of telecommunications services worldwide.

The services and products that we offer vary by market, and include: local exchange services, wireless communications, long-distance services, data/broadband and internet services, telecommunications equipment, managed networking, and wholesale transport services and directory advertising and publishing. In 2004, we began offering satellite television services through our agreement with EchoStar, which was subsequently amended in September 2005, to an agency agreement under which we will continue marketing the co-branded AT&T | DISH Network satellite television service but will receive only commission revenues when signing up future customers. We group our operating subsidiaries as follows, corresponding to our operating segments for financial reporting purposes:

- AT&T wireline subsidiaries (i.e., SBC’s traditional wireline subsidiaries) provide primarily landline telecommunications services in thirteen states,
- AT&T Corp. subsidiaries provide landline telecommunications services to large business and governmental customers, and to a lesser degree to small- and mid-sized businesses and residential consumers,



- Cingular provides both wireless voice and data communications services across the U.S. and is held by a wireless subsidiary of AT&T,
- directory subsidiaries provide services related to directory advertising and publishing,
- international subsidiaries, other than those acquired in our acquisition of ATTC, hold investments with primarily international operations, and
- other subsidiaries provide primarily corporate operations and also our paging services, which was sold in November 2005.

We provide telecommunications services throughout the U.S. and internationally. Our traditional wireline subsidiaries operate in thirteen states: Arkansas, California, Connecticut, Illinois, Indiana, Kansas, Michigan, Missouri, Nevada, Ohio, Oklahoma, Texas and Wisconsin (13-state area). Wireline local exchange services offered in our 13-state area are provided through regulated subsidiaries which operate within authorized regions subject to regulation by each state in which they operate and by the Federal Communications Commission (FCC). Subsidiaries of our AT&T Corp. segment provide services both domestically and internationally with domestic services subject to regulation by various states and the FCC. Additional information relating to regulation is contained under the heading "Government Regulation" below and in the 2005 AT&T Annual Report to Stockholders under the heading "Operating Environment and Trends of the Business," and is incorporated herein by reference pursuant to General Instruction G(2).

Our acquisition of ATTC will help change the focus of our company towards business and broadband/data revenues. Cingular's late 2004 acquisition of AT&T Wireless Services Inc. (AT&T Wireless) also increased our potential for growth in the wireless area. Discussed below are the factors upon which we are focusing in 2006.

#### **Business Markets**

With the acquisition of ATTC, we expect to strengthen the reach and sophistication of our network facilities and our ability to offer a variety of global communications services to large businesses worldwide. We expect significant opportunity in the small and medium business markets and to increase our governmental and large-business (referred to as "enterprise") customer base. We also expect to extend our wholesale business to other service products and systems integrations.

#### **Data/Broadband**

**Project Lightspeed** In June 2004, we announced key advances in developing a network capable of delivering a new generation of integrated digital television, super-high-speed broadband and Voice over Internet Protocol (VoIP) services to our residential and small business customers, referred to as Project Lightspeed. We have been building out this network in numerous locations and began providing services in one limited market, including Internet Protocol (IP) video, in late 2005. Our goal in this controlled initial launch is to ensure all operating and back-office systems function at a level capable of supporting our targeted mid-2006 scaled-up deployment. To that end, we have restricted the number of customers and services offered to the necessary minimum. Subject to successful results from this controlled launch and successful testing of our additional IP video services, we plan to enter additional markets in mid-2006. At that time we expect to add additional services and features to our service offerings. We expect to have the capability to offer service to approximately 18 million households by the end of 2008, as part of our initial deployment, and expect to spend approximately \$4.4 billion in network related deployment costs and capital expenditures beginning in 2006 through 2008 as well as additional success-based customer activation capital expenditures.

With respect to our IP video service (marketed under AT&T U-verse TV) we continue to work with our vendors to develop, in a timely manner, the requisite hardware and software technology. Our deployment plans could be delayed if we do not receive the required equipment and software on schedule. We also continue to negotiate with programming owners (e.g., movie studios and cable networks) for permission to offer existing television programs and movies and, if applicable, other new interactive services we could offer in the future using advances in the IP technology we are testing. Our ability to provide an attractive and profitable video offering will depend in large part on the results of these efforts. We are supporting legislation at both the federal and

state levels that would streamline the regulatory process for new video competitors to enter the market. If the legislation or regulatory outcomes are not as we expect, it could have a material adverse effect on the cost, timing and extent of our deployment plans. Additional information about Project Lightspeed is included in our "Operating Environment and Trends of the Business" section under the heading "Expected Growth Areas" on page 34 of the 2005 AT&T Annual Report to Stockholders and is incorporated herein by reference pursuant to General Instruction G(2).

**Voice over Internet Protocol** VoIP is generally used to describe the transmission of voice using internet-protocol-based technology rather than a traditional wire and switch-based telephone network. A company using this technology often can provide voice services at a lower cost because this technology uses bandwidth more efficiently than a traditional network and because this technology has not been subject to traditional telephone industry regulation. But, depending on the bandwidth allocated, VoIP services may not necessarily be of the same quality as traditional telephone service. In early 2004, the FCC opened a proceeding to establish the regulatory framework for IP-enabled services, including VoIP. In this ongoing proceeding, the FCC will address various regulatory issues, including universal service, intercarrier compensation, numbering, disability access, consumer protection and customer access to 911 emergency services.

Notwithstanding the unresolved regulatory questions before the FCC and various state public utility commissions, numerous communications providers have begun providing various forms of VoIP or announced their intentions to do so in the near future. These providers include both established companies as well as new entrants. Thus, while the deployment of VoIP will result in increased competition for our voice services, it also presents growth opportunities for us to develop new products for our customers. Additional information relating to VoIP is contained in the 2005 AT&T Annual Report to Stockholders in our "Regulatory Developments" section under the heading "Voice over Internet Protocol," and is incorporated herein by reference pursuant to General Instruction G(2).

#### **Wireless**

Cingular, our wireless joint venture with BellSouth, began operations in October 2000 and in October 2004 acquired AT&T Wireless. As of December 31, 2005, Cingular served approximately 54.1 million customers and is the largest provider of mobile wireless voice and data communications services in the U.S. Additional information on the merger and our funding sources is contained in the 2005 AT&T Annual Report to Stockholders in Note 16 and is incorporated herein by reference pursuant to General Instruction G(2).

As part of the merger of Cingular and AT&T Wireless, ATTC retained the right to offer products under the AT&T Wireless brand. In November 2005, following our merger with ATTC, we announced that where the joint venture agreement allows, we intend to sell Cingular services using the AT&T Wireless brand. Revenues from AT&T Wireless customers are recorded by Cingular and are recognized as equity in net income in our Consolidated Statements of Income and are recorded in our Cingular segment for segment reporting.

Cingular's wireless networks use equipment with digital transmission technologies known as Global System for Mobile Communication (GSM) technology and Time Division Multiple Access (TDMA) technology. Cingular has upgraded its existing TDMA markets to use GSM technology in order to provide a common voice standard. Cingular is also upgrading its network wireless data technology by adding General Packet Radio Services (GPRS) and Enhanced Data Rates for GSM Evolution (EDGE), which allows customers to access the Internet from their wireless devices at higher speeds than GPRS. Cingular will continue to deploy Universal Mobile Telecommunications System (UMTS) third generation (3G) network technology with High-Speed Downlink Packet Access (HSDPA) concurrent with its network integration. UMTS and HSDPA provide 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.

## BUSINESS OPERATIONS

### Operating Segments

Our segments are strategic business units that offer different products and services and are managed accordingly. Due to the proximity of our acquisition of ATTC to year end, we have reported those results in the AT&T Corp. segment even though there may be some overlap in the products and service provided by that segment and our wireline segment. Under U.S. generally accepted accounting principles (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 consolidated results. Each segment's percentage of total segment operating revenue calculation is derived from our segment results and reflects amounts before eliminations. We have six reportable segments that reflect the current management of our business: (1) wireline, (2) AT&T Corp., (3) Cingular, (4) directory, (5) international and (6) other.

Additional information about our segments, including financial information, is included under the heading "Segment Results" on pages 22 through 33 and in Note 4 of the 2005 AT&T Annual Report to Stockholders and is incorporated herein by reference pursuant to General Instruction G(2).

### Wireline

Wireline is our largest operating segment, providing approximately 47% of 2005 segment operating revenues and 55% of our 2005 total segment income. Our wireline segment consists of our former SBC wireline subsidiaries and operates as both a retail and wholesale seller of our traditional communication services in the 13-state area in which we operate as an ILEC. Our traditional services include landline telecommunications services, including local, long-distance voice, switched access, data and messaging services. We also record revenues from our satellite television services which were offered through our agreement with EchoStar prior to the September 2005 amendment. Under the new terms, we will now receive and record sales commissions as revenues and will no longer record retail revenue on new customers while continuing to serve previously existing customers on the prior terms. At December 31, 2005, our wireline subsidiaries were serving approximately 27 million retail consumer lines, 17 million retail business lines and 5 million wholesale lines (including approximately 1.6 million lines purchased by ATTC), for a total of 49 million access lines.

### *Services and Products*

We divide our wireline services into four product-based categories: voice, data, long-distance and other.

**Voice-** Voice includes traditional local service provided to retail customers and wholesale access to our network and individual network elements provided to competitors. Voice also includes calling features, fees to maintain wire located inside customer premises, pay telephones, customer premise equipment and other equipment sales and other miscellaneous voice products.

Calling features are enhanced telephone services available to retail customers such as Caller ID, Call Waiting and voice mail. Customers that subscribe to these services can have the number and/or name of callers displayed on their phone, be signaled that additional calls are incoming, and send and receive voice messages. These services are not regulated by the FCC and are generally more profitable than basic local phone service.

Customer premises equipment and other equipment sales range from single-line and cordless telephones to sophisticated digital PBX systems. PBX is a private telephone switching system, typically used by businesses and usually located on a customer's premises, which provides intra-premise telephone services as well as access to our network.

**Data -** Data includes traditional products, such as switched and dedicated transport, internet access and network integration, and data equipment sales.

Switched Transport services transmit data using switching equipment to transfer the data between multiple lines before reaching its destination. Dedicated Transport services use a single direct line to transmit data between destinations. Integrated Services Digital Network (ISDN), Dedicated Frame Relay, broadband digital subscriber lines (DSL), Digital Services and Synchronous Optical Network (SONET) are examples of Dedicated Transport services. ISDN transmits voice, video and data over a single line in support of a wide range of applications, including internet access. Frame Relay is a routing technology that breaks a data signal into individual pieces of data to travel at high speeds and then recombines the data prior to arriving at its destination. DSL is a digital modem technology that converts existing twisted-pair telephone lines into access paths for multimedia and high-speed data communications to the Internet or private networks. DSL allows customers to simultaneously make a phone call and access information via the Internet or an office local area network. Digital Services use dedicated digital circuits to transmit digital data at various high rates of speed. SONET provides customer access to our backbone network at various high speeds.

Network integration services include installation of business data systems, local area networking and other data networking offerings. Internet access services include a wide range of products for residences and businesses, varying by market. Internet services offered include basic dial-up access service, dedicated access, web hosting, e-mail and high-speed access services.

**Long-distance voice** - Long-distance voice consists of all interLATA (traditional long-distance) and intraLATA (local toll) wireline revenues, including calling card and 1-800 services. We provide traditional long-distance services nationwide to customers in our 13-state area covered within this segment, and to customers in selected areas outside our wireline subsidiaries' 13-state operating area.

**Other** -Other includes directory and operator assistance, billing and collection services for other carriers and AT&T | DISH Network video services.

#### **AT&T Corp.**

Operating results following the November 18, 2005 acquisition of ATTC are reported in our AT&T Corp. segment. The 43 days of post-merger results provided approximately 4% of 2005 segment operating revenues and 2% of our 2005 total segment income. Our AT&T Corp. segment operates as both a retail and wholesale seller of communication services both domestically and internationally.

#### *Services and Products*

We divide our AT&T Corp. segment into four product-based categories: voice, data, long-distance and other.

**Voice** - Voice includes a variety of integrated service products targeted at business customers, including basic local exchange service, in major metropolitan markets throughout the U.S. Our AT&T Corp. segment does not actively market to acquire new consumer customers, but continues to provide local services to existing customers and accept orders from existing and new customers.

Additional features include speed dialing and voice messaging. Among the features of the integrated services offering is the ability to electronically order new services, perform maintenance and manage administrative functions. We also have a number of integrated voice and data services, such as integrated network connections, that provide customers the ability to integrate access for their voice and data services, the data component of which is included in the data category.

**Data** -Data products include high speed connections such as private lines, packet, dedicated internet and enterprise networking services as well as products such as DSL/broadband, dial-up internet access and WiFi (local radio frequency commonly known as wireless fidelity). We also provide businesses voice applications over IP-based networks (i.e., Enhanced Virtual Private Networks or "EVPN"). Over the past several years, we have built out our new multi protocol label switching/asynchronous transfer mode, or MPLS/ATM network, to supplement, and eventually replace, our other extensive global data networks. These products allow us to provide highly complex global data networks.

Private line uses high-capacity digital circuits to transmit from point-to-point in multiple configurations and allows customers to create internal data networks and to access external data networks.

Packet services consist of data networks using packet switching and transmission technologies, including frame relay, asynchronous transfer mode (ATM) and IP connectivity services. Packet services enable customers to transmit large volumes of data economically and securely and are used for local area network interconnection, remote site, point of sale and branch office communications. Frame relay, including IP-enabled frame relay and ATM Services are widely deployed as private data networks. High speed packet services, including IP-enabled frame relay service, are used extensively by enterprise (large business) customers.

Dedicated internet services are designed to meet the needs of all types of commercial and governmental enterprises, including small and medium sized businesses and were available in over 50 countries at December 31, 2005. Our managed internet services provide customers with dedicated high speed access to the internet managed by us.

Enterprise networking services provide comprehensive support from network design, implementation and installation to ongoing network operations and management for networks of varying scales, including local area networks, wide area networks, and virtual private networks. These services include applications such as e-mail, order entry systems, employee directories, human resource transactions and other database applications and were available in 127 countries at December 31, 2005.

We provide customers a variety of remote access services including dial, broadband, WiFi and cellular wireless technologies. At December 31, 2005, we provided dial access in 150 countries, WiFi access in 48 countries and third-party customer contracted cellular access in 7 countries.

We also provide local, interstate and international wholesale networking capacity to other service providers. We offer a combination of high volume transmission capacity and conventional dedicated line services on a regional, national and international basis to internet service providers (ISPs) and facility-based and switchless resellers. Our wholesale customers are primarily large ISPs, wireless carriers, competitive local exchange carriers, regional phone companies, interexchange carriers, cable companies and systems integrators. We also have sold dedicated network capacity through indefeasible rights-of-use agreements under which capacity is furnished for contract terms as long as 25 years.

**Long-distance voice-** Long-distance voice consists of traditional long-distance and international long-distance for customers that select us as their primary long distance carrier. Long-distance voice also includes services provided by calling card, 1-800 services and conference calling. These services are used in a wide variety of business applications, including sales, reservation centers or customer service centers. Other long-distance services offered include call routing by origination point and time-of-day routing and virtual private network applications, including dedicated outbound facilities. We also provide wholesale switched access service to other service providers.

**Other** -Other primarily consists of outsourcing, managed web hosting, security services and network integration.

Our managed web hosting services for businesses provide network, server and security infrastructure as well as built-in data storage and include application performance management, database management, hardware and operating system management. Our hosting services also provide customers with secure access to detailed reporting information about their infrastructure and applications.

Our security services include business continuity and disaster recovery services as well as premise and network based security products.

### **Cingular**

The Cingular segment reflects 100% of the results reported by Cingular, our wireless joint venture. In our consolidated financial statements, we report our 60% proportionate share of Cingular's results as equity in net income (loss) of affiliates. As required by GAAP, for segment reporting, we report this equity in net income (loss) of affiliates in our other segment.

When analyzing our segment results, we evaluate Cingular's results on a stand-alone basis using information provided by Cingular during the year. Our consolidated operating revenues do not include Cingular's results. However, we do include 100% of Cingular's revenues and expenses excluding this adjustment when we analyze our operating segment results. On that segment basis, the Cingular segment provided approximately 44% of total segment operating revenues and 7% of our 2005 total segment income.

#### *CingularWireless Joint Venture*

In April 2000, we formed a joint venture with BellSouth to provide domestic wireless services nationally. In October 2000, most of our and BellSouth's domestic wireless operations were contributed to Cingular, which then began operations. Economic ownership in Cingular is held 60% by us and 40% by BellSouth. We have equal voting rights and representation on the board of directors that controls Cingular. Because we share control equally, we use the equity method of accounting to account for our interest. Cingular is an SEC registrant by virtue of its publicly traded debt securities. Accordingly, it files separate Forms 10-K, 10-Q and other reports with the SEC.

Additional information on Cingular is contained in the 2005 AT&T Annual Report to Stockholders in the "Operating Environment and Trends of Business" section under the heading "Expected Growth Areas," "Wireless" beginning on page 35 and is incorporated herein by reference pursuant to General Instruction G(2).

### **Directory**

Our directory segment includes advertising, Yellow and White Pages directories and electronic directory publishing. The directory segment provided approximately 5% of total segment operating revenues and 27% of our 2005 total segment income. Our directory subsidiaries operate primarily in the 13-state area in which we operate as an ILEC. In November 2004, a subsidiary in our directory segment entered into a joint venture agreement with BellSouth and purchased the online directory publisher YELLOWPAGES.COM (YPC) for approximately \$98 million, our portion of which was \$65 million. In our consolidated financial statements, we report our proportionate share of YPC's results as equity in net income (loss) of affiliates. As required by GAAP, for segment reporting, we report this equity in net income (loss) of affiliates in our directory segment.

### **International**

Other than those acquired in the acquisition of ATTC, all investments with primarily international operations are included in our international segment. At December 31, 2005, we had direct or indirect investments with a carrying value of approximately \$2.1 billion and operations in 14 countries reported in this segment. These investments include companies that provide local and long-distance telephone services, wireless communications, voice messaging, data services, internet access, telecommunications equipment, and directory publishing. Our two major international investments included in this segment are described below.

We report earnings from this segment as equity in net income of affiliates rather than as operating revenue because this segment consists almost exclusively of investments where, under GAAP, we have significant influence rather than control. Because these international investments are accounted for on the equity method, revenues from our international segment were less than 1% of 2005 total segment operating revenues from all our segments. The international segment provided approximately 5% of our 2005 total segment income. Additional information about this segment is included in Note 6 of the 2005 AT&T Annual Report to Stockholders and is incorporated herein by reference pursuant to General Instruction G(2).

#### *Telmex*

We own an 8.2% equity share in Teléfonos de México, S.A. de C.V. (Telmex), Mexico's largest national provider of wireline services. Telmex operates approximately 18 million access lines. 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.

As of December 31, 2005, Telmex had approximately 34% of the long-distance market in Mexico. In June 2004, Mexico agreed to essentially eliminate its current rate system and introduce new regulations authorizing the resale of international long-distance, public, switched telecommunications services. This change in regulation has not had a material affect on the results of Telmex.

*América Móvil*

In 2000, Telmex spun-off its wireless and certain other operations to its stockholders as a separate business, América Móvil S.A. de C.V. (América Móvil). We own a 7.9% interest in América Móvil. We are a member of a consortium that holds all of the class AA shares of América 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.

América Móvil began an international expansion and now serves more than 93 million customers in Latin America and the U.S. A substantial majority of its wireless customers are prepaid customers. América Móvil is the largest fixed-line operator in Central America with over 2 million lines. América Móvil provides wireless communications in Argentina, Brazil, Chile, Colombia, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Paraguay, Peru, Uruguay and the U.S.

América Móvil provides cellular telecommunications service in all nine regions in Mexico, with a network covering approximately 31% of the geographical area, including all major cities, and approximately 90% of Mexico's population.

## MAJOR CLASSES OF SERVICE

The following table sets forth the percentage of consolidated total reported operating revenues by any class of service that accounted for 10% or more of our consolidated total operating revenues in any of the last three fiscal years. Our AT&T Corp. segment is included below because it provides similar services to our wireline segment's services.

	Percentage of Consolidated Total Operating Revenues		
	2005	2004	2003
<b>Wireline Segment</b>			
Voice	45%	51%	54%
Data	27%	27%	25%
Long-distance voice	9%	8%	6%
<b>AT&amp;T Corp. Segment</b>			
Voice	1%	-	-
Data	3%	-	-
Long-distance voice	3%	-	-
<b>Directory Segment</b>			
Directory advertising <sup>1</sup>	9%	9%	10%

<sup>1</sup>Approximately 96%, 96% and 95% of directory advertising revenues were recorded in the directory segment for 2005, 2004 and 2003. The remaining directory advertising revenues were recorded in the wireline segment.

Our Cingular segment revenues are reported in equity in net income of affiliates in our consolidated financial statements due to our equity accounting for the joint venture. Directory advertising revenues are included in our directory segment's results of operations and are approximately 98% of directory's total operating revenues.

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. This means that our consolidated reported results include Cingular's results in the "Equity in Net Income of Affiliates" line. We do not report Cingular revenues on our consolidated financial statements. However, when analyzing our segment results, we evaluate Cingular's results on a stand-alone basis. The table below shows the effect on our other classes of services (shown in the above table) if we include 100% of Cingular's revenues added to our total segment operating revenues.



	Percentage of Total Segment Operating Revenues (including 100 % of Cingular)		
	2005	2004	2003
<b>Wireline Segment</b>			
Voice	25%	34%	39%
Data	15%	18%	18%
<b>AT&amp;T Corp. Segment</b>			
Data	1%	-	-
<b>Cingular Segment</b>			
Wireless subscriber	39%	29%	26%

Directory advertising contributes less than 10% of total segment operating revenues when we include 100% of Cingular in the calculation.

#### GOVERNMENT REGULATION

Our wireline and ATTC subsidiaries are subject to regulation by state commissions which have the power to regulate intrastate rates and services, including local, long-distance and network access services. These subsidiaries are also subject to the jurisdiction of the FCC with respect to interstate and international rates and services, including interstate access charges. Access charges are designed to compensate our wireline subsidiaries for the use of their networks by other carriers.

ATTC subsidiaries operating outside the U.S. are subject to the jurisdiction of national regulatory authorities in the market where service is provided. Regulation is generally limited to operational licensing authority for the provision of enterprise services.

Additional information relating to federal and state regulation of our wireline and ATTC subsidiaries is contained in the 2005 AT&T Annual Report to Stockholders under the heading "Regulatory Developments" beginning on page 35, and is incorporated herein by reference pursuant to General Instruction G(2).

#### IMPORTANCE, DURATION AND EFFECT OF LICENSES

Certain of our subsidiaries own or have licenses to various patents, copyrights, trademarks and other intellectual property necessary to conduct business. We actively pursue patents, trademarks and service marks to protect our intellectual property within the U.S. and abroad. We maintain a global portfolio of more than 5,000 trademark and service mark registrations. We have also entered into agreements that permit other companies, in exchange for fees and subject to appropriate safeguards and restrictions, to utilize certain of our trademarks and service marks. We periodically receive offers from third parties to obtain licenses for patent and other intellectual rights in exchange for royalties or other payments as well as notices asserting that our products or services infringe on their patents and other intellectual property rights. While the outcome of any litigation is uncertain, we do not believe that the resolution of any of these infringement claims or the expiration or non-renewal of any of our intellectual property rights would have a material adverse affect on our results of operations.

#### MAJOR CUSTOMER

No customer accounted for more than 10% of our consolidated revenues in 2005, 2004 or 2003.

## **COMPETITION**

Information relating to competition in each of our operating segments is contained in the 2005 AT&T Annual Report to Stockholders under the heading "Competition" beginning on page 39, and is incorporated herein by reference pursuant to General Instruction G(2).

## **RESEARCH AND DEVELOPMENT**

The majority of our research and development activities are related to our AT&T Corp. segment, performed at our subsidiary AT&T Labs. AT&T Labs' scientists and engineers conduct research in a variety of areas, including IP; advanced network design and architecture; network operations support systems; data mining technologies and advanced speech technologies. AT&T Labs works with our business units to create new services and invent tools and systems to manage secure and reliable networks for us and our customers. In addition to AT&T Labs, applied research, technology planning and evaluation services are also conducted at our wireline subsidiary, SBC Laboratories, Inc. We also have a research agreement with Telcordia Technologies, formerly Bell Communications Research, Inc. Research and development expenses were approximately \$130 million in 2005, \$86 million in 2004 and \$78 million in 2003.

## **EMPLOYEES**

As of January 31, 2006, we employed approximately 189,000 persons. Approximately 60 percent of our employees are represented by the Communications Workers of America (CWA), the International Brotherhood of Electrical Workers (IBEW) or other unions.

In December 2005, we agreed to new contracts with the CWA and IBEW for certain employees covered under labor agreements previously negotiated by ATTC. The new labor agreements are for three years and four months, cover approximately 11,000 employees and replace three-year contracts that expired in December 2005. The union members ratified the labor agreements which contain provisions dealing with employment security and changes to active nonmanagement employees' pension benefits and medical coverage.

## **ITEM 1A. RISK FACTORS**

Information required by this Item is included in the 2005 AT&T Annual Report to Stockholders under the heading "Risk Factors" on page 49 through page 51 which is incorporated herein by reference pursuant to General Instruction G(2).

**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. Many of these factors are discussed in more detail in the “Risk Factors” section. 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.
- Increases in our benefit plans’ costs including increases due to adverse changes in the U.S. securities markets, resulting in worse-than-assumed investment returns and discount rates, and adverse medical cost trends.
- The final outcome of FCC proceedings and reopenings of such proceedings 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 the states in which we operate 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 our ability to maintain capital expenditures.
- The extent of competition 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 lower cost structures and regulatory and legislative actions adverse to us, 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; the development of attractive and profitable service offerings; the extent to which regulatory, franchise fees and build-out requirements apply to this initiative, and; the availability and reliability of the various technologies required to provide such 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; and the resolution of disputes with any taxing jurisdictions.
- 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 time frame expected, the capital and expense synergies and other benefits expected from its acquisition of AT&T Wireless.
- The impact of our acquisition of ATTC, including 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, legislative and technological developments.

Readers are cautioned that other factors discussed in this report, although not enumerated here, also could materially affect our future earnings.

## **ITEM 2. PROPERTIES**

Our properties do not lend themselves to description by character and location of principal units. At December 31, 2005, approximately 92% of our property, plant and equipment was owned by our wireline subsidiaries and 8% was owned by ATTC's subsidiaries. Network access lines represented approximately 37% of our telephone plant; central office equipment represented 38%; land and buildings represented 11%; other equipment, comprised principally of furniture and office equipment and vehicles and other work equipment, represented 8%; and other miscellaneous property represented 6%.

Substantially all of the installations of central office equipment are located in buildings and on land we own. Many garages, administrative and business offices and telephone centers are in leased quarters.

## **ITEM 3. LEGAL PROCEEDINGS**

We are a party to numerous lawsuits, regulatory proceedings and other matters arising in the ordinary course of business. Additional information regarding litigation is included in the 2005 AT&T Annual Report to Stockholders under the headings "Antitrust Litigation," "AT&T Wireless Litigation," "Retiree Phone Concession Litigation" on page 43 and "Hepting Litigation" on page 44, which is incorporated herein by reference pursuant to General Instruction G(2). As of the date of this report, we do not believe any pending legal proceedings to which we or our subsidiaries are subject are required to be disclosed as material legal proceedings pursuant to this item.

## **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

No matter was submitted to a vote of stockholders in the fourth quarter of the fiscal year covered by this report.

**EXECUTIVE OFFICERS OF THE REGISTRANT**  
**(As of February 28, 2006)**

<u>Name</u>	<u>Age</u>	<u>Position</u>	<u>Held Since</u>
Edward E. Whitacre Jr.	64	Chairman and Chief Executive Officer	1/1990
James W. Callaway	59	Senior Executive Vice President – Business Development	1/2006
James W. Cicconi	53	Senior Executive Vice President – External and Legislative Affairs	11/2005
James D. Ellis	62	Senior Executive Vice President and General Counsel	3/1989
Karen E. Jennings	55	Senior Executive Vice President – Human Resources and Communications	10/1998
James S. Kahan	58	Senior Executive Vice President – Corporate Development	7/1993
Richard G. Lindner	51	Senior Executive Vice President and Chief Financial Officer	5/2004
Forrest E. Miller	53	Group President AT&T Communications Corp.	11/2005
John T. Stankey	43	Senior Executive Vice President and Chief Technology Officer	3/2004
Randall L. Stephenson	45	Chief Operating Officer	5/2004
Rayford Wilkins, Jr.	54	Group President	2/2005

All of the above executive officers have held high-level managerial positions with AT&T or its subsidiaries or Cingular for more than the past five years. Executive officers are not appointed to a fixed term of office.

**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Our common stock is listed on the New York Stock Exchange. The number of stockholders of record as of December 31, 2005 and 2004 was 1,516,977 and 910,044. The number of stockholders of record as of February 24, 2006 was 1,504,535. We declared dividends, on a quarterly basis, totaling \$1.30 per share in 2005 and \$1.26 per share in 2004.

During 2005, non-employee directors acquired shares of common stock pursuant to the Non-Employee Director Stock and Deferral Plan. Under the plan, a director may make an annual election to receive all or part of his or her annual retainer or fees in the form of shares or deferred stock units (DSUs) that are convertible into shares. Each director also receives an annual grant of DSUs. During 2005, an aggregate of 108,029 shares and DSUs were acquired by non-employee directors at prices ranging from \$23.38 to \$24.91, in each case the fair market value of the shares on the date of acquisition. The issuances of shares and DSUs were exempt from registration pursuant to Section 4(2) of the Securities Act. During the fourth quarter of 2005, two non-employee directors acquired a total of 8,140 restricted stock units in connection with our acquisition of ATTC, under ATTC's AT&T 2004 Long Term Incentive Program. Under the program, units are convertible into shares of common stock. The issuance of restricted stock units was exempt from registration pursuant to Section 4(2) of the Securities Act.

On November 18, 2005, in connection with the completion of our acquisition of ATTC, we issued 768,391.4 shares of AT&T Perpetual Cumulative Preferred Stock, par value \$1 per share (the "Subsidiary Preferred Shares"), with an aggregate liquidation preference of \$768,391,400, to certain wholly owned subsidiaries of AT&T. The Subsidiary Preferred Shares were issued in connection with the merger in exchange for shares of preferred stock of ATTC that were formerly owned exclusively by wholly owned subsidiaries of ATTC. We received no cash proceeds as a result of the issuance of the Subsidiary Preferred Shares. The exchange of Subsidiary Preferred Shares was exempt from registration pursuant to Section 4(2) of the Securities Act.

Other information required by this Item is included in the 2005 AT&T Annual Report to Stockholders under the headings "Quarterly Financial Information" on page 83, "Selected Financial and Operating Data" on page 18, "Issuer Equity Repurchases" on page 49, and "Stock Trading Information" on the back cover, which are incorporated herein by reference pursuant to General Instruction G(2).

**ITEM 6. SELECTED FINANCIAL DATA**

Information required by this Item is included in the 2005 AT&T Annual Report to Stockholders under the heading "Selected Financial and Operating Data" on page 18 which is incorporated herein by reference pursuant to General Instruction G(2).

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION**

Information required by this Item is included in the 2005 AT&T Annual Report to Stockholders on page 19 through page 52, which is incorporated herein by reference pursuant to General Instruction G(2).

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Information required by this Item is included in the 2005 AT&T Annual Report to Stockholders under the heading "Market Risk" on page 47 through page 49, which is incorporated herein by reference pursuant to General Instruction G(2).

## **ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

Information required by this Item is included in the 2005 AT&T Annual Report to Stockholders on page 53 through page 83, which is incorporated herein by reference pursuant to General Instruction G(2).

## **ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

During our two most recent fiscal years, there has been no change in the independent accountant engaged as the principal accountant to audit our financial statements and the independent accountant has not expressed reliance on other independent accountants in its reports during such time period.

## **ITEM 9A. CONTROLS AND PROCEDURES**

### **Disclosure Controls and Procedures**

The registrant maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed by the registrant 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 in the SEC's rules and forms. The Chief Executive Officer and Chief Financial Officer have performed an evaluation of the effectiveness of the design and operation of the registrant's disclosure controls and procedures as of December 31, 2005. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the registrant's disclosure controls and procedures were effective as of December 31, 2005.

### **Internal Control Over Financial Reporting**

#### **(a) Management's Annual Report on Internal Control over Financial Reporting**

The management of AT&T is responsible for establishing and maintaining adequate internal control over financial reporting. AT&T's internal control system was designed to provide reasonable assurance as to the integrity and reliability of the published financial statements. AT&T management assessed the effectiveness of the company's internal control over financial reporting as of December 31, 2005. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control – Integrated Framework*. We have excluded from the scope of our assessment of internal control over financial reporting the operations and related assets of ATTC, which we acquired on November 18, 2005. At December 31, 2005 and for the period from November 18 through December 31, 2005, total assets and total segment revenues subject to ATTC's internal control over financial reporting represented 29.0% and 6.6% of AT&T's consolidated total assets and total revenues as of and for the year ended December 31, 2005. Based on its assessment, AT&T management believes that, as of December 31, 2005, the Company's internal control over financial reporting is effective based on those criteria.

#### **(b) Attestation Report of the Registered Public Accounting Firm**

AT&T's independent registered public accounting firm, Ernst & Young LLP, has issued an attestation report on management's assessment of the company's internal control over financial reporting. The attestation report is included in the 2005 AT&T Annual Report to Stockholders on page 86, which is incorporated herein by reference pursuant to General Instruction G(2).

## **ITEM 9B. OTHER INFORMATION**

There is no information that was required to be disclosed in a report on Form 8-K during the fourth quarter of 2005 but was not reported.

### **PART III**

#### **ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT**

Information regarding executive officers required by Item 401 of Regulation S-K is furnished in a separate disclosure at the end of Part I of this report since the registrant did not furnish such information in its definitive proxy statement prepared in accordance with Schedule 14A. Information regarding directors required by Item 401 of Regulation S-K is incorporated herein by reference pursuant to General Instruction G(3) from the registrant's definitive proxy statement, dated on or about March 10, 2006 (Proxy Statement) under the heading "Election of Directors," under the heading "Compensation of Directors," under the heading "Contracts with Management" and under the heading "Audit Committee."

The registrant has a separately-designated standing audit committee established in accordance with Section 3(a)(58)(A) of the Exchange Act of 1934. The members of the committee are Messrs. Aldinger, Amelio, Eby, Madonna, McCoy and Ritchey.

The registrant has adopted a code of ethics entitled "Code of Ethics" that applies to the registrant's principal executive officer, principal financial officer and principal accounting officer or controller or persons performing similar functions. The additional information required by Item 406 of Regulation S-K is provided in this report under the heading "General" under Part I, Item 1. Business.

#### **ITEM 11. EXECUTIVE COMPENSATION**

Information required by this Item is included in the registrant's Proxy Statement, under the heading "Compensation of Directors," and the pages beginning with the heading "Summary Compensation Table," and ending with, and including, the page immediately before the heading "Equity Compensation Plan Information" which are incorporated herein by reference pursuant to General Instruction G(3).

#### **ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

Information required by Item 403 of Regulation S-K is included in the Proxy Statement under the heading "CommonStock Ownership," which is incorporated herein by reference pursuant to General Instruction G(3).

#### **Equity Compensation Plan Information**

Information required by Item 201(d) of Regulation S-K is included in the Proxy Statement under the heading "Equity Compensation Plan Information," which is incorporated herein by reference pursuant to General Instruction G(3).

#### **ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

Information required by this Item is included in the Proxy Statement under the heading "Contracts with Management," which is incorporated herein by reference pursuant to General Instruction G(3).

#### **ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

Information required by this Item is included in the Proxy Statement under the heading "Principal Accountant Fees and Services," which is incorporated herein by reference pursuant to General Instruction G(3).



**Part IV****ITEM 15. EXHIBITS and FINANCIAL STATEMENT SCHEDULES**

(a) Documents filed as a part of the report:

	Page
(1) Report of Independent Registered Public Accounting Firm	*
Financial Statements covered by Report of	
Independent Registered Public Accounting Firm:	
Consolidated Statements of Income	*
Consolidated Balance Sheets	*
Consolidated Statements of Cash Flows	*
Consolidated Statements of Stockholders' Equity	*
Notes to Consolidated Financial Statements	*
* Incorporated herein by reference to the appropriate portions of the registrant's annual report to stockholders for the fiscal year ended December 31, 2005. (See Part II.)	

	Page
(2) Financial Statement Schedules:	
II - Valuation and Qualifying Accounts	22

Financial statement schedules other than those listed above have been omitted because the required information is contained in the financial statements and notes thereto, or because such schedules are not required or applicable.

(3) Exhibits:

Exhibits identified in parentheses below, on file with the SEC, are incorporated herein by reference as exhibits hereto. Unless otherwise indicated, all exhibits so incorporated are from File No. 1-8610.

Exhibit  
Number

2	Agreement and Plan of Merger, dated as of January 30, 2005, among AT&T Corp., SBC Communications Inc. and Tau Merger Sub Corporation (incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed on January 31, 2005). (Exhibit 4.1 to Form 8-K dated November 18, 2005.)
3-a	Restated Certificate of Incorporation, filed with the Secretary of State of Delaware on November 18, 2005. (Exhibit 3-a to Form 8-K dated November 18, 2005.)
3-b	Bylaws amended April 29, 2005. (Exhibit 3-b to Form 10-Q filed for March 31, 2005.)
4-a	Certificate of Designations for Perpetual Cumulative Preferred Stock of SBC Communications Inc., filed with the Secretary of State of the State of Delaware on November 18, 2005. (Contained in Restated Certificate of Incorporation filed as Exhibit 3-a.)
4-b	No instrument which defines the rights of holders of long-term debt of the registrant and all of its consolidated subsidiaries is filed herewith pursuant to Regulation S-K, Item 601b(4)(iii)(A), except for the instruments referred to in 4-c, 4-d, 4-e, and 4-f below. Pursuant to this regulation,

the registrant hereby agrees to furnish a copy of any such instrument not filed herewith to the SEC upon request.

- 4-c Guaranty of certain obligations of Pacific Bell Telephone Co. and Southwestern Bell Telephone Co. (Exhibit 4-d to Form 10-K for 1999.)
- 4-d Guaranty of certain obligations of Ameritech Capital Funding Corp., Illinois Bell Telephone Co., Indiana Bell Telephone Co. Inc., Michigan Bell Telephone Co., The Ohio Bell Telephone Co., Pacific Bell Telephone Co., Southern New England Telecommunications Corp., The Southern New England Telephone Co., Southwestern Bell Telephone Co., Wisconsin Bell, Inc. (Exhibit 4-c to Form 10-Q for September 30, 2005.)
- 4-e Guarantee of AT&T Corp. Euro notes. (Exhibit 4-d to Form 8-K dated November 18, 2005.)
- 4-f Guarantee of certain obligations of AT&T Corp. (Exhibit 4-e to Form 8-K dated December 16, 2005.)
- 10-a Short Term Incentive Plan.
- 10-b Supplemental Life Insurance Plan.
- 10-c Supplemental Retirement Income Plan. (Exhibit 10-c to Form 10-K for 2004.)
- 10-d Senior Management Deferred Compensation Plan (effective for Units of Participation Having a Unit Start Date Prior to January 1, 1988). (Exhibit 10-d to Form 10-K for 2002.)
- 10-e Senior Management Deferred Compensation Program of 1988 (effective for Units of Participation Having a Unit Start Date of January 1, 1988 or later). (Exhibit 10-e to Form 10-K for 2002.)
- 10-f Officer Disability Plan, formerly the Senior Management Long Term Disability Plan.
- 10-g Salary and Incentive Award Deferral Plan.
- 10-h Executive Health Plan, formerly the Supplemental Health Plan.
- 10-i Retirement Plan for Non-Employee Directors. (Exhibit 10-k to Form 10-K for 1997.)
- 10-j Form of Indemnity Agreement, effective July 1, 1986, between SBC and its directors and officers. (Appendix 1 to Definitive Proxy Statement dated March 18, 1987.)
- 10-k Forms of Change of Control Severance Agreements for officers of SBC and certain officers of SBC's subsidiaries (Approved November 21, 1997). (Exhibit 10-n to Form 10-K for 1997.)
- 10-l Stock Savings Plan.
- 10-m 1992 Stock Option Plan. (Exhibit 10-n to Form 10-K for 2001.)
- 10-n 1996 Stock and Incentive Plan. (Exhibit 10-o to Form 10-K for 2002.)
- 10-o Non-Employee Director Stock and Deferral Plan. (Exhibit 10-p to Form 10-K for 2004.)



10-p Pacific Telesis Group Deferred Compensation Plan for Nonemployee Directors. (Exhibit 10gg to Form 10-K for 1996 of Pacific Telesis Group (Reg. 1-8609).)

10-p(i) Resolutions amending the Plan, effective November 21, 1997. (Exhibit 10-v(i) to Form 10-K for 1997.)

10-q Pacific Telesis Group Outside Directors' Deferred Stock Unit Plan. (Exhibit 10oo to Form 10-K for 1995 of Pacific Telesis Group (Reg. 1-8609).)

10-r Pacific Telesis Group 1996 Directors' Deferred Compensation Plan. (Exhibit 10qq to Form 10-K for 1996 of Pacific Telesis Group (Reg. 1-8609).)

10-r(i) Resolutions amending the Plan, effective November 21, 1997. (Exhibit 10-v(i) to Form 10-K for 1997.)

10-s Pacific Telesis Group 1994 Stock Incentive Plan. (Attachment A to Pacific Telesis Group's 1994 Proxy Statement filed March 11, 1994, and amended March 14 and March 25, 1994.)

10-s(i) Resolutions amending the Plan, effective January 1, 1995. (Attachment A to Pacific Telesis Group's 1995 Proxy Statement, filed March 13, 1995.)

10-t 2001 Incentive Plan. (Exhibit 10-u to Form 10-K for 2002.)

10-u Employment Agreement between SBC and Edward E. Whitacre Jr. (Exhibit 10-y to Form 10-K for 2001.)

10-v 2001 Stock Option Grant to Bargained-for and Certain Other Employees. (Exhibit 10-x to Form 10-K for 2002.)

10-w 1995 Management Stock Option Plan. (Exhibit 10-y to Form 10-K for 2002.)

10-x Investment and Reorganization Agreement dated October 25, 2004, by and among BellSouth Corporation, SBC Communications Inc., Cingular Wireless Corporation, Cingular Wireless LLC, Links I Corporation, Cingular Wireless II, Inc., BLS Cingular Holdings, LLC, SBC Alloy Holdings, Inc., BellSouth Enterprises, Inc., BellSouth Mobile Systems, Inc., BellSouth Mobile Data, Inc. and SBC Long Distance, Inc. (Exhibit 99.01 to Cingular Wireless LLC's Form 8-K dated October 25, 2004.)

10-y Concession Program for Directors. (Exhibit 10-bb to Form 10-Q for March 31, 2004.)

10-z Amended and Restated Revolving Credit Agreement with Cingular Wireless LLC. (Exhibit 10-bb to Form 10-Q for June 30, 2005.)

10-aa Three Year Credit Agreement. (Exhibit 10-cc to Form 10-Q for September 30, 2004.)

10-bb Administrative Plan. (Exhibit 10-ee to Form 10-K for 2004.)

10-cc Stock Purchase and Deferral Plan.

10-dd Cash Deferral Plan.

10-ee	Master Trust Agreement for SBC Communications Inc. Deferred Compensation Plans and Other Executive Benefit Plans and subsequent amendments dated August 1, 1995 and November 1, 1999. (Exhibits 99.1-a, 99.1-b and 99.1-c to Schedule 13-D/A filed on December 28, 2004.)
10-ff	2005 Supplemental Employee Retirement Plan.
10-gg	AT&T 1997 Long Term Incentive Program.
10-hh	AT&T 2004 Long Term Incentive Program.
10-ii	AT&T Senior Management Incentive Award Deferral Plan.
10-jj	2006 Incentive Plan.
10-kk	Retention Agreement for James W. Cicconi dated January 26, 2006. (Exhibit 10.1 to Form 8-K dated January 26, 2006.)
12	Computation of Ratios of Earnings to Fixed Charges.
13	Portions of AT&T's Annual Report to Stockholders for the fiscal year ended December 31, 2005. Only the information incorporated by reference into this Form 10-K is included in the exhibit.
21	Subsidiaries of AT&T Inc.
23-a	Consent of Ernst & Young LLP, registered public accounting firm for AT&T.
23-b	Consent of Ernst & Young LLP, registered public accounting firm for Cingular.
23-c	Consent of PricewaterhouseCoopers LLP, registered public accounting firm for Omnipoint Facilities Network II, LLC.
24	Powers of Attorney.
31	Rule 13a-14(a)/15d-14(a) Certifications 31.1 Certification of Principal Executive Officer 31.2 Certification of Principal Financial Officer
32	Section 1350 Certifications
99	Consolidated Financial Statements of Cingular Wireless, L.L.C. (Excerpt from Cingular's 2005 Form 10-K.)

We will furnish to stockholders upon request, and without charge, a copy of the annual report to stockholders and the proxy statement, portions of which are incorporated by reference in the Form 10-K. We will furnish any other exhibit at cost.

**AT&T INC.**  
**SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS**  
**Allowance for Uncollectibles**  
Dollars in Millions

COL. A	COL. B	COL. C			COL. D	COL. E
		Additions				
		(1)	(2)	(3)		
	Balance at Beginning of Period	Charged to Costs and Expenses (a)	Charged to Other Accounts (b)	Acquisition of ATTC	Deductions (c)	Balance at End of Period
<b>Year 2005</b>	<b>\$ 1,001</b>	<b>744</b>	<b>184</b>	<b>356</b>	<b>1,109</b>	<b>\$ 1,176</b>
Year 2004 (d)	\$ 1,058	761	447	-	1,265	\$ 1,001
Year 2003 (d)	\$ 1,425	846	381	-	1,594	\$ 1,058

- (a) Excludes direct charges and credits to expense on the statements of income and reinvested earnings related to interexchange carrier receivables.
- (b) Includes amounts previously written off which were credited directly to this account when recovered and amounts related to long-distance carrier receivables which were billed by AT&T.
- (c) Amounts written off as uncollectible.
- (d) Amounts reflect the classification of balances related to a change in the way we report accounts receivable for our directory segment, which increased our Allowance for Uncollectibles. Additional information relating to this change is contained in the 2005 AT&T Annual Report to Stockholders in Note 1, and is incorporated herein by reference pursuant to General Instruction G(2).

**AT&T INC.**  
**SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS**  
**Accumulated Amortization of Intangibles**  
Dollars in Millions

COL. A	COL. B	COL. C		COL. D	COL. E
		Additions			
	Balance at Beginning of Period	(1) Charged to Costs and Expenses	(2) Charged to Other Accounts	Deductions	Balance at End of Period
<b>Year 2005</b>	<b>\$ 719</b>	<b>271</b>	<b>-</b>	<b>4</b>	<b>\$ 986</b>
Year 2004	\$ 691	117	-	89 (a)	\$ 719
Year 2003	\$ 493	203	-	5	\$ 691

(a) Includes \$85 reversal of amount that was fully amortized.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on the 28th day of February, 2006.

AT&T INC.

/s/ Richard G. Lindner  
Richard G. Lindner  
Senior Executive Vice President and  
Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

Principal Executive Officer:  
Edward E. Whitacre Jr.\*  
Chairman and  
Chief Executive Officer

Principal Financial and  
Accounting Officer:  
Richard G. Lindner  
Senior Executive Vice President and  
Chief Financial Officer

/s/ Richard G. Lindner  
Richard G. Lindner, as attorney-in-fact  
and on his own behalf as Principal  
Financial Officer and Principal  
Accounting Officer

February 28, 2006

### Directors:

Edward E. Whitacre Jr.*	John B. McCoy*
William F. Aldinger III*	Mary S. Metz*
Gilbert F. Amelio*	Toni Rembe*
August A. Busch III*	S. Donley Ritchey*
Martin K. Eby Jr.*	Joyce M. Roché*
James A. Henderson*	Randall L. Stephenson*
Charles F. Knight*	Laura D'Andrea Tyson*
Jon C. Madonna*	Patricia P. Upton*
Lynn M. Martin*	

\* by power of attorney





## **SHORT TERM INCENTIVE PLAN**

Plan Effective: January 1, 1984  
Revisions Effective: September 1, 2005

## SHORT TERM INCENTIVE PLAN

1. **Purpose.** The purpose of the Short Term Incentive Plan (the "Plan") is to provide Eligible Employees with incentive compensation based upon the achievement of financial, service, and operating performance levels and management effectiveness.
2. **Definitions.** For purposes of this Plan, the following words and phrases shall have the meanings indicated, unless the context clearly indicates otherwise:

**Award Year.** "Award Year" shall mean the calendar year for which performance is used to determine one's award under the Plan.

**Chairman.** "Chairman" shall mean the Chairman of the Board of SBC Communications Inc.

**Committee.** "Committee" shall mean the Human Resources Committee of the Board of SBC Communications Inc.

**Eligible Employee.** "Eligible Employee" shall mean an Officer and any other individual who is participating in the Plan as of September 1, 2005. Notwithstanding the foregoing, the CEO of SBC Communications Inc. ("CEO") may, from time to time, exclude any Officer or group of Officers from being an "Eligible Employee" under this Plan. Further, an employee of a company acquired by SBC shall not be considered an Eligible Employee unless designated as eligible by the CEO.

**Officer.** "Officer" shall mean an individual who is designated as an officer of SBC or of any SBC subsidiary for compensation purposes on SBC's records.

**Retirement.** "Retirement" shall mean the termination of an Eligible Employee's employment with SBC or any of its subsidiaries, for reasons other than death, on or after the earlier of the following dates: (1) the date a participant has attained age 55, and, for an individual who becomes a participant on or after January 1, 2002, has five (5) years of service, or (2) the date the Eligible Employee has attained one of the following combinations of age and service at termination of employment on or after April 1, 1997, except as otherwise indicated below:

Net Credited Service

10 years or more  
20 years or more  
25 years or more  
30 years or more

Age

65 or older  
55 or older  
50 or older  
Any age

With respect to an Eligible Employee who is granted an EMP Service Pension under and pursuant to the provisions of the SBC Pension Benefit Plan - Nonbargained Program ("SBCBPB") upon termination of Employment, the term "Retirement" shall include such Eligible Employee's termination of employment.

Termination Under EPR. In determining whether an Eligible Employee's termination of employment under the Enhanced Pension and Retirement Program ("EPR") is a Retirement for purposes of this Plan, five years shall be added to each of age and net credited service ("NCS"). If with such additional age and years of service, (1) an Eligible Employee upon such termination of employment under EPR is Retirement Eligible according to the SBC Supplemental Retirement Income Plan ("SRIP") or (2) the Eligible Employee upon such termination of employment under EPR has attained one of the following combinations of age and service,

Actual NCS + 5 Years

10 years or more  
20 years or more  
25 years or more  
30 years or more

Actual Age + 5 Years

65 or older  
55 or older  
50 or older  
Any age

then such termination of employment shall be a Retirement for all purposes under this Plan and the Eligible Employee shall be entitled to the treatment under this Plan afforded in the case of a termination of employment which is a Retirement.

SBC. "SBC" shall mean SBC Communications Inc.

3. Eligibility. Each Eligible Employee who during an Award Year was in active service may be eligible for an award under the Plan, as provided under Section 4 below. Employees are not rendered ineligible by reason of being a member of the Board.
4. Awards. The Committee with respect to Officers, or the Chairman with respect to non-Officer Eligible Employees, shall approve a Target Award for each employee eligible for an award under the Plan for each Award Year that the

Committee or the Chairman, as applicable, intends to make awards.

The Target Award applicable to an employee otherwise eligible for an award under the Plan for an Award Year shall be prorated over the Award Year or the employee shall be ineligible for an award, as follows:

- |      |   |  |
|------|---|--|
| (1)  | become eligible or ineligible for an award under Plan or change from one eligible position to another after the beginning of the Award Year | prorate according to time of active service in each eligible position to the nearest half month                                      |
| (2)  | inter-company transfers   | prorate for each respective entities' performance according to time of active service at each entity to the nearest half month       |
| (3)  | receipt of Disability Benefits for more than three months in an Award Year  | prorate to the day based on service while not receiving Disability Benefits  |
| (4)  | receipt of Disability Benefits for three months or less in an Award Year  | no reduction is applicable Target Award  |
| (5)  | Retirement  | prorate to date of Retirement  |
| (6)  | leave of absence  | prorate to date leave commences and from date leave ceases unless otherwise provided by the Committee or the Chairman, as applicable |
| (7)  | death during an Award Year  | prorate to date of death   |
| (8)  | dismissal for cause during or after an Award Year   | no award   |
| (9)  | termination with severance payment  | prorate to date of termination   |
| (10) | resignation with no severance payment   | no award   |
| (11) | mandatory termination at age 65   | Prorate to date of termination   |

A percentage of the Target Award for each Award Year to be distributed to the award recipient will be determined by the Committee, or Chairman, for Officers and non-Officer Eligible Employees, respectively, based upon achievement of performance levels during such Award Year of criteria established by the Committee, or the Chairman, respectively.

The criteria established by the Committee for Officers, or the Chairman with respect to non-Officer Eligible Employees, upon which the percentages of the Target Awards referred to above are determined shall give due regard, as the Committee, or the Chairman, as applicable, deems appropriate, to one or more of the following for the Award Year:

- (a) Financial performance of SBC, individual operating entities thereof and/or SBC and its consolidated subsidiaries.
- (b) Service performance of SBC and of individual operating entities; or other appropriate operating performance criteria for entities where service performance is not relevant.
- (c) Other criteria in lieu of or in addition to the above as determined by the Committee or the Chairman, as applicable.

The Committee then with respect to Officers, or the Chairman with respect to non-Officer Eligible Employees, shall determine the payout of Awards in such amounts and to such of the Eligible Employees as each may determine in its sole discretion. Awards shall be paid in cash in the calendar year the awards are determined, except to the extent that an Eligible Employee has made an election to defer the receipt of such award pursuant to the SBC Salary and Incentive Award Deferral Plan or other SBC deferred compensation plan.

The award to be distributed to an individual may be more or less in the Committee's or the Chairman's discretion, as applicable, including no award, than the percentage of the Target Award determined for such individual; for example, the Committee or the Chairman, as applicable, may approve an award greater than the Target Award, adjusted for performance, based on individual performance.

5. Adjustments.

- (a) In order to assure the incentive features of the Plan and to avoid distortion in the operation of the Plan, the Committee or the Chairman, as applicable, may make adjustments in the criteria established for any Award Year, whether before or after the end of the Award Year, to the extent the Committee or the Chairman, as applicable, deems appropriate, to compensate for or reflect any extraordinary changes which may have occurred during the Award Year which significantly alter the basis upon which performance levels were determined. Such changes may include, without limitation, changes in accounting practices, tax laws, or other laws or regulations, or economic changes not in the ordinary course of business cycles.
- (b) In the event of any change in outstanding shares of SBC by reason of any stock dividend or split, recapitalization, merger, consolidation, combination or exchange of shares or other similar corporate change, the Committee or the Chairman, as applicable, shall make such adjustments, if any, that the Committee or the Chairman, as applicable, deems appropriate in the performance levels established for any Award Year.
- (c) The Senior Executive Vice President-Human Resources (or his or her successor) may approve a new Target Award for any Eligible Employee whose position is modified by changes in job responsibilities, reorganization, or otherwise; provided, however, such authority may not be exercised for positions with a total compensation market rate exceeding \$2.0 million (in such a case the new Target Award shall be approved by the Committee).

6. Other Conditions.

- (a) No person shall have any claim to be granted an award under the Plan and there is no obligation for uniformity of treatment of Eligible Employees under the Plan. Awards under the Plan may not be assigned or alienated.

- (b) Neither the Plan nor any action taken hereunder shall be construed as giving to any employee the right to be retained in the employ of SBC or any subsidiary thereof.
- (c) SBC or subsidiary thereof, as applicable, shall have the right to deduct from any award to be paid under the Plan any federal, state or local taxes required by law to be withheld with respect to such payment.
- (d) Unless otherwise provided by the Committee, awards under the Plan shall be excluded in determining benefits under any pension, retirement, savings, disability, death, or other benefit plans of SBC except where required by law.

7. Designation of Beneficiaries. An Eligible Employee may designate pursuant to SBC's Rules for Employee Beneficiary Designations as may hereafter be amended from time-to-time ("Rules"), which Rules shall apply hereunder and are incorporated herein by this reference, a beneficiary or beneficiaries to receive in case of the employee's death all or part of the awards which may be made to the employee under the Plan. A designation of beneficiary may be replaced by a new designation or may be revoked by the employee at any time. A designation or revocation shall be on a form to be provided for the purpose and shall become effective only when filed with SBC during the employee's lifetime with written acknowledgement of receipt from SBC. In case of the employee's death, an award made under the Plan with respect to which a designation of beneficiary has been made (to the extent it is valid and enforceable under applicable law) shall be paid to the designated beneficiary or beneficiaries. Any award made to an employee who is deceased and not subject to such a designation shall be distributed in accordance with the Rules.

8. Plan Administration.

- (a) The Committee or the Chairman, as applicable, shall have full power to administer and interpret the Plan and to establish rules for its administration. Awards under the Plan shall be conclusively determined by the Committee or the Chairman, as applicable. Any determinations or actions required or permitted to be made by the Committee or the Chairman, as applicable, may be delegated by the Committee or the Chairman in its sole discretion. The Committee or the Chairman, as applicable, or any delegate thereof, in making any determinations under or referred to in the Plan shall be entitled to rely on opinions, reports or statements of officers or employees of SBC and/or of any subsidiary thereof and of counsel, public accountants and other professional or expert persons.

(b) The Plan shall be governed by the laws of the State of Texas and applicable Federal law.

9. Modification or Termination of Plan. This Plan may be modified or terminated at any time in accordance with the provisions of SBC's Schedule of Authorizations. A modification may affect present and future Eligible Employees.



SHORT TERM INCENTIVE PLAN  
ADMINISTRATIVE GUIDELINES

1. Purpose. The purpose of these Guidelines is to outline the procedures to be followed in administering SBC's Short Term Incentive Plan (the "Plan").
2. Award Process. The Committee shall approve a Target Award for each eligible Officer. The Chairman shall approve a Target Award for each non-Officer Eligible Employee. These Target Awards are based on market-based rates established for each Eligible Employee and shall generally be established in January of the Award Year.

Annual financial and/or other performance objectives for Officers for an Award Year shall be approved by the Committee each year, generally in January of the Award Year. Objectives for non-Officer Eligible Employees shall be approved by the Chairman. Annual financial and/or other performance results (upon which the payment of Awards for Officers shall be based), maximum funding levels, and payout recommendations requiring Committee approval, will be submitted to and approved by the Committee after the Award Year is completed. Results for non-Officer Eligible Employees shall be approved by the Chairman.

An individual's Target Award will be prorated over the Award Year, if applicable, according to Section 4 of the Plan.

Target Awards will be adjusted for distribution based upon achievement during the Award Year, of the financial and/or other performance criteria established by the Committee or the Chairman, as applicable. Discretionary awards may also be granted as described in Section 5, to be paid out of funds from the Discretionary Pools.

3. Performance Criteria. The performance criteria established by the Committee or the Chairman, as applicable, may be one or more of the following:

- Financial Performance Criteria

Achievement of Value Added objectives or other financial objectives (e.g., gross contributions, revenues, net income, operating contribution, etc.) will be used as financial performance criteria for all entities.

Value Added shall be a measure of earnings above a return required by investors (i.e., generally, net operating contribution less a capital charge).

Value Added or other financial measurement's performance is determined after adjustment in accordance with the following:

In order to assure the incentive features of the Plan and to avoid distortion in the operation of the Plan, the Committee or the Chairman, as applicable, shall make adjustments in the criteria established for any Award Year, whether before or after the end of the Award Year to compensate for or reflect any extraordinary changes which may have occurred during the Award Year which alter the basis upon which performance levels were determined. Such changes include the following: accounting changes, extraordinary items, income from discontinued operations, and the impact of material events that have been publicly disclosed.

- Other Performance Criteria

Other performance criteria may include, but are not limited to, Value Drivers, i.e., quantifiable operational and other indicators, such as revenue growth, customer or subscriber growth, operating margin, etc., that are tied to the strategy of the operating entity and are key barometers of value creation.

4. Funding. Each year, a maximum funding level of 1.0 percent of reported SBC net income (before any extraordinary loss and/or cumulative effect of changes in accounting principles) minus amounts paid as Key Executive Officer Short Term Award(s) pursuant to the 1996 Stock and Incentive Plan and/or the 2001 Incentive Plan shall be available to payment or awards under the Plan with respect to the preceding Award Year.
5. Distribution of Awards. Awards for the preceding Award Year will generally be distributed after completion of the Award Year in accordance with the following paragraphs. Distribution of all awards is subject to approval by the Committee or the Chairman, as applicable, generally obtained in January following the completion of an Award Year.

Formula-Driven Awards -

The Committee, or the Chairman, as applicable, shall establish financial and/or other performance objectives for SBC and such other entities as deemed appropriate by the Committee or the Chairman, as applicable.

A percentage of the Target Award for the preceding Award Year is paid to Officers and to non-Officer Eligible Employees in each entity based on the achievement of

applicable financial and/or other performance results of their entity.

Discretionary Pools -

After determination of formula-driven awards, the Committee for Officers and the Chairman for non-Officer Eligible Employees may establish Discretionary Pools to reward individuals and/or entities for exceptional performance. Maximum funding available for Discretionary Pools is the maximum funding level described in Section 4 less the formula-driven amounts distributed.

The Committee or the Chairman, as applicable, will determine funding for each pool and provide guidelines for distribution of awards. The following are examples of factors that may be considered:

- Financial results above objective
- Outstanding customer service results
- Advancement of workforce diversity
- Outstanding individual contribution

The Chairman will recommend to the Committee the discretionary awards for officers reporting directly to the Chairman.

6. Changes/Exceptions. Changes in these Guidelines and exceptions to their provisions may be authorized by the Committee.



## **SUPPLEMENTAL LIFE INSURANCE PLAN**

Effective: January 1, 1986  
Revisions Effective: September 1, 2005

## SUPPLEMENTAL LIFE INSURANCE PLAN

1. **Purpose.** The purpose of the Supplemental Life Insurance Plan ("Plan") is to allow for provision of additional survivor benefits for Eligible Employees.
2. **Definitions.** For purposes of this Plan, the following words and phrases shall have the meanings indicated, unless the context clearly indicates otherwise:

**Annual Base Salary or Annual Salary, or Salary.**

"Annual Base Salary" or "Annual Salary" or "Salary" shall mean an Eligible Employee's annual base salary rate determined by SBC, excluding (1) all differentials regarded as temporary or extra payments and (2) all payments and incentive awards and distributions made either as a long term award or as a short term award; and such Salary shall be as before reduction due to any contribution pursuant to any deferred compensation plan or agreement provided by SBC, including but not limited to compensation deferred in accordance with Section 401(k) of the Internal Revenue Code. Annual Salary or Salary shall mean an annualized amount determined from an Eligible Employee's Annual Base Salary rate.

**Beneficiary.** "Beneficiary" shall mean any beneficiary or beneficiaries designated by the Eligible Employee pursuant to the SBC Rules for Employee Beneficiary Designations as may hereafter be amended from time-to-time ("Rules").

**Chairman.** "Chairman" shall mean the Chairman of the Board of SBC Communications Inc.

**Committee.** "Committee" shall mean the Human Resources Committee of the Board of SBC Communications Inc.

**Eligible Employee.** "Eligible Employee" shall mean an Officer and any other individual who is participating in the Plan as of September 1, 2005. Notwithstanding the foregoing, the CEO may, from time to time, exclude any Officer or group of Officers from being an "Eligible Employee" under this Plan. Further, an employee of a company acquired by SBC shall not be considered an Eligible Employee unless designated as eligible by the CEO.

**Insurance Contract.** "Insurance Contract" shall mean a contract(s) of life insurance insuring the life of the Eligible Employee entered into by SBC.

**Officer.** "Officer" shall mean an individual who is designated as an officer of SBC or of any SBC subsidiary for compensation purposes on SBC's records.

**Retirement.** "Retirement" shall mean the termination of an Eligible Employee's employment with SBC or any of its subsidiaries, for reasons other than death, on or after the earlier of the following dates: (1) the date a participant has attained age 55, and, for an individual who becomes a participant on or after January 1, 2002, has five (5) years of service, or (2) the date the Eligible Employee has attained one of the following combinations of age and service at termination of employment on or after April 1, 1997, except as otherwise indicated below:

<u>Net Credited Service</u>	<u>Age</u>
10 years or more	65 or older
20 years or more	55 or older
25 years or more	50 or older
30 years or more	Any age

With respect to an Eligible Employee who is granted an EMP Service Pension under and pursuant to the provisions of the SBC Pension Benefit Plan - Nonbargained Program ("SBCBPB") upon termination of Employment, the term "Retirement" shall include such Eligible Employee's termination of employment.

**Termination Under EPR.** In determining whether an Eligible Employee's termination of employment under the Enhanced Pension and Retirement Program ("EPR") is a Retirement for purposes of this Plan, five years shall be added to each of age and net credited service ("NCS"). If with such additional age and years of service, (1) an Eligible Employee upon such termination of employment under EPR is Retirement Eligible according to the SBC Supplemental Retirement Income Plan ("SRIP") or (2) the Eligible Employee upon such termination of employment under EPR has attained one of the following combinations of age and service,

<u>Actual NCS + 5 Years</u>	<u>Actual Age + 5 Years</u>
10 years or more	65 or older
20 years or more	55 or older
25 years or more	50 or older
30 years or more	Any age

then such termination of employment shall be a Retirement for all purposes under this Plan and the Eligible Employee shall be entitled to the treatment under this Plan afforded in the case of a termination of employment which is a Retirement.

**SBC.** "SBC" shall mean SBC Communications Inc.

3. Eligibility. Each Eligible Employee shall be eligible to participate in the Plan

4. Pre-Retirement Benefits and Post-Retirement Benefits.

Basic Death Benefit

While this plan is in effect, the Beneficiary who is designated by the Eligible Employee shall be entitled to receive as a Basic Death Benefit from the proceeds of the Insurance Contract an amount equal to the result of multiplying the Eligible Employee's Annual Salary rounded to the next higher \$1,000 by the following amounts:

Chief Executive Officer	3
Direct Reporting Officer as such term is defined in SBC's Schedule of Authorizations	2
Other Eligible Employees	1

This amount shall be reduced (but not below zero) by any amount payable under any group term life insurance covering the Eligible Employee which is maintained by SBC, which amount of group term life insurance will be limited to a maximum of \$50,000.

The amount of Basic Death Benefit payable hereunder will automatically increase if pay increases.

At Retirement, the pre-retirement benefit converts to a post-retirement benefit. This benefit is equal to one times Salary rounded to the next higher \$1,000 (at the time of retirement) and shall be reduced (but not below zero) by any amount payable under any group term life insurance covering the Eligible Employee which is maintained by SBC, which amount of group term life insurance will be limited to a maximum of \$50,000; provided, however, for an executive who first becomes a Plan participant on or after January 1, 1998, this post-retirement death benefit shall be reduced by 10% of its original post-retirement amount each year for five years beginning at the later of the date the Eligible Employee attains age 65 or Retirement.

#### Optional Supplementary Benefit

Subject to the limitations in the remaining paragraphs in this section describing optional supplementary benefits, each Eligible Employee may also purchase optional supplementary pre-retirement life insurance coverage from SBC in an amount equal to one times the Eligible Employee's Annual Salary rounded to the next higher \$1,000, and an additional amount of such insurance in an amount equal to another one times such amount (for a total of two times the Annual Salary rounded to the next higher \$1,000), which insurance shall be payable from the proceeds of the Insurance Contract. Each such amount of insurance ("one times salary") continued until such employee reaches age 65, by continuing to contribute for it, shall entitle the beneficiary under the Insurance Contract to receive an amount from the proceeds of such Insurance Contract equal to one times the Eligible Employee's final Annual Salary rounded to the next higher \$1,000, when such Eligible Employee dies after Retirement.

To elect this optional supplementary coverage, the Eligible Employee must complete an enrollment form on which he or she specifies the amount of coverage he or she wishes to purchase and authorizes his or her employing company to deduct his or her contributions for coverage from his or her salary.

An Eligible Employee may not elect this coverage while receiving disability benefits under any Company disability benefit plan.

An Eligible Employee must make his or her election to purchase optional supplementary coverage within three calendar months of being declared eligible to participate in the Plan; except any Eligible Employee who was declared an Eligible Employee before October 1, 1997, shall have until December 31, 1997 to enroll for such optional supplementary coverage or to increase such coverage.

The optional supplementary life insurance is effective upon SBC's binding of life insurance coverage for the Eligible Employee pursuant to an Insurance Contract.

Effective January 1, 1998, once an Eligible Employee enrolls for optional supplementary coverage, he or she can later decrease or terminate such coverage but never increase or reinstate such coverage.

Regardless of the amount of coverage elected, the amount in force will automatically increase if Salary



increases. The cost for this coverage will increase accordingly.

This optional supplementary life insurance is paid for on a contributory basis by those Eligible Employees who enroll in the coverage. The cost of coverage, and therefore, how much an Eligible Employee contributes, depends on age and the amount of coverage and shall be as determined by SBC. There will be no periodic waiver of premium payments.

In the event of death, the Eligible Employee's optional supplementary life insurance benefit will be paid to the Eligible Employee's Beneficiary or Beneficiaries in a lump sum, unless the Salary Continuation Death Benefit form of payment was elected on the Eligible Employee's enrollment form. The option to elect other than a lump sum payment is limited to an Eligible Employee who became an Eligible Employee on or before January 1, 1998. If the Eligible Employee has no surviving beneficiaries, the benefit will be paid in a lump sum in accordance with the Rules.

The optional supplementary life insurance coverage hereunder will automatically continue while an Eligible Employee is receiving disability benefits under any SBC disability benefit plan, provided the Eligible Employee continues his or her contributions.

If an Eligible Employee terminates employment with SBC or any of its subsidiaries for any reason other than Retirement, this coverage will stop at the end of the month of termination; provided, however, Eligible Employees who are 65 at the time of their termination will continue to have non-contributory unreduced coverage after age 65.

#### Alternate Death Benefit

Alternate death benefit coverage shall only be available to an Eligible Employee who became an Eligible Employee before January 1, 1998. Such Eligible Employees shall be entitled to elect to receive alternate death benefit life insurance coverage; provided such election is made before January 1, 1998.

Under such coverage, an Eligible Employee's Beneficiary or Beneficiaries will be entitled to receive from the proceeds of the Insurance Contract a payment equal to the Eligible Employee's final Annual Salary upon his or her death. This benefit will not be rounded to the next higher \$1,000. The amount of insurance in force will automatically increase if salary increases. Coverage applies to death from any cause, except with

respect to an on-the-job accident for which an Eligible Employee is protected while an active employee by any Accident Death Benefit feature of the SBCPPB.

By enrolling in this coverage, an Eligible Employee automatically waives his or her eligibility for any Sickness Death Benefit and Pensioner Death Benefits otherwise payable under the SBCPPB.

The coverage provided by the alternate death benefit life insurance coverage will continue after Retirement.

To elect this coverage, an Eligible Employee must complete an irrevocable enrollment and waiver form.

SBC pays the full cost of the alternate death benefit life insurance coverage.

The insurance benefit provided under this alternate death benefit life insurance will be paid in a lump sum, unless otherwise elected on the Eligible Employee's enrollment form.

Alternate death benefit coverage ceases upon an Eligible Employee's Termination of Employment other than a Retirement. This alternate death benefit life insurance may not be converted to an individual policy.

#### Salary Continuation Death Benefit.

The salary continuation death benefit shall only be available under the conditions specified hereunder, to an Eligible Employee who became an Eligible Employee before January 1, 1998.

By a written election filed with SBC before January 1, 1998, an Eligible Employee may terminate his or her rights to a Basic Death Benefit and/or to Optional Supplementary Coverage (if any) and/or to an Alternate Death Benefit (if any).

If such an election is filed, and the Eligible Employee dies on or after the first day of the calendar year following the year in which such election is filed and prior to the termination of coverage pursuant to Section 7, the Eligible Employee's Beneficiary or Beneficiaries theretofore named shall be paid by SBC an amount per annum for ten (10) years which amounts, in the aggregate, have a net present value, using an eleven percent (11%) discount rate, equal to one hundred eight-five percent (185%) of the (i) Basic Death Benefit amount and/or (ii) the amount elected as Optional Supplementary coverage (if any) and/or (iii) the amount elected as an Alternate Death Benefit (if

any) which would be payable to his or her Beneficiary or Beneficiaries as of the date of the Eligible Employee's death, and no other benefit shall be payable hereunder as either a Basic Death Benefit, Optional Supplementary Coverage or Alternate Death Benefit . Such payment(s) shall commence no later than sixty (60) days following the date of the Eligible Employee's death.

On or after January 1, 1998, an Eligible Employee who has elected death benefits in the form of salary continuation pursuant to this Section may cancel such election and have his or her Beneficiaries receive death benefits as insurance in a lump-sum but, an Eligible Employee who cancels his or her salary continuation election may not thereafter re-elect such option.

#### Survivor Annuity Equivalent

Additionally, each Eligible Employee who is not eligible for the Immediate Automatic Pre-retirement Survivor Annuity of the SBCBPB (or equivalent thereof) shall be eligible hereunder for a Survivor Annuity Equivalent benefit of one times salary payable to the surviving spouse of such Eligible Employee. Such benefit shall be paid as follows: an amount per annum for ten (10) years shall be paid to the Eligible Employee's surviving spouse which amounts, in the aggregate, shall have a net present value, using an eleven percent (11%) discount rate, equal to one hundred eighty-five percent (185%) of one times the Eligible Employee's salary at the time of his or her death; provided, however, no such Survivor Annuity Equivalent payments will be made on or after the date of death of the surviving spouse. Such payments shall commence no later than sixty (60) days following the date of the Eligible Employee's death.

For the purposes of the Survivor Annuity Equivalent, the Eligible Employee's surviving spouse means a spouse legally married to the Eligible Employee at the time of the Eligible Employee's death.

Eligibility for the Survivor Annuity Equivalent shall automatically cease on the date of termination of the Eligible Employee's employment. If the Eligible Employee becomes totally disabled prior to Retirement, the Eligible Employee shall continue to be eligible for the Survivor Annuity Equivalent until the expiration of disability benefits. If the Eligible Employee is granted a leave of absence, other than for military service of more than four weeks, the Eligible Employee

shall continue to be eligible for the Survivor Annuity Equivalent during such leave of absence.

The Eligible Employee shall cease to be eligible for the Survivor Annuity Equivalent at the conclusion of the day immediately preceding the date the Eligible Employee becomes eligible for the Immediate Automatic Pre-retirement Survivor Annuity of the SBCBPB.

5. Incidents of Ownership. SBC will be the owner and hold all the incidents of ownership in the Insurance Contract, including the right to dividends, if paid. The Eligible Employee may specify in writing to SBC, the Beneficiary or Beneficiaries and the mode of payment for any death proceeds not in excess of the amounts payable under this Plan. Upon receipt of a written request from the Eligible Employee, SBC will immediately take such action as shall be necessary to implement such Beneficiary appointment. Any balance of proceeds from the Insurance Contract not paid as either a Basic Death Benefit or otherwise pursuant to the Plan shall be paid to SBC.

6. Premiums. All premiums due on the Insurance Contract shall be paid by SBC. However, the Eligible Employee agrees to reimburse SBC by January 31 following the date of each premium payment in an amount such that, for Federal Income Tax purposes the reimbursement for each year is equal to the amount which would be required to be included in the Eligible Employee's income for Federal Income Tax purposes by reasons of the "economic benefit" of the Insurance Contract provided by SBC; provided, however, that SBC, in its sole discretion, may decline to accept any such reimbursement and require the inclusion of such "economic benefit" in the Eligible Employee's income. In its discretion SBC may deduct the Eligible Employee's portion of the premiums from the Eligible Employee's pay. For purposes of this Plan, the value of the "economic benefit" shall be determined based on the insurers published premium rates available to all standard risks for initial issue one-year term insurance in compliance with Revenue Rulings 66-110 and 67-154 issued by the Internal Revenue Service.

7. Termination of Coverage. An Eligible Employee's coverage under this Plan shall terminate immediately when the Eligible Employee realizes an "Event of Termination" which shall mean any of the following:

(a) Termination of an Eligible Employee's employment with his or her employing company for any reason other than (i) death, (ii) Disability as such term is defined in the SRIP, or (iii) Retirement.

(b) In the case of an Eligible Employee who terminates employment by reason of a disability but who does not realize an Event of Termination because of Section 7a(ii) above, a termination of the Eligible Employee's total Disability that is not accompanied by either a return to employment with his or her employing company or the Eligible Employee's death or Retirement.

(c) Except in the case of an Eligible Employee who has theretofore terminated employment for a reason described in Section 7a(ii) or (iii) above, SBC elects to terminate the Eligible Employee's coverage under the Plan by a written notice to that effect given to the Eligible Employee. SBC shall have no right to amend the Plan or terminate the Eligible Employee's coverage under the Plan with respect to an Eligible Employee who has theretofore terminated employment for a reason described in Section 7a(ii) or (iii) above without the written consent of the Eligible Employee.

8. Non-Competition. Notwithstanding any other provision of this Plan, no coverage shall be provided under this Plan with respect to any Eligible Employee who shall, without the written consent of SBC, and while employed by SBC or any subsidiary thereof, or within three (3) years after termination of employment from SBC or any subsidiary thereof, engage in competition with SBC or any subsidiary thereof or with any business with which a subsidiary of SBC or an affiliated company has a substantial interest (collectively referred to herein as "Employer business"). For purposes of this Plan, engaging in competition with any Employer business shall mean engaging by Eligible Employee in any business or activity in the same geographical market where the same or substantially similar business or activity is being carried on as an Employer business. Such term shall not include owning a nonsubstantial publicly traded interest as a shareholder in a business that competes with an Employer business. However, engaging in competition with an Employer business shall include representing or providing consulting services to, or being an employee of, any person or entity that is engaged in competition with any Employer business or that takes a position adverse to any Employer business. Accordingly, coverage shall not be provided under this Plan if, within the time period and without the written consent specified, Eligible Employee either engages directly in competitive activity or in any capacity in any location becomes employed by, associated with, or renders service to any company, or parent or affiliate thereof, or any subsidiary of any of them, if any of them is engaged in competition with an Employer business, regardless of the position or duties the Eligible Employee takes and regardless of whether or not the employing company, or the company that Eligible Employee becomes associated with or renders service to, is itself engaged in direct competition with an Employer business.

9. Restriction on Assignment. The Eligible Employee may assign all or any part of his or her right, title, claim, interest, benefits and all other incidents of ownership which he or she may have in the Insurance Contract to any other individual or trustee, provided that any such assignment shall be subject to the terms of this Plan; except neither the Eligible Employee nor any other person shall have any right to commute, sell, assign, transfer, pledge, anticipate, mortgage or otherwise encumber, transfer, hypothecate or convey in advance of actual receipt the amounts, if any, payable as a Salary Continuation Death Benefit hereunder, which are, and all rights to which are, expressly declared to be unassignable and non-transferable. No part of the amounts payable as a Salary Continuation Death Benefit hereunder shall, prior to actual payment, be subject to seizure or sequestration for the payment of any debts, judgments, alimony or separate maintenance owed by the Eligible Employee or any other person, nor be transferable by operation of law in the event of the Eligible Employee's or any other person's bankruptcy or insolvency. Except as provided in this Section 8, no assignment or alienation of any benefits under the Plan will be permitted or recognized.

10. Unsecured General Creditor. Except to the extent of rights with respect to the Insurance Contract in the absence of an election to receive benefits in Salary Continuation Death Benefit form, the Eligible Employee and his or her Beneficiaries, heirs, successors and assigns shall have no legal or equitable rights, interest or claims in any property or assets of SBC, nor shall they be beneficiaries, or have any rights, claims or interests in, any life insurance policies, annuity contracts or the proceeds therefrom owned or which may be acquired by SBC ("Policies"); such Policies or other assets of SBC shall not be held under any trust for the benefit of the Eligible Employee, his or her designated beneficiaries, heirs, successors or assigns, or held in any way as collateral security for the fulfilling of the obligations of SBC under this Agreement; any and all of SBC's assets and Policies shall be, and remain, the general, unpledged, unrestricted assets of SBC; SBC shall have no obligation to acquire any Policies or any other assets; and SBC's obligations under this Agreement shall be merely that of an unfunded and unsecured promise of SBC to pay money in the future.

11. Employment Not Guaranteed. Nothing contained in this Plan nor any action taken hereunder shall be construed as a contract of employment or as giving the Eligible Employee any right to be retained in the employ of any SBC company.

12. Protective Provisions. The Eligible Employee will cooperate with SBC by furnishing any and all information requested by SBC, in order to facilitate the payment of

benefits hereunder, taking such physical examinations as SBC may deem necessary and taking such other relevant action as may be requested by SBC, in order to facilitate the payment of benefits hereunder. If the Eligible Employee refuses so to cooperate, the Eligible Employee's participation in the Plan shall terminate and SBC shall have no further obligation to the Eligible Employee or his or her designated Beneficiary hereunder. If the Eligible Employee commits suicide during the two-year period beginning on the date of eligibility under the Plan, or if the Eligible Employee makes any material misstatement of information or nondisclosure of medical history, then no benefits will be payable by reason of this Plan to the Eligible Employee or his or her designated Beneficiary, or in SBC's sole discretion, benefits may be payable in a reduced amount.

13. Change in Status. In the event of a change in the employment status of an Eligible Employee to a status in which he or she is no longer an Eligible Employee under the Plan, such Eligible Employee shall immediately cease to be eligible for any benefits under this Plan; provided, however, such survivor benefits as would be available to such employee by reason of his or her new status but which do not automatically become effective upon attainment of such new status shall continue to be provided under this Plan until such benefits become effective or until such employee has had reasonable opportunity to effectuate such benefits but has failed to take any requisite action necessary for such benefits to become effective.

14. Named Fiduciary. If this Plan is subject to the Employee Retirement Income Security Act of 1974 (ERISA), SBC is the "named fiduciary" of the Plan.

15. Applicable Law. This Plan and the rights and obligations hereunder shall be governed by and construed in accordance with the laws of the State of Texas to the extent such law is not preempted by ERISA.

16. Administration of the Plan. The Committee shall be the sole administrator of the Plan and will administer the Plan, interpret, construe and apply its provisions in accordance with its terms. The Committee shall further establish, adopt or revise such rules and regulations as it may deem necessary or advisable for the administration of the Plan. All decisions of the Committee shall be binding.

17. Relation to Prior Plans. This Plan supersedes and replaces prior Senior Management Survivor Benefit, Senior Management Supplementary Life Insurance, and Senior Management Alternate Death Benefit Life Insurance Plans as in effect prior to January 1, 1986, except such plans shall continue to apply to Eligible Employees who retired before January 1, 1986; provided, however, that with respect to

those Eligible Employees who retired during calendar year 1986 by reason of the fact of attaining age 65, the Post-Retirement Benefit provided pursuant to the Senior Management Survivor Benefit Plan as in effect prior to January 1, 1986, shall continue to apply and the post-retirement benefit provided under the Basic Death Benefit portion hereof shall not apply.

18. Amendments and Termination. This Plan may be modified or terminated at any time in accordance with the provisions of SBC's Schedule of Authorizations. A modification or Plan termination may affect present and future Eligible Employees; provided, however, that no modification shall be made to this Plan with respect to an Eligible Employee who terminates employment for reason of disability or Retirement), nor shall a termination of the Plan operate so as to be applicable to such an individual, without the written consent of the Eligible Employee.



SBC Communications Inc.

## **OFFICER DISABILITY PLAN**

Plan Effective: January 1, 1984  
Revisions Effective: September 1, 2005



## OFFICER DISABILITY PLAN

The SBC Communications Inc. ("SBC" or "Company") Officer Disability Plan ("Plan") was formerly known as the Senior Management Long Term Disability Plan prior to November 1, 2002. The purpose of the Plan is to supplement an Eligible Employee's disability benefits provided under an SBC Group Disability Plan.

### Section 1 - Definitions

**"Eligible Employee"** shall mean an Officer and any other individual who is participating in the Plan as of September 1, 2005. Notwithstanding the foregoing, the CEO of SBC Communications Inc. ("CEO") may, from time to time, exclude any Officer or group of Officers from being an "Eligible Employee" under this Plan. Further, an employee of a company acquired by SBC shall not be considered an Eligible Employee unless designated as eligible by the CEO.

**"Employer"** shall mean SBC or any of its Subsidiaries; provided, however, that Cingular Wireless LLC and its subsidiaries shall not be considered an Employer under this Plan.

**"Group Disability Plan"** shall mean the SBC Disability Benefits Plan, SBC Disability Income Plan, PTG Comprehensive Disability Benefits Plan, SNET Disability Benefits Plan, Ameritech Sickness and Accident Disability Benefit Plan, Ameritech Long Term Disability Plan, or any other group disability plan sponsored by SBC or any Subsidiary.

**"Long Term Disability Benefit"** shall mean the disability benefit provided under Section 3 of this Plan.

**"Officer"** shall mean an individual who is designated as an officer for compensation purposes on the records of SBC.

**"Participant"** shall mean an Eligible Employee who is disabled within the meaning of Section 2.1 or 3.1 of this Plan.

**"Pay"** shall mean the monthly amount of an Eligible Employee's annual base salary rate (as determined by his or her Employer) on the last day prior to entitlement to disability benefits under this Plan, but excluding all differentials regarded as temporary or extra payments and excluding all cash payments and distributions made under the SBC Short Term Incentive Plan and the SBC 2001 Incentive Plan, or successor plans.

**"Short Term Disability Benefit"** shall mean the disability benefit provided under Section 2 of this Plan.

**"Subsidiary"** shall mean any corporation in which the Company owns, directly or indirectly, more than fifty percent (50%) of the total combined voting power of all classes of equity interests, or any other entity (including, but not limited to, partnerships and joint

ventures) in which the Company owns more than fifty percent (50%) of the combined equity thereof; provided, however, Cingular Wireless LLC and its subsidiaries shall not be considered a Subsidiary under this Plan.

## **Section 2 - Short Term Disability Benefits**

- 2.1 If an Eligible Employee is eligible to receive short term disability benefits under the Group Disability Plan, he/she is also eligible to receive Short Term Disability Benefits under this Plan. Otherwise, an Eligible Employee who, due to a physical or mental impairment, is prevented from meeting the performance requirements of the position he or she held immediately preceding the onset of his or her physical or mental impairment shall be entitled to Short Term Disability Benefits under this Section 2.
- 2.2 Subject to the reductions and offsets described in Section 2.3, the Short Term Disability Benefits provided under this Section 2 shall be a monthly amount equal to one hundred percent (100%) of the Participant's Pay.
- 2.3 The Participant's Short Term Disability Benefit shall be reduced by his or her short term disability benefit received under a Group Disability Plan, if any. In addition, the Participant's combined Short Term Disability Benefit under this Plan and his or her short term disability benefit under the Group Disability Plan, if any, shall be reduced by any offsets as provided in the Group Disability Plan.
- 2.4 Short Term Disability Benefits shall commence on the eighth day immediately following the onset of the Participant's mental or physical impairment. Short Term Disability Benefits under this Plan shall be paid until earliest to occur of (i) the lapse of 52 weeks from the eighth day immediately following the onset of the Participant's mental or physical impairment, or (ii) the Participant's ability to meet the performance requirements of the position he or she held immediately preceding the onset of his or her physical or mental impairment. Successive periods of physical or mental impairment shall be counted together in computing the fifty-two (52) week period; provided, however, any absence as a result of a physical or mental impairment after the Participant has been continuously engaged in the performance of his or her employment responsibilities for thirteen (13) or more weeks shall be considered to commence a new period of physical or mental impairment for purposes of the fifty-two (52) week limitation on Short Term Disability Benefits.

## **Section 3 – Long Term Disability Benefits**

- 3.1 If an Eligible Employee is eligible to receive long term disability benefits under the Group Disability Plan, he/she is also eligible to receive Long Term Disability Benefits under this Plan. Otherwise, an Eligible Employee shall be entitled to Long Term Disability Benefits after the lapse of the fifty-two (52) week period of a Participant's Short Term Disability Benefits if the Eligible Employee, due to a physical or mental impairment, is prevented from meeting the performance

requirements of (i) the position he or she held immediately preceding the onset of his or her physical or mental impairment, (ii) a similar position, and (iii) any appropriate position that the Participant would otherwise be capable of performing by reason of his or her background or experience.

- 3.2 Subject to the reductions and offsets described in Section 3.3, the Long Term Disability Benefits provided under this Section 3 shall be a monthly amount equal to eighty percent (80%) of the Participant's Pay.
- 3.3 The Participant's Long Term Disability Benefit shall be reduced by his or her long term disability benefit received under a Group Disability Plan, if any. In addition, the Participant's combined Long Term Disability Benefit under this Plan and his or her long term disability benefit under the Group Disability Plan, if any, shall be reduced by any offsets as provided in the Group Disability Plan.
- 3.4 Long Term Disability Benefits under this Plan shall be paid until earliest to occur of (i) the Participant's attainment of age 65, or (ii) the Participant's ability to meet the performance requirements of (a) the position he or she held immediately preceding the onset of his or her physical or mental impairment, (b) a similar position, or (c) any appropriate position that the Participant would otherwise be capable of performing by reason of his or her background or experience.

#### **Section 4 – Claims and Appeals**

- 4.1 A Disability Review Committee ("Committee") will be established to review any issues arising under this Plan, including any claims made under this Plan. The Committee shall be appointed by the Senior Executive Vice President-Human Resources and shall be comprised of at least three managers, one of which shall be an executive. The Committee, which shall be a fiduciary under the Plan with respect to the review of claims, shall have the authority, in its sole and absolute discretion, to interpret and administer the Plan, including the authority, in its sole and absolute discretion, to make the determinations as to whether an Eligible Employee is disabled within the meaning of Sections 2 and 3 of the Plan and any other claim arising under the Plan. The Senior Executive Vice President-Human Resources, or his or her successor, which shall be a fiduciary under the Plan with respect to the review of appealed claims, shall have the sole and absolute discretion to make determinations with respect to an appeal of a claim that is denied by the Committee.
- 4.2 An Eligible Employee or a Participant (the "Claimant") may file a claim under the Plan by sending a written notice of such claim to SBC Executive Compensation, 175 East Houston, Room 3-N-10, San Antonio, Texas, which shall include a brief description of the Claimant's claim.
- 4.3 Upon receipt of a written claim, the Committee shall notify the Claimant of the Committee's decision regarding the claim within forty-five (45) days of the date the claim is made. The Committee may extend this 45-day period for up to 30 days (plus

an additional 30 days if needed) if it determines that special circumstances require more time to determine the claim. The Committee shall notify the Claimant, in writing, within the initial 45-day period (and within the first 30-day extension period if an additional 30 days is needed) if additional time is needed and what special circumstances require the extra time. If extensions are required because the Committee needs additional information from the Claimant, the Claimant shall be given 45 days from the Committee's notification within which to provide that information.

- 4.4 A claim is denied if: (a) the Claimant receives a written denial from the Committee, (b) the Claimant receives no reply from the Committee after 45 days, or (c) the Committee has extended the time to reply by an additional 30 or 60 days and the Claimant receives no reply after the additional 30 or 60 days. The written notice of a denied claim shall include: (a) the specific reasons for the denial, (b) a specific reference to the Plan provision upon which the denial is based, (c) a description of any additional information that is needed to make the claim acceptable and the reason it is needed, and (d) a description of the procedure by which the Claimant may appeal the denial to the Human Resources Committee of the SBC Board of Directors.
- 4.5 If a claim is denied by the Committee, or treated as denied, and the Claimant disagrees with the Committee's decision, the Claimant may appeal the Committee's decision by filing a written request for review. The Claimant or someone authorized by the Claimant must make the request for review within 180 days of receipt of the denial notice or, if no notice is received, 180 days after the expiration of 45, 75 or 105 days, whichever is applicable. A written request for review must be sent to the Senior Executive Vice President-Human Resources at the address provided in the claim denial letter or, if no denial letter was sent, to the Senior Executive Vice President-Human Resources, 175 East Houston Street, Room 3-N-10, San Antonio, Texas 78205. The appeal of a denied claim may include: (a) a written statement of the issues and any other comments, along with any new or additional evidence or materials in support of the Claimant's appeal, (b) a request to examine documents that bear on the Claimant's appeal, and (c) a request to review pertinent Plan documents.
- 4.6 Unless the Claimant is notified in writing that more time is needed, a review and decision on the Claimant's appeal must be made within 45 after the appeal is received. If special circumstances require more time to consider the appeal, the Senior Executive Vice President-Human Resources may take an additional 45 days to reach a decision after providing written notice that there will be a delay. The appeal is deemed denied if notice of the decision is not provided by the end of the 45 or 90-day period. If an appeal is denied by the Senior Executive Vice President-Human Resources, it is final and not subject to further review, however, the Claimant may have further rights under ERISA.

## **Section 5 - General Provisions**

- 5.1 SBC, in its sole discretion may reduce the disability allowance by the amount of outside compensation or earnings of the Participant for work performed by the Participant during the period for which any Short Term Disability Benefit or Long Term Disability Benefit is provided.
- 5.2 The rights of a Participant to benefits under the Plan shall not be subject to assignment or alienation, except as required by law.
- 5.3 SBC may from time to time make changes in the Plan and may terminate the Plan in its sole and absolute discretion. In addition, the Senior Executive Vice President-Human Resources of SBC (or his or her successor), shall be authorized to make minor or administrative changes to the Plan, as well as changes dictated by any requirement of Federal or state statutes or authorized or made desirable by such statutes. Such changes or termination shall not affect the rights of any Participant, without his/her consent, to any benefit under the Plan to which such Participant may have previously become entitled as a result of a disability, death or termination of Employment that occurred prior to the effective date of such change or termination.
- 5.4 Should a claim, other than under this Plan or under any other plan maintained by the Employer, be presented or suit brought against the Company, an Employer, or against any other Subsidiary, for damages on account of injury or death of a Participant, nothing shall be payable under this Plan; provided however, that the Committee may, in its discretion and upon such terms as it may prescribe waive this provision if such claims be withdrawn or if such suit be discontinued.
- 5.5 All benefits provided under the Plan with respect to a Participant shall be forfeited and cancelled in their entirety if the Participant directly or indirectly, engages in competitive activity, or has become associated with, employed by, controls, or renders service to any business that is engaged in competitive activity, with (i) the Company, (ii) any Subsidiary, or (iii) any business in which any of the foregoing have a substantial interest, or if the Participant attempts, directly or indirectly, to induce any employee of the Company or a Subsidiary to be employed or perform services elsewhere without the permission of the Company. The phrase "has become associated with" shall include, among other things, the beneficial ownership of 1/10 of 1% or more of a business engaged in competitive activity. The determination of whether a Participant has engaged in any such activity and whether to cancel benefits under this Plan shall be made by SBC, and in each case such determination shall be final, conclusive and binding on all persons. All benefits provided under the Plan with respect to a Participant shall be forfeited and cancelled in their entirety if the Participant is discharged for cause or the Participant engages in misconduct in connection with the Participant's employment.
- 5.6 All benefits authorized under the Plan shall be charged to the operating expense accounts of the Participant's Employer when and as paid.

- 5.7 The expenses of administering the Plan shall be borne by the Employers in such proportions as shall be mutually agreed upon by such Employers.
- 5.8 In the event any provision of the Plan shall be held illegal or invalid for any reason, the illegality or invalidity shall not affect the remaining parts of the Plan, and the Plan shall be construed and enforced as if the illegal or invalid provision had not been included.
- 5.9 At any time SBC may correct any error made under the Plan without prejudice to SBC. Such corrections may include, among other things, changing or revoking a disability benefit.
- 5.10 To the extent not preempted by Federal law, this Plan shall be governed by and construed in accordance with the substantive laws of the State of Texas, excluding any conflicts or choice of law rule or principle that might otherwise refer construction or interpretation of this Plan to provisions of the substantive law of any jurisdiction other than the State of Texas.
- 5.11 The use of personal pronouns of either gender in the Plan is intended to include both masculine and feminine genders.



**SALARY AND  
INCENTIVE AWARD DEFERRAL PLAN**

Effective: January 1, 1984  
Revision Effective: December 31, 2004

**SBC COMMUNICATIONS INC.**  
**SALARY AND INCENTIVE AWARD DEFERRAL PLAN**

As amended through December 31, 2004

**Article 1 - Statement of Purpose**

The purpose of the Salary and Incentive Award Deferral Plan ("Plan") is to provide a select group of management employees consisting of Eligible Employees of SBC Communications Inc. ("SBC" or the "Company") and its Subsidiaries with a means for deferring the receipt of income.

**Article 2 - Definitions**

For the purposes of this Plan, the following words and phrases shall have the meanings indicated, unless the context indicates otherwise:

**Base Compensation.** The following types of cash-based compensation, in each case as determined by SBC, paid by an Employer (but not including payments made by a non-Employer, such as state disability payments), before reduction due to any contribution pursuant to this Plan or reduction pursuant to any deferral plan of an Employer, including but not limited to a plan that includes a qualified cash or deferral arrangement under Section 401(k) of the Internal Revenue Code, as amended ("Code"):

(a) annual base salary.

Payments by an Employer under a Disability plan made in lieu of any compensation described in (a) above, shall be deemed to be a part of the compensation it replaces for purposes of this definition. Base Compensation does not include the TEAM Award (the annual award determined to be the "Team Award" by SBC together with the individual award determined by SBC to be the Individual Discretionary Award made in connection therewith) or comparable awards, if any, determined by SBC to be used in lieu of these awards, commissions or zone allowances or any other geographical differential and shall not include payments made in lieu of unused vacation or other paid days off, and such payments shall not be contributed to this Plan.

**Business Day.** Any day during regular business hours that SBC is open for business.

**Chairman.** The Chairman of the Board of Directors of SBC Communications Inc.

**Committee.** The Human Resources Committee of the Board of Directors of SBC Communications Inc.

**Declared Rate.** The interest rate for each calendar year as determined by the Senior Executive Vice President-Human Resources, with the concurrence of the Senior Executive Vice President, Chief Financial Officer and Treasurer and announced on or before January 1 of the applicable calendar year. However, in no event will the Declared Rate for any calendar be less than the Moody's Corporate Bond Yield Average-Monthly Average Corporates as published by



Moody's Investor's Service, Inc. (or any successor thereto) for the month of September before the calendar year in question, or, if such yield is no longer published, a substantially similar average selected by the Senior Executive Vice President-Human Resources or his or her successor.

**Disability.** Absence of an Employee from work with an Employer under the relevant Employer's disability plan.

**Eligible Employee.** An Employee who:

(a) is a full time, salaried Employee of SBC or an Employer in which SBC has a direct or indirect 100% ownership interest and who is on active duty, Disability (but only while such Employee is deemed by the Employer to be an Employee of such Employer) or Leave of Absence;

(b) is, as determined by SBC, a member of Employer's "select group of management or highly compensated employees" within the meaning of the Employment Retirement Income Security Act of 1974, as amended, and regulations thereunder ("ERISA"); and

(c) is (i) an Officer or (ii) a non-Officer Employee who has been approved by SBC to be eligible to participate in this Plan.

Notwithstanding the foregoing, SBC may, from time to time, exclude any Employee or group of Employees from being deemed an "Eligible Employee" under this Plan.

In the event a court or other governmental authority determines that an individual was improperly excluded from the class of persons who would be considered Eligible Employees during a particular time for any reason, that individual shall not be an Eligible Employee for purposes of the Plan for the period of time prior to such determination.

**Employee.** Any person employed by an Employer, excluding persons hired for a fixed maximum term and excluding persons who are neither citizens nor permanent residents of the United States, all as determined by SBC. For purposes of this Plan, a person on Leave of Absence who otherwise would be an Employee shall be deemed to be an Employee.

**Employer.** SBC Communications Inc. or any of its Subsidiaries.

**Executive Officer.** A person identified as an "executive officer" of SBC in the then most recent SBC Form 10-K containing such information that was filed with the United States Securities and Exchange Commission or who subsequent to such filing was notified by SBC's General Counsel to be an executive officer of SBC.

**Grandfathered Senior Manager.** An individual who, as of January 31, 2003, is not an Officer but is a Participant in the Plan.

**Incentive Award.** A cash award paid by an Employer (and not by a non-Employer, such as state disability payments) as either a short term or long term award under the Short Term Incentive Plan, the 1996 Stock and Incentive Plan, or the 2001 Incentive Plan; or paid by an Employer as the Key Executive Officer Short Term Award paid under the 1996 Stock and Incentive Plan or the 2001 Incentive Plan; or any other award that the Committee designates as a short term or long term incentive award specifically for purposes of this Plan (regardless of the purpose of the award) including an award which would otherwise be paid in stock, other than stock of SBC.

**Leave of Absence.** Where a person is absent from employment with an Employer on a formally granted leave of absence (i.e., the absence is with formal permission in order to prevent a break in the continuity of term of employment, which permission is granted (and not revoked) in conformity with the rules of the Employer which employs the individual, as adopted from time to time). For purposes of this Plan, a Leave of Absence shall be deemed to also include a transfer by an Employer of a person to, and continuous employment by, an entity for a rotational work assignment. In the event a transfer to such an entity lasts more than 5 years or the rotational work assignment status is canceled by SBC, it shall be deemed a Termination of Employment with the Employer at that time for purposes of this Plan. To be a rotational work assignment, the Employer must have indicated in writing to the person that the person was to be rehired by the Employer on termination of the rotational work assignment.

**Officer.** An individual who is designated as an officer level employee for compensation purposes on the records of SBC.

**Participant.** An Eligible Employee or former Eligible Employee who participates in this Plan.

**Pre-Tax Account.** The account maintained on a pre-tax basis on the books of account of SBC for each Participant.

**Retirement or Retire.** "Retirement" or "Retire" shall mean the termination of an Eligible Employee's employment with SBC or any of its subsidiaries, for reasons other than death, on or after the earlier of the following dates: (1) solely with respect to Officers and Grandfathered Senior Managers, the date the Officer or Grandfathered Senior Manager has attained age 55, and, for an Officer who became a participant on or after January 1, 2002, has five (5) years of service, or (2) the date the Eligible Employee has attained one of the following combinations of age and service at termination of employment on or after April 1, 1997, except as otherwise indicated below:

<u>Net Credited Service</u>	<u>Age</u>
10 years or more	65 or older
20 years or more	55 or older
25 years or more	50 or older
30 years or more	Any age

With respect to an Eligible Employee who is granted an EMP Service Pension under and pursuant to the provisions of the SBC Pension Benefit Plan - Nonbargained Program ("SBCBPB") upon termination of Employment, the term "Retirement" shall include such Eligible Employee's termination of employment.

**Senior Manager.** An individual who is designated as a Senior Manager or a Grandfathered Senior Manager for compensation purposes on the records of SBC.

**Subsidiary.** Any corporation, partnership, venture or other entity in which SBC holds, directly or indirectly, a 50% or greater ownership interest. SBC may, at its sole discretion, designate any other corporation, partnership, venture or other entity a Subsidiary for the purpose of participating in this Plan.

**Termination of Employment.** References herein to "Termination of Employment," "Terminate Employment" or a similar reference, shall mean the event where the Employee ceases to be an Employee of any Employer, including but not limited to where the employing company ceases to be an Employer.

**Termination Under EPR.** In determining whether an Eligible Employee's termination of employment under the Enhanced Pension and Retirement Program ("EPR") is a Retirement for purposes of this Plan, five years shall be added to each of age and net credited service ("NCS"). If with such additional age and years of service, (1) an Eligible Employee upon such termination of employment under EPR is Retirement Eligible according to the SBC Supplemental Retirement Income Plan ("SRIP") or (2) the Eligible Employee upon such termination of employment under EPR has attained one of the following combinations of age and service,

<u>Actual NCS + 5 Years</u>	<u>Actual Age + 5 Years</u>
10 years or more	65 or older
20 years or more	55 or older
25 years or more	50 or older
30 years or more	Any age

then such termination of employment shall be a Retirement for all purposes under this Plan and the Eligible Employee shall be entitled to the treatment under this Plan afforded in the case of a termination of employment which is a Retirement.

### **Article 3 - Administration of the Plan**

The Committee shall be the administrator of the Plan and will administer the Plan, interpret, construe and apply its provisions and determine entitlement to benefits, all in its discretion. The Committee may further establish, adopt or revise such rules and regulations as it may deem necessary or advisable for the administration of the Plan. References to determinations or other actions by SBC, herein, shall mean actions authorized by the Committee, the Chairman, the Senior Executive Vice President of SBC in charge of Human Resources, or their respective successors or duly authorized delegates, in each case in the discretion of such person; except that with respect to Executive Officers, only the Committee may take such action. All decisions by SBC shall be final and binding.

### **Article 4 - Contributions**

Notwithstanding anything in this Plan to the contrary, there shall be no Employee Contributions or contributions of deferred amounts related to Incentive Awards which would otherwise have been distributed in shares of stock other than shares of common stock of SBC to the Plan after December 31, 2004.

#### **4.1 Election to Make Contributions.**

- (a) An Eligible Employee may elect to participate in the Plan through payroll

deductions contributed to the Plan as follows (such contributions to the Plan are "Employee Contributions"):

1. An Eligible Employee who is an Officer or a Grandfathered Senior Manager may elect to contribute up to 50% (in whole percentage increments) of his or her monthly Base Compensation, as the same may change from time to time; provided, however, any Base Compensation deferral hereunder is conditioned upon a 30% Base Compensation deferral election being in effect in the Stock Savings Plan.
2. An Eligible Employee who is an Officer or a Senior Manager may elect to contribute up to 100% (in whole percentage increments or a specified dollar amount) of an Incentive Award.

(b) An Eligible Employee may only make an election, change an election, or terminate an election to make Employee Contributions as follows:

1. An Employee who is an Eligible Employee as of September 30 may make an election on or prior to the last Business Day of the immediately following November with respect to the contribution of Base Compensation, if authorized hereunder, and/or Incentive Awards paid on or after the immediately following January 1.

2. An Employee who was not an Eligible Employee as of September 30 but who is an Eligible Employee the immediately following March 31 may make an election on or prior to the last Business Day of the immediately following May with respect to the contribution of Base Compensation, if authorized hereunder, and/or Incentive Awards paid on or after the immediately following July 1.

SBC may refuse or terminate any election to make Employee Contributions at any time.

In the event the Participant takes a hardship withdrawal from a benefit plan qualified under the Code and sponsored by SBC or an Employer, any election to make Employee Contributions by such Participant shall be immediately cancelled, and the Participant shall not be permitted to make a new election with respect to Employee Contributions that would be contributed during the then current and immediately following calendar year.

**4.2 Contributions To Pre-Tax Account; Interest/Dividends.**

(a) Employee Contributions shall be made solely pursuant to a proper election and only during the Employee's lifetime and while the Employee remains an Eligible Employee (if the Employee ceases to be an Eligible Employee, his or her election to make Employee Contributions shall be cancelled); provided, however, Termination of Employment of an Eligible Employee shall not constitute loss of eligibility solely with respect to contribution of Base Compensation (if otherwise permitted hereunder) that is earned prior to termination but paid within 60 days thereafter or with respect to an Incentive Award paid after Retirement (and such person shall be deemed an Eligible Employee for such contributions).

(b) Employee Contributions shall be credited to the Participant's Pre-Tax Account in accordance with the provisions of Section 4.2(e) and such contributions and earnings thereon shall bear interest beginning the first day of the month at the applicable Declared Rate on the balance from month-to-month in such account. The interest will be credited monthly to the account at one-twelfth of the annual Declared Rate for that calendar year compounded quarterly.

(c) In addition, if the Participant's account under the Bell System Senior Management Incentive Award Deferral Plan ("Predecessor Plan") was transferred to this Plan as of January 1, 1984, the effective date of this Plan, then the Participant's Pre-Tax Account under this Plan shall be credited as of such date with the amount credited to the Participant's account under the Predecessor Plan as of December 31, 1983, and such amount shall bear interest in accordance with the terms of this Plan.

(d) Deferred amounts related to Incentive Awards which would otherwise have been distributed in shares of stock other than shares of common stock of SBC shall be credited to the Participant's Pre-Tax Account as deferred shares. The Participant's Pre-Tax Account shall also be credited on each dividend payment date with an amount equivalent to the dividend payable on the number of such shares equal to the number of deferred shares in the Participant's Pre-Tax Account on the record date for such dividend. Such amount shall then be converted to a number of additional deferred shares determined by dividing such amount by the closing price of such shares on the New York Stock Exchange on such date, or if not listed on such exchange, then on the principal market for such shares. If not traded on such exchange on such date, then the closing price on the next preceding day the stock was so traded shall be utilized.

In the event of a merger, reorganization, consolidation, recapitalization, separation, liquidation, stock dividend, stock split, share combination, or stock dividend, stock split or other change in the corporate structure of the issuer of stock described in the preceding paragraph, affecting such stock, the Committee shall make an adjustment to the number and class of shares of deferred stock, in its discretion, to avoid any dilution or enlargement of rights.

(e) A contribution to the Plan shall be made when the compensation – from which the contribution is to be deducted – is paid using the "check date" shown on the related pay record (sometimes referred to as the "paycheck stub") as the contribution date (if no "check date" is shown, then the date of the pay record). When there is an underpayment or delayed payment of gross compensation for any reason, the related contribution shall be determined and made when the underpayment or delayed payment is paid, again using the date of the pay record. When there is an overpayment of gross compensation, the amount of the overpayment will not be considered in determining the contribution amount.

## **Article 5 - Distributions**

### **5.1 Distributions From Pre-Tax Account.**

(a)Retirement. Beginning March 10 (or such other date as determined by SBC) of the first (1st) calendar year following the calendar year of the Retirement of a Participant and on March 10 (or such other date as determined by SBC) of each of the successive 14 calendar years, SBC shall distribute to the Participant that portion of the Participant's Pre-Tax Account that is equal to the total dollar amount of the Participant's Pre-Tax Account (and/or number of deferred shares then held in the Participant's Pre-Tax Account) divided by the number of remaining installments. Notwithstanding the foregoing, if the Participant Retires prior to 2001, then any undistributed portion of the Participant's Pre-Tax Account will be distributed in a lump sum on March 10 of the fifteenth (15<sup>th</sup>) calendar year following the calendar year of the Retirement of the Participant.

(b)Non-Retirement Termination of Employment. Beginning March 10 (or such other date as determined by SBC) of the calendar year following the calendar year of Termination of

Employment which is not a Retirement and on March 10 (or such other date as determined by SBC) of each of the successive 2 calendar years, SBC shall distribute that portion of the Participant's Pre-Tax Account that is equal to the total dollar amount of the Participant's Pre-Tax Account (and/or number of deferred shares held in the Participant's Pre-Tax Account) divided by the number of remaining installments.

(c)Death. Notwithstanding (a) or (b) above to the contrary, in the event of the death of a Participant, any amounts remaining in the Participant's Pre-Tax Account (and/or number of deferred shares then held in the Participant's Pre-Tax Account) shall be promptly distributed to the Participant's beneficiary designated in accordance with the SBC Rules for Employee Beneficiary Designations, as the same may be amended from time to time ("Rules"). If no designation has been made or if all designated beneficiaries predecease the Participant, the Participant's Pre-Tax Account shall be distributed according to the Rules.

Notwithstanding any other provision of this Plan, if a surviving beneficiary of a Plan participant disclaims in whole or in part, that beneficiary's interest or share in the distribution of the Plan participant's Plan proceeds, and such disclaimer satisfies the requirements of Section 2518(b) of the Internal Revenue Code (or any successor provision) and any applicable state law, such disclaimer shall not constitute an assignment, transfer or alienation by any method of such interest or share or proceeds and the portion of such proceeds subject to such disclaimer shall be distributed as if that beneficiary had predeceased the Plan participant.

(d)Discharge for Cause/Non Competition. Notwithstanding any other provision of this Plan to the contrary, all amounts (including deferred shares) then credited to the Participant's Pre-Tax Account shall be paid immediately in a single payment if a Participant is discharged for cause by his or her Employer, or if a Participant otherwise ceases to be employed by his or her Employer and engages in competition with SBC or any direct or indirect Subsidiary thereof or with any business with which a Subsidiary of SBC or an affiliated company has a substantial interest (collectively referred to herein as an "Employer Business"), or becomes employed by a governmental agency having jurisdiction over the activities of SBC or any of its Subsidiaries. For purposes hereof, engaging in competition with any Employer business shall mean engaging by the Participant in any business or activity in the same geographical market where the same or substantially similar business or activity is being carried on as an Employer business. Such term shall not include owning a nonsubstantial publicly traded interest as a shareholder in a business that competes with an Employer business. However, engaging in competition with an Employer business shall include representing or providing consulting services to, or being an employee of, any person or entity that is engaged in competition with any Employer business or that takes a position adverse to any Employer business in a judicial, regulatory, legislative or administrative proceeding. Further, engaging in competition with an Employer business would result if the Participant either engages directly in competitive activity or in any capacity in any location becomes employed by, associated with, or renders service to any company, or parent or affiliate thereof, or any subsidiary of any of them, if any of them is engaged in competition with an Employer business, regardless of the position or duties the Participant takes and regardless of whether or not the employing company, or the company that the Participant becomes associated with or renders service to, is itself engaged in direct competition with an Employer business.

(e) Deferred amounts held pending distribution shall continue to be credited with interest or additional deferred shares, as applicable, determined in accordance with Section 4.2(b) or 4.2 (d), as applicable.

(f) The obligation to make distribution of deferred amounts credited to a Participant's Pre-Tax Account during any calendar year, plus the additional amounts credited on such deferred amounts pursuant to Section 4.2(b) or 4.2(d), as applicable, shall be borne by SBC or the applicable Employer which otherwise would have paid the related award currently. However, the obligation to make distributions with respect to deferred amounts which are related to amounts credited to a Participant's Pre-Tax Account as of the effective date of the Plan pursuant to Section 4.2(c), and with respect to which no SBC company would otherwise have paid the related award currently, shall be borne by the Employer which employed the Participant on the effective date of the Plan.

(g) For the purpose of this Plan, a beneficiary designation like that described in Section 5.1(c) that was made under the comparable provisions of the Predecessor Plan shall be considered as a beneficiary designation made under Section 5.1(c).

(h) Notwithstanding the other provisions of this Section 5.1 to the contrary, but subject to the provisions of Section 5.2(b), a Participant who was a Participant on, and made contributions to the Plan prior to, September 1, 2000, may request that receipt of the cash portion of Participant's Pre-Tax Account be deferred to Participant's death, or to be received earlier if accelerated in accordance with the provisions of 5.2(a). Approval of such request shall be in SBC's sole discretion.

## **5.2 Accelerated Distribution.**

(a) On or before the last Business Day of a calendar year, a Participant may elect to receive a distribution of all or a portion of the Participant's Pre-Tax Account. Such distribution shall be made March 10 (or such other date as determined by SBC) of the immediately following calendar year. This distribution shall be in addition to the portion of the Pre-Tax Account to be distributed at the same time under Section 5.1, which distribution shall be calculated without regard to an election under this section. No distribution under this Section 5.2(a) shall be made of amounts contributed to or earned under this Plan in the same calendar year as the distribution.

(b) In the event the Participant Terminates Employment for reasons other than Retirement, SBC may, at its sole discretion, accelerate the distribution of all or a portion of a Participant's Pre-Tax Account to the date of SBC's choosing, without notice to, or the consent of, the Participant.

## **5.3 Small Distribution.**

Notwithstanding any election made by the Participant, after the Termination of Employment of the Participant for any reason, if at the time the total value of the Participant's Pre-Tax Account is less than \$10,000, SBC may, in its discretion, distribute all of such account in the form of a lump sum distribution.

## **5.4 Determination by Internal Revenue Service.**

In the event that a final determination shall be made by the Internal Revenue Service or any court of competent jurisdiction that a Participant has recognized gross income for Federal income tax purposes in excess of the portion of Participant's Pre-Tax Account actually distributed by SBC, SBC shall promptly distribute to the Participant that portion of Participant's Pre-Tax Account to which such additional gross income is attributable.

## **5.5 Emergency Distribution.**

In the event that SBC, upon written petition of the Participant, determines in its sole

discretion that the Participant has suffered an unforeseeable financial emergency, SBC shall distribute to the Participant, as soon as practicable following such determination, that portion of Participant's Pre-Tax Account determined by SBC in its sole discretion to meet the emergency (the "Emergency Distribution. For purposes of this Plan, an unforeseeable financial emergency is an unexpected need for cash arising from an illness, casualty loss, sudden financial reversal, or other such unforeseeable occurrence. Cash needs arising from foreseeable events such as the purchase of a house or education expenses for children shall not be considered to be the result of an unforeseeable financial emergency. Upon such distribution, any election to make Employee Contributions by such Participant shall be immediately cancelled, and the Participant shall not be permitted to make a new election with respect to Employee Contributions that would be contributed during the then current and immediately following calendar year.

#### **5.6 Ineligible Participant.**

Notwithstanding any other provisions of this Plan to the contrary, if SBC receives an opinion from counsel selected by SBC, or a final determination is made by a Federal, state or local government or agency, acting within its scope of authority, to the effect that an individual is not, or was not at the time of his or her making Employee Contributions to this Plan, to be a member of Employer's "select group of management or highly compensated employees" within the meaning of ERISA, then such person will not be eligible to participate in this Plan and shall receive an immediate lump sum distribution of the Participant's Pre-Tax Account. Upon such payment no other distribution shall thereafter be payable under this Plan either to the individual or any beneficiary of the individual, except as provided under Section 8.1 Additional Benefit.

### **Article 6 - Transition Provisions**

The transition rules of this Article 6 shall supercede all other terms of this Plan.

#### **6.1 Effective Dates.**

Except as otherwise provided herein, the amendments to this Plan made September 1, 2000 (the "2000 Amendments") shall be effective September 1, 2000, and no election regarding the further deferral of a distribution of contributions to this Plan may be made on or after September 1, 2000.

#### **6.2 Combination of Existing Contributions.**

(a) Effective January 1, 2001, all prior contributions made to the Plan by a Participant shall be combined into Participant's single Pre-Tax Account.

(b) To the extent any Participant who Retires before 2001 would, were it not for the 2000 Amendments, under valid elections made prior to September 1, 2000, receive a distribution that would extend the Participant's distributions beyond 2015, then the contributions so affected shall not be combined with other contributions and shall be distributed in accordance with such elections. Notwithstanding the foregoing, the Participant may, with the consent of SBC, elect to have all of Participant's contributions to the Plan governed by this Plan as in effect after September 1, 2000.

(c) In the event a Participant dies prior to 2001, the Participant's accounts shall not be combined with and shall be distributed in accordance with the Plan as it existed immediately prior to September 1, 2000.



### **6.3 Termination of Elections.**

(a) Distributions from the Plan that would be made in the year 2000 under the Plan as it existed immediately prior to September 1, 2000, based on elections made before September 1, 2000, shall continue to be made in the year 2000 as provided in the Plan immediately prior to September 1, 2000. All other distribution elections are cancelled, including but not limited to distributions which have already commenced, but only to the extent such elections call for distributions after the year 2000. All amounts (or shares) remaining undistributed after such distributions shall be held and distributed in accordance with the terms of the Plan as in effect after September 1, 2000.

(b) Contributions to the Plan that would be made in the year 2000 under the Plan as it existed immediately prior to September 1, 2000, based on elections made before September 1, 2000, shall continue to be made in the year 2000 as provided in the Plan immediately prior to September 1, 2000. Elections to participate in the Plan shall not automatically be renewed for the year 2001. Each Eligible Employee must make a new election after September 1, 2000, in order to make Employee Contributions after 2000. Provided, however, valid elections made prior to September 1, 2000, to contribute Incentive Awards in 2001 shall be valid elections under this Plan.

### **6.4 Annual Base Salary Contribution Transition.**

Annual base salary earned prior to January 1, 2001, shall be contributed when earned, while annual base salary earned on or after such date shall be contributed when paid. In order to avoid any double contribution of annual base salary, that part of annual base salary earned in the year 2000 shall not be included in any determination of contributions to the Plan in a later calendar year, even though paid in such calendar year.

## **Article 7 - Discontinuation, Termination, Amendment**

### **7.1 SBC's Right to Terminate Plan.**

The Committee may terminate the Plan at any time. Upon termination of the Plan, contributions shall no longer be made under the Plan.

After termination of the Plan, Participants shall continue to earn interest/dividend equivalents and shall continue to receive all distributions under this Plan at such time as provided in and pursuant to the terms and conditions of this Plan at the time of the Plan's termination.

### **7.2 Amendment.**

This Plan may be modified or terminated at any time in accordance with the provisions of SBC's Schedule of Authorizations; provided, however, that no amendment, including but not limited to an amendment to this section, shall be effective, without the consent of a Participant, to alter, to the material detriment of such Participant, the distributions described in this Plan as applicable to the Participant or to decrease such Participant's Pre-Tax Account. For purposes of this section, an alteration to the material detriment of a Participant shall mean a material reduction in the period of time over which Participant's Pre-Tax Account may be distributed to a Participant or a reduction in the amounts then credited to a Participant's Pre-Tax Account. Any such consent may be in a writing, telecopy, or e-mail or in another electronic format. An election to make Employee Contributions and the failure to terminate an election to make Employee Contributions when able to do so shall each be conclusively deemed to be the consent of the Participant to any and all amendments to the Plan prior to such election or failure to terminate an

election, and such consent shall be a condition to making any election with respect to Employee Contributions.

## **Article 8 – Miscellaneous**

### **8.1 Additional Benefit.**

The reduction of any benefit payable under the SBC Pension Benefit Plan (or comparable plan identified by SBC as a replacement therefor), which results from participation in this Plan, will be restored as an additional benefit ("make-up piece") under this Plan. The Participant shall elect prior to commencement of payment of the make-up piece whether to receive such benefit in cash in a lump sum (consisting of the present value equivalent of the pension retirement benefit (life annuity) make-up piece) or such benefit in an annuity form of payment. Notwithstanding the proceeding provisions of this section, if all or a portion of the make-up piece is paid pursuant to SRIP or another non-qualified plan, then such amount shall not be payable pursuant to this Plan.

### **8.2 Tax Withholding.**

Upon a distribution from Participant's Pre-Tax Account, SBC shall withhold such amount (or shares) as determined by SBC to satisfy the minimum amount of Federal, state, and local taxes required by law to be withheld as a result of such distribution, or such greater amount as specified by the Participant.

### **8.3 Elections and Notices.**

Notwithstanding anything to the contrary contained in this Plan, all elections and notices of every kind shall be made on forms prepared by SBC or the General Counsel, Secretary or Assistant Secretary, or their respective delegates or shall be made in such other manner as permitted or required by SBC or the General Counsel, Secretary, or Assistant Secretary, or their respective delegates, including through electronic means, over the Internet or otherwise. An election shall be deemed made when received by SBC (or its designated agent, but only in cases where the designated agent has been appointed for the purposes of receiving such election), which may waive any defects in form. Unless made irrevocable by the electing person, each election with regard to making Employee Contributions or distributions under the Plan shall become irrevocable at the close of business on the last day to make such election. SBC may limit the time an election may be made in advance of any deadline.

If not otherwise specified by this Plan or SBC, any notice or filing required or permitted to be given to SBC under the Plan shall be delivered to the principal office of SBC, directed to the attention of the Senior Executive Vice President-Human Resources of SBC or his or her successor. Such notice shall be deemed given on the date of delivery.

Notice to the Participant shall be deemed given when mailed (or sent by telecopy) to the Participant's work or home address as shown on the records of SBC or, at the option of SBC, to the Participant's e-mail address as shown on the records of SBC. It is the Participant's responsibility to ensure that the Participant's addresses are kept up to date on the records of SBC. In the case of notices affecting multiple Participants, the notices may be given by general distribution at the Participants' work locations.

By participating in the Plan, each Participant agrees that SBC may provide any documents required or permitted under the Federal or state securities laws, including but not

limited to the Securities Act of 1933 and the Securities Exchange Act of 1934 by e-mail, by e-mail attachment, or by notice by e-mail of electronic delivery through SBC's Internet Web site or by other electronic means.

#### **8.4 Unsecured General Creditor.**

Participants and their beneficiaries, heirs, successors, and assigns shall have no legal or equitable rights, interest, or claims in any property or assets of any Employer. No assets of any Employer shall be held under any trust for the benefit of Participants, their beneficiaries, heirs, successors, or assigns, or held in any way as collateral security for the fulfilling of the obligations of any Employer under this Plan. Any and all of each Employer's assets shall be, and remain, the general, unpledged, unrestricted assets of such Employer. The only obligation of an Employer under the Plan shall be merely that of an unfunded and unsecured promise of SBC to make distributions under, and in accordance with the terms of, the Plan.

#### **8.5 Offset.**

SBC may offset against the amount (or shares) otherwise distributable to a Participant, any amounts due an Employer by a Participant, including but not limited to overpayments under any compensation or benefit plans.

#### **8.6 Non-Assignability.**

Neither a Participant nor any other person shall have any right to commute, sell, assign, transfer, pledge, anticipate, mortgage, or otherwise encumber, transfer, hypothecate or convey in advance of actual receipt, any amounts (or shares) distributable under the Plan, or any part thereof, which are, and all rights to which are, expressly declared to be unassignable and non-transferable. No part of the amount (or shares) distributable shall, prior to actual distribution, be subject to seizure or sequestration for the payment of any debts, judgments, alimony or separate maintenance owed by a Participant or any other person, nor be transferable by operation of law in the event of a Participant's or any other person's bankruptcy or insolvency.

Notwithstanding the foregoing, in the event a Participant becomes employed by Cingular Wireless LLC ("Cingular") or an entity directly or indirectly owned by Cingular and elects or has elected to have his or her interest in this Plan transferred to the Cingular Wireless Cash Deferral Plan, the Participant shall have no further interest in the transferred amounts under this Plan and shall look solely to Cingular for any rights previously held under this Plan.

#### **8.7 Employment Not Guaranteed.**

Nothing contained in this Plan nor any action taken hereunder shall be construed as a contract of employment or as giving any employee any right to be retained in the employ of an Employer or to serve as a director.

#### **8.8 Errors.**

At any time SBC may correct any error made under the Plan without prejudice to SBC. Such corrections may include, among other things, refunding contributions to a Participant with respect to any period he or she made Employee Contributions while not an Eligible Employee, or canceling the enrollment of a non-Eligible Employee.

#### **8.9 Captions.**

The captions of the articles, sections, and paragraphs of this Plan are for convenience only and shall not control nor affect the meaning or construction of any of its provisions.

**8.10 Governing Law.**

To the extent not preempted by Federal law, the Plan, and all awards and agreements hereunder, and any and all disputes in connection therewith, shall be governed by and construed in accordance with the substantive laws of the State of Texas, without regard to conflict or choice of law principles which might otherwise refer the construction, interpretation or enforceability of this Plan to the substantive law of another jurisdiction.

Because awards under the Plan are granted in Texas, records relating to the Plan and awards thereunder are located in Texas, and the Plan and awards thereunder are administered in Texas, the Company and the Participant to whom an award under this Plan is granted, for themselves and their successors and assigns, irrevocably submit to the exclusive and sole jurisdiction and venue of the state or federal courts of Texas with respect to any and all disputes arising out of or relating to this Plan, the subject matter of this Plan or any awards under this Plan, including but not limited to any disputes arising out of or relating to the interpretation and enforceability of any awards or the terms and conditions of this Plan. To achieve certainty regarding the appropriate forum in which to prosecute and defend actions arising out of or relating to this Plan, and to ensure consistency in application and interpretation of the Governing Law to the Plan, the parties agree that (a) sole and exclusive appropriate venue for any such action shall be an appropriate federal or state court in Bexar County, Texas, and no other, (b) all claims with respect to any such action shall be heard and determined exclusively in such Texas court, and no other, (c) such Texas court shall have sole and exclusive jurisdiction over the person of such parties and over the subject matter of any dispute relating hereto and (d) that the parties waive any and all objections and defenses to bringing any such action before such Texas court, including but not limited to those relating to lack of personal jurisdiction, improper venue or *forum non conveniens*.

**8.11 Validity.**

In the event any provision of this Plan is held invalid, void, or unenforceable, the same shall not affect, in any respect whatsoever, the validity of any other provision of this Plan.

**8.12 Successors and Assigns.**

This Plan shall be binding upon SBC and its successors and assigns.



**EXECUTIVE HEALTH PLAN**  
(Formerly the SUPPLEMENTAL HEALTH PLAN prior to September 1, 2001)

Effective: January 1, 1987  
Revisions Effective: January 1, 2006

## EXECUTIVE HEALTH PLAN

### ARTICLE 1: PURPOSE

The Executive Health Plan ("Plan") provides Eligible Employees, certain Retired Eligible Employees, and each of their Dependents with supplemental medical, dental, and vision benefits.

### ARTICLE 2: DEFINITIONS

For purposes of this Plan, the following words and phrases shall have the meanings indicated, unless the context clearly indicates otherwise:

- 2.1 Basic Plan(s).** "Basic Plan(s)" shall mean SBC's group managed care medical (known as the SBC Medical Plan), dental (non-DHMO option), and vision care plans (including the SBC Retiree Vision Care Program). For a Participant who Retired on or before August 31, 1992, Basic Plans shall mean the SBC Medical and Group Life Insurance Plan – CustomCare ("CustomCare") and dental (non-DHMO option) plans.
- 2.2 CEO.** "CEO" shall mean the Chief Executive Officer of SBC Communications Inc.
- 2.3 COBRA.** "COBRA" shall mean the Consolidated Omnibus Budget Reconciliation Act of 1985, as amended.
- 2.4 Committee.** "Committee" shall mean the Human Resources Committee of the Board of Directors of SBC Communications Inc.
- 2.5 Dependent(s).** "Dependent(s)" shall mean those individuals who would qualify as an Eligible Employee's dependents under the terms of the major medical Basic Plan in which the Eligible Employee participates,, or, if applicable, Substitute Basic Coverage.
- 2.6 Disability.** "Disability" shall mean qualification for long term disability benefits under section 3.1 of the Officer Disability Plan.
- 2.7 Eligible Employee.** "Eligible Employee" shall mean an Officer. Notwithstanding the foregoing, the CEO may, from time to time, exclude any Officer or group of Officers from being an "Eligible Employee" under this Plan. Employees of a company acquired by SBC shall not be considered an Eligible Employee unless designated as such by the CEO.
- 2.8 Employer.** "Employer" shall mean SBC Communications Inc. or any of its Subsidiaries.

- 2.9 Officer.** "Officer" shall mean an individual who is designated as an officer level Employee for compensation purposes on the records of SBC.
- 2.10 Participant.** "Participant" shall mean an Eligible Employee or Retired Eligible Employee who has been designated to participate in the Plan and his or her Dependents.
- 2.11 Plan Year.** "Plan Year" shall mean the calendar year.
- 2.12 Qualified Dependent.** "Qualified Dependent" shall mean a Dependent who loses coverage under a COBRA Eligible Program due to a Qualifying Event.
- 2.13 Qualifying Event.** "Qualifying Event" shall mean any of the following events if, but for COBRA continuation coverage, they would result in a Participant's loss of coverage under this Plan:
- (1) death of a covered Employee;
  - (2) termination (other than by reason of such Employee's gross misconduct) of an Employee's employment;
  - (3) reduction in hours of an Employee;
  - (4) divorce or legal separation of an Employee or dissolution of an Employee's registered domestic partnership;
  - (5) an Employee's entitlement to Medicare benefits; or
  - (6) a Dependent child ceasing to qualify as a Dependent under a Program.
- 2.14 Retire or Retirement.** "Retire" or "Retirement" shall mean the termination of an Eligible Employee's employment with SBC or any of its Subsidiaries, for reasons other than death, on or after the earlier of the following dates: (1) the date such Eligible Employee has attained age 55, and, for an Eligible Employee on or after January 1, 2002, has five (5) years of service, or (2) the date the Eligible Employee has attained one of the following combinations of age and service at termination of employment on or after April 1, 1997:
- |                             |             |
|-----------------------------|-------------|
| <u>Net Credited Service</u> | <u>Age</u>  |
| 25 years or more            | 50 or older |
| 30 years or more            | Any age     |
- 2.15 SEVP-HR.** "SEVP-HR shall mean SBC's highest ranking Officer, specifically responsible for human resource matters.
- 2.16 Subsidiary.** "Subsidiary" shall mean any corporation, partnership, venture or other entity in which SBC holds, directly or indirectly, a 50% or greater ownership interest. The Committee may, at its sole discretion, designate any other corporation, partnership, venture or other entity a Subsidiary for the purpose of participating in this Plan. Notwithstanding anything herein to the

contrary, unless designated a "Subsidiary" pursuant to the immediately preceding sentence, Cingular Wireless LLC, Sterling Commerce, Inc. and their respective subsidiaries shall not be considered a Subsidiary under this Plan.

**2.17 SBC.** "SBC" shall mean SBC Communications Inc.

### **ARTICLE 3: ELIGIBILITY**

**3.1 Active Participants and their Dependents.** Each Eligible Employee shall be eligible to participate in this Plan along with his or her Dependents beginning on the effective date of the employee becoming an Eligible Employee.

Upon becoming an Eligible Employee, he or she shall have 90 days to elect to participate in this Plan. In order to continue participation, the Eligible Employee must pay all applicable contributions. If an Eligible Employee terminates participation in this Plan at any time for any reason, that Eligible Employee and his or her Dependents shall be ineligible to participate in the Plan at any time in the future.

**3.2 Retired Participants and their Dependents.** Provisions of this Plan will continue in effect during Retirement for each Eligible Employee and his or her Dependents with respect to any Eligible Employee who became a Participant before January 1, 1999. Neither an Eligible Employee who became an Eligible Employee after December 31, 1998 nor his or her Dependents shall be eligible for participation hereunder on or after such Eligible Employee's Retirement.

**3.3 Requirement to Enroll and Participate in Basic Plans and Medicare.** As a condition to participation in the Plan, each Participant must be enrolled in, paying for, and participating in (i) the Basic Plans, or, if applicable, Substitute Basic Coverage, and (ii) all parts of Medicare for which such Participant is eligible except for Medicare Part D relating to prescription drug coverage.

Notwithstanding any other provision of the Plan to the contrary, an individual who first becomes an Eligible Employee in the middle of a Plan Year and who is enrolled in SBC sponsored group health plans other than the Basic Plans, will be allowed to participate in the Plan for the remainder of the Plan Year along with his or her Dependents who are enrolled in such other SBC sponsored health plans, as if they were participating in the Basic Plans. At the next group enrollment opportunity for the Basic Plans, the Eligible Employee and his or her Dependents must enroll in the Basic Plans to continue participation in this Plan.

### **ARTICLE 4: BENEFITS**

**4.1 Covered Benefits.** Subject to the limitations in this Article, this Plan provides 100% payment, through reimbursement or otherwise, of all medical,



dental, and vision services not paid under the Eligible Employee's (i) Basic Plans or, if applicable, Substitute Basic Coverage, or (ii) Medicare, provided expenses for such services would qualify as deductible medical expenses for federal income tax purposes, whether deducted or not. Contributions or premiums for participation in this Plan, the Basic Plans, Medicare, or any other health plan are not considered "services", and are therefore not eligible benefits under this Plan.

**4.2 Benefit Limits.** Benefits paid to any Eligible Employee or any one of his or her Dependents under this Plan shall not exceed \$50,000 per Plan Year per individual, and benefits paid to any Eligible Employee and his or her Dependents under this Plan shall not exceed \$100,000 total per Plan Year. Amounts paid to or on behalf of an Eligible Employee or his or her Dependents under (i) the Basic Plans, or if applicable, Substitute Basic Coverage, (ii) Medicare, or (iii) any other SBC sponsored group health plan will not be included in these limits.

**4.3 Priority of Paving Covered Claims.** Claims for benefits will be applied against the various health plans in the following order:

- (1) Medicare, to the extent the Participant is eligible therefore and such claim is actually paid by Medicare,
- (2) Basic Plans,
- (3) CarePlus, if elected,
- (4) Long Term Care Plan, if elected,
- (5) this Plan.

**4.4 Substitute Basic Coverage.** Notwithstanding any other provision of this Plan to the contrary, if an Eligible Employee is eligible for participation under this Plan during Retirement, but not eligible to participate under the Basic Plans, the Plan shall provide medical, dental, and vision benefits for the Eligible Employee and his or her Dependents substantially equivalent to the benefits under the Basic Plans through an insured product (hereinafter, "Substitute Basic Coverage"). Eligibility for Substitute Basic Coverage is conditioned upon the Eligible Employee's payment of contributions in the same amount that a similarly situated retired Basic Plan participant is required to pay under the Basic Plans. Such Substitute Basic Coverage shall constitute such Eligible Employee's Basic Plans for all purposes under this Plan. The costs of Substitute Basic Coverage (except for the required monthly contributions referenced in this paragraph) shall be borne by SBC, and the costs of Substitute Basic Coverage shall not be included in the determination of any Participant's annual Plan contribution amount as provided in Article 7.

## **ARTICLE 5: TERMINATION OF PARTICIPATION**

**5.1 Termination of Participation.** Participation will cease on the last day of the month in which one of the following conditions occurs:

- (1) The Participant is no longer a participant in the Basic Plans or Substitute Basic Coverage, in which case participation ceases for such Participant;

- (2) A Participant eligible to enroll in Medicare is no longer a participant in all parts of Medicare for which such Participant is eligible to enroll except for Medicare Part D relating to prescription drug coverage, in which case participation ceases for such Participant;
- (3) The Eligible Employee's termination of employment for reasons other than Death, Disability, or Retirement, in which case participation ceases for the Eligible Employee and his or her Dependents;
- (4) The demotion or designation of an Eligible Employee so as to no longer be eligible to participate in the Plan, in which case participation ceases for the Eligible employee and his or her Dependents;
- (5) The Eligible Employee (or Retired Eligible Employee) engages in competitive activity under Article 8, in which case participation ceases for the Eligible Employee (or Retired Eligible Employee) and his or her Dependents; or
- (6) Discontinuance of the Plan by SBC, or, with respect to a Subsidiary's Eligible Employees (or Retired Eligible Employees), such Subsidiary's failure to make the benefits hereunder available to Eligible Employees employed by it (or its Retired Eligible Employees), in which case participation ceases for the Eligible Employee (or Retired Eligible Employee) and his or her Dependents.

**5.2 Dependents Failure to Participate in Basic Plans.** If a Dependent ceases participation under a Basic Plan or, if applicable, Substitute Basic Coverage, such Dependent's participation under this Plan will cease with the same effective date.

**5.3 Death.** In the event of the Eligible Employee's (or Retired Eligible Employee's) death, the Eligible Employee's (or Retired Eligible Employee's) Dependents may continue participation in this Plan as follows:

- (1) In the event of the death of a Retired Eligible Employee such Retired Eligible Employee's Dependents may continue participation in this Plan for so long as such Dependents are participating in the Basic Plans (or, if applicable, Substitute Basic Coverage) and are paying any applicable contributions for this Plan as provided in Article 7.
- (2) In the event of an in-service death of an Eligible Employee eligible to participate in the Plan in Retirement as provided under Article 3.2, such Eligible Employee's surviving Dependents may continue participation in this Plan for so long as such Dependents are participating in the Basic Plans (or, if applicable Substitute Basic Coverage) and are paying any

applicable contributions for this Plan as provided in Article 7. If a surviving spouse of such Eligible Employee otherwise eligible for participation in the Plan remarries, his or her participation will cease with the effective date of his or her marriage.

- (3) In the event of an in-service death of an Eligible Employee not eligible to participate in the Plan in Retirement as provided in Article 3.2, such Eligible Employee's Dependents may continue participation in this Plan for a 12 month period commencing the month following the month in which such Eligible Employee dies as long as such Dependents are participating in the Basic Plans and are paying any applicable contributions for this Plan as provided in Article 7.

#### **ARTICLE 6: DISABILITY**

**6.1 Disability.** With respect to any Eligible Employee who is receiving short term or long term disability benefits under the Officer Disability Plan, participation under this Plan will be as follows:

- (1) The Eligible Employee will be eligible to participate in this Plan for as long as he/she receives short term or long term disability benefits under the Officer Disability Plan.
- (2) An individual who became an Eligible Employee on or after January 1, 1999 will no longer be eligible to participate in this Plan once long term disability benefits under the Officer Disability Plan are discontinued, unless the Eligible Employee is otherwise eligible for continued benefits under this Plan.
- (3) An Employee who became an Eligible Employee before January 1, 1999, will be eligible for participation in this Plan as follows:

(A) If the individual is Retirement eligible at the time long term disability benefits under the Officer Disability Plan commence, he/she will be eligible to continue participation in this Plan on the same terms and conditions that participation would be available to such Eligible Employee in Retirement, regardless of his/her continued receipt of long term disability benefits.

(B) If the individual is not Retirement eligible at the time long term disability benefits under the Officer Disability Plan commence, he/she will be eligible to participate in this Plan for as long as such Eligible Employee participates in the Basic Plans.

#### **ARTICLE 7: COSTS**

**7.1 Costs of the Plan.** Except as provided below in this Article 7, costs and

expenses incurred in the operation and administration of this Plan will be borne by SBC, and each Subsidiary shall reimburse SBC for applicable costs and expenses attributable to Eligible Employees employed by it (and Retired Eligible Employees formerly employed by it).

**7.2 Participant Contributions for 2006 and 2007.** For Plan Years 2006 and 2007 contributions made by Eligible Employees shall be set annually by the SEVP-HR in an amount that approximates the aggregate monthly contribution the Participant would have paid under this Plan and CustomCare as if CustomCare was the applicable Basic Plan. The SEVP-HR may adopt tiered rates for similarly situated groups of Eligible Employees based on factors such as the number of Dependents covered or Medicare eligibility.

**7.3 Eligible Employee Contributions.** Effective January 1, 1999, an Eligible Employee electing to participate in the Plan will pay to participate in the Plan while in active service or while receiving short term or long term disability benefits under the Officer Disability Plan. The contribution for participation may change annually, effective at the beginning of each Plan Year. Except as provided in Article 7.2 such contribution will equal 10% of the Plan's actual costs per Eligible Employee and Retired Eligible Employee for the entire Plan Year beginning two years prior to the Plan Year for which the calculation is being made (e.g., the contribution for 2004 are based on the Plan's costs during calendar year 2002).

**7.4 Retired Eligible Employees.** Eligible Employees entitled to participate in the Plan after Retirement or after termination of long term disability benefits under the Officer Disability Plan who elect to participate will pay to participate in the Plan. The contribution for participation may change annually, effective at the beginning of each Plan Year. Except as provided in Article 7.2 such contribution will equal a percentage of the Plan's actual costs per Eligible Employee and Retired Eligible Employee for the entire Plan Year beginning two (2) years prior to the Plan Year for which the calculation is being made (e.g., the contributions for 2004 are based on the Plan's costs during calendar year 2002). An Eligible Employee retiring prior to January 1, 1999 will pay a 10% contribution percentage. Eligible Employees retiring after December 31, 1998 shall pay the lower of the annual contribution percentage determined using such Eligible Employee's age or years until Retirement as of December 31, 1997 as follows:

Age As Of December 31, 1997	Annual Contribution Percentage	OR	Years Until Retirement As Of December 31, 1997	Annual Contribution Percentage
if age 55 or older	10%		if retirement eligible	10%
if age 50 or older but less than 55	25%		if not retirement eligible	10% plus 5% for each whole year* until retirement eligibility (not to exceed 50%)
if less than age 50	50%			

\*In the event an Eligible Employee is less than one whole year from retirement eligibility, the Annual

Contribution Percentage shall be determined as if one whole year from retirement eligibility.

Upon the death of an Eligible Employee the contribution percentage paid by the surviving spouse will be equal to the contribution, adjusted (if applicable) for factors such as the number of Dependents or Medicare eligibility that that would have been paid by the Eligible Employee had he or she survived. In the event there is no surviving spouse but there are surviving eligible Dependents, such Dependents shall pay a ratable share of the contribution, adjusted (if applicable) for factors such as the number of Dependents or Medicare eligibility that would have been paid by the Eligible Employee had he or she survived.

In order to continue participation, the Retired Eligible Employee or his or her Dependents must pay all applicable contributions.

If a Retired Eligible Employee terminates participation at any time for any reason, participation of that Retired Eligible Employee and his or her Dependents may not be reinstated for any reason.

#### **ARTICLE 8: COVENANT NOT TO COMPETE**

**Non-Competition.** Notwithstanding any other provision of this Plan, no coverage shall be provided under this Plan with respect to any Eligible Employee who shall, without the written consent of SBC, and while employed by SBC or any Subsidiary thereof, or within three (3) years after termination of employment from SBC or any Subsidiary thereof, engage in competition with SBC or any Subsidiary thereof or with any business with which a subsidiary of SBC or an affiliated company has a substantial interest (collectively referred to herein as "Employer business"). For purposes of this Plan, engaging in competition with any Employer business shall mean engaging by Eligible Employee in any business or activity in the same geographical market where the same or substantially similar business or activity is being carried on as an Employer business. Such term shall not include owning a nonsubstantial publicly traded interest as a shareholder in a business that competes with an Employer business. However, engaging in competition with an Employer business shall include representing or providing consulting services to, or being an employee of, any person or entity that is engaged in competition with any Employer business or that takes a position adverse to any Employer business. Accordingly, benefits shall not be provided under this Plan if, within the time period and without the written consent specified, the Eligible Employee either engages directly in competitive activity or in any capacity in any location becomes employed by, associated with, or renders service to any company, or parent or affiliate thereof, or any subsidiary of any of them, if any of them is engaged in competition with an Employer business, regardless of the position or duties the Eligible Employee takes and regardless of whether or not the employing company, or the company that Eligible Employee becomes associated with or renders service to, is itself engaged in direct competition with an Employer business.

#### **ARTICLE 9: MISCELLANEOUS**

**9.1 Administration.** Subject to the terms of the Plan, the CEO or SEVP-HR shall establish such rules as are deemed necessary for the proper administration of the Plan. SBC will compute a "gross-up" allowance which will be paid to an Eligible Employee to offset any income tax liabilities incurred as a result of receiving benefits under this Plan.

**9.2 Amendments and Termination.** This Plan may be modified or terminated at any time in accordance with the provisions of SBC's Schedule of Authorizations.

**9.3 Newborns' and Mothers' Health Protection Act of 1996.** To the extent this Plan provides benefits for hospital lengths of stay in connection with childbirth, the Plan will cover the minimum length of stay required for deliveries (i.e., a 48 hour hospital stay after a vaginal delivery or a 96 hour stay following a delivery by Cesarean section.) The mother's or newborn's attending physician, after consulting with the mother, may discharge the mother or her newborn earlier than the minimum length of stay otherwise required by law. Such coverage shall be subject to all other provisions of this Plan.

**9.4 Women's Health and Cancer Rights Act of 1998.** To the extent this Plan provides benefits for mastectomies, it will provide, for an individual who is receiving benefits in connection with a mastectomy and who elects breast reconstruction in connection with such mastectomy, coverage for reconstruction on the breast on which the mastectomy was performed, surgery and reconstruction on the other breast to give a symmetrical appearance, and prosthesis and coverage for physical complications of all stages of the mastectomy, including lymphedemas. Such coverage shall be subject to all other provisions of this Plan.

**9.5 Mental Health Parity Act of 1996.** To the extent this Plan provides mental health benefits other than treatment for substance or alcohol abuse, it will not place annual or lifetime maximums for such benefits that are lower than the annual and lifetime maximums for physical health benefits. Such coverage shall be subject to all other provisions of this Plan.

**9.6 Continuation of Coverage During Family or Medical Leave.** During any period which an Eligible Employee is on a family or medical leave as defined in the Family or Medical Leave Act, any benefit elections in force for the Eligible Employee shall remain in effect. While the Eligible Employee is on paid leave, contributions shall continue. If the Eligible Employee is on an unpaid leave, the Eligible Employee may elect to prepay required contributions on a pre-tax basis before the commencement of such unpaid leave. Alternatively, the Eligible Employee may elect to make such payments on an after-tax basis monthly in accordance with an arrangement that the Plan Administrator shall provide. If coverage is not continued during the entire period of the family or medical leave because the Eligible Employee declines to pay the premium, the coverage must

be reinstated upon reemployment with no exclusions or waiting periods, notwithstanding any other provision of this Plan to the contrary. If the Eligible Employee does not return to work upon completion of the leave, the Eligible Employee must pay the full cost of any health care coverage that was continued on his behalf during the leave. These rules apply to the COBRA Eligible Programs.

**9.7 Rights While on Military Leave.** Pursuant to the provisions of the Uniformed Services Employment and Reemployment Rights Act of 1994, an Employee on military leave will be considered to be on a Leave of Absence and will be entitled during the leave to the health and welfare benefits that would be made available to other similarly situated Employees if they were on a Leave of Absence. This entitlement will end if the Employee provides written notice of intent not to return to work following the completion of the military leave. The Employee shall have the right to continue his coverage, including any Dependent coverage, for the lesser of the length of the leave or 18 months. If the military leave is for a period of 31 days or more, the Employee can be required to pay 102 percent of the total premium (determined in the same manner as a COBRA continuation coverage premium). If coverage is not continued during the entire period of the military leave because the Employee declines to pay the premium or the leave extends beyond 18 months, the coverage must be reinstated upon reemployment with no pre-existing condition exclusions (other than for service-related illnesses or injuries) or waiting periods (other than those applicable to all eligible Employees).

**9.8 Qualified Medical Child Support Orders.** The Plan will comply with any Qualified Medical Child Support Order issued by a court of competent jurisdiction or administrative body that requires the Plan to provide medical coverage to a Dependent child of an Eligible Employee. The Plan Administrator will establish reasonable procedures for determining whether a court order or administrative decree requiring medical coverage for a Dependent child meets the requirements for a Qualified Medical Child Support Order. The cost of coverage or any additional cost of such coverage, if any, shall be borne by the Eligible Employee.

**9.9 Right of Recovery.** If the Plan has made an erroneous or excess payment to any Participant, the Plan Administrator shall be entitled to recover such excess from the individual or entity to whom such payments were made. The recovery of such overpayment may be made by offsetting the amount of any other benefit or amount payable by the amount of the overpayment under the Plan.

#### **ARTICLE 10: COBRA**

**10.1 Continuation of Coverage Under COBRA.** Participants shall have all COBRA continuation rights required by federal law and all conversion rights. COBRA continuation coverage shall be continued as provided in this Article 10.

**10.2 COBRA Continuation Coverage for Terminated Participants.** A covered Participant may elect COBRA continuation coverage, at his own expense, if his participation under this Plan would terminate as a result of one of the following Qualifying Events: an Employee's termination of employment or reduction of hours with an Employer.

**10.3 COBRA Continuation Coverage for Dependents.** A Qualified Dependent may elect COBRA continuation coverage, at his own expense, if his or her participation under this Plan would terminate as a result of a Qualifying Event.

**10.4 Period of Continuation Coverage for Covered Participants.** A covered Participant who qualifies for COBRA continuation coverage as a result of an Eligible Employee's termination of employment or reduction in hours of employment described in Subsection 10.2 may elect COBRA continuation coverage for up to 18 months measured from the date of the Qualifying Event.

Coverage under this Subsection 10.4 may not continue beyond the:

- (1) date on which the Participant's Employer ceases to maintain this Plan;
- (2) last day of the month for which premium payments have been made with respect to this Plan, if the individual fails to make premium payments on time, in accordance with Subsection 10.6;
- (3) date the covered Participant becomes entitled to Medicare; or
- (4) date the covered Participant is no longer subject to a pre-existing condition exclusion under the Participant's other coverage or new employer plan for the type of coverage available under the COBRA Eligible Program for which the COBRA election was made.

**10.5 Period of COBRA Continuation Coverage for Dependents.** If a Qualified Dependent elects COBRA continuation coverage under a COBRA Eligible Program as a result of the an Employee's termination of employment as described in Subsection 10.2, continuation coverage may be continued for up to 18 months measured from the date of the Qualifying Event. COBRA continuation coverage for all other Qualifying Events may continue for up to 36 months.

Continuation coverage under this Subsection 10.5 with respect to a COBRA Eligible Program may not continue beyond the date:

- (1) on which premium payments have not been made, in accordance with Subsection 10.6 below;
- (2) the Participant becomes entitled to Medicare;
- (3) on which the Employer ceases to maintain this Plan; or
- (4) the Participant is no longer subject to a pre-existing condition exclusion under the Participant's other coverage or new employer plan for the type of coverage available under this Plan.

**10.6 Contribution Requirements for COBRA Continuation Coverage.**



Covered Participants and Qualified Dependents who elect COBRA continuation coverage as a result of a Qualifying Event will be required to pay continuation coverage payments. Continuation coverage payments are the payments required for COBRA continuation coverage that is an amount equal to a reasonable estimate of the cost to this Plan of providing coverage for all covered Participants at the time of the Qualifying Event plus a two (2) percent administrative expense. In the case of a disabled individual who receives an additional 11-month extended coverage under COBRA, the Employer may assess up to 150 percent of the cost for this extended coverage period. Such cost shall be determined on an actuarial basis and take into account such factors as the Secretary of the Treasury may prescribe in regulations.

Covered Participants and Qualified Dependents must make the continuation coverage payment prior to the first day of the month in which such coverage will take effect. However, a covered Participant or Qualified Dependent has 45 days from the date of an affirmative election to pay the continuation coverage payment for the first month's payment and the cost for the period between the date medical coverage would otherwise have terminated due to the Qualifying Event and the date the covered Participant and/or Qualified Dependent actually elects COBRA continuation coverage.

The covered Participant and/or Qualified Dependent shall have a 30-day grace period to make the continuation coverage payments due thereafter. Continuation coverage payments must be postmarked on or before the completion of the 30-day grace period. If continuation coverage payments are not made on a timely basis, COBRA continuation coverage will terminate as of the last day of the month for which timely premiums were made. The 30-day grace period shall not apply to the 45-day period for the first month's payment of COBRA premiums as set out in the section above.

If payment is received that is significantly less than the required continuation coverage payment, then continuation coverage will terminate as of the last day of the month for which premiums were paid. A payment is considered significantly less than the amount due if it is greater than the lesser of \$50 or 10% of the required continuation coverage payment. Upon receipt of a continuation coverage payment that is insignificantly less than the required amount, the Plan Administrator must notify the covered Participant or Qualified Dependent of the amount of the shortfall and provide them with an additional 30-day grace period from the date of the notice for this payment only.

#### **10.7 Limitation on Participant's Rights to COBRA Continuation Coverage.**

- (1) If a Qualified Dependent loses, or will lose medical coverage under this Plan as a result of divorce, legal separation, entitlement to Medicare, or ceasing to be a Dependent, such Qualified Dependent is responsible for notifying the Plan Administrator in writing within

60 days of the Qualifying Event. Failure to make timely notification will terminate the Qualified Dependent's rights to COBRA continuation coverage under this Article.

- (2) A Participant must complete and return the required enrollment materials within 60 days from the later of (A) the date of loss of coverage, or (B) the date the Plan Administrator sends notice of eligibility for COBRA continuation coverage. Failure to enroll for COBRA continuation coverage during this 60-day period will terminate all rights to COBRA continuation coverage under this Article. An affirmative election of COBRA continuation coverage by a Participant or his or her spouse shall be deemed to be an election for that Participant's Dependents who would otherwise lose coverage under the Plan.

**10.8 Subsequent Qualifying Event.** If a second Qualifying Event occurs during an 18-month extension explained above, coverage may be continued for a maximum of 36 months from the date of the first Qualifying Event. In the event the Dependent loses coverage due to a Qualifying Event and after such date the Participant becomes entitled to Medicare, the Dependent shall have available up to 36 months of coverage measured from the date of the Qualifying Event that causes the loss of coverage. If the Participant was entitled to Medicare prior to the Qualifying Event, the Dependent shall have up to 36 months of coverage measured from the date of entitlement to Medicare.

**10.9 Extension of COBRA Continuation Period for Disabled Individuals.** The period of continuation shall be extended to 29 months in total (measured from the date of the Qualifying Event) in the event the individual is disabled as determined by the Social Security laws within 60 days of the Qualifying Event. The individual must provide evidence to the Plan Administrator of such Social Security determination prior to the earlier of 60 days after the date of the Social Security determination, or the expiration of the initial 18 months of COBRA continuation coverage. In such event, the Employer may charge the individual up to 150 percent of the COBRA cost of the coverage.

## **ARTICLE 11: PRIVACY OF MEDICAL INFORMATION**

**11.1 Privacy Provisions Relating to Protected Health Information ("PHI").** The Plan and its Business Associates (collectively referred to in this Article 11 as a "HIPAA Plan") shall use and disclose PHI to the extent permitted by, and in accordance with, HIPAA. Specifically, each HIPAA Plan will use and disclose PHI for Treatment, Payment and Health Care Operations.

**11.2 Definitions.** For purposes of this Article 11, the following defined terms shall have the meaning assigned to such terms in this subsection:

- (1) "Business Associate" shall mean an outside entity or person that performs administrative or other functions on behalf of the Plan;

(2) “Health Care Operations” shall mean activities that involve, but are not limited to, quality assessment and improvement, the assessment of health care professionals, disease management, case management, legal services, benefits fraud and abuse investigations, and business planning and development (including cost-management and planning analyses). Health Care Operations also include, but are not limited to, general health care plan administrative functions such as management activities relating to compliance with HIPAA’s administrative simplification requirements, customer service involving the provision of data analysis for the Plan Sponsor of the HIPAA Plan and other entities whose employees participate in the HIPAA Plan, resolution of internal grievances and due diligence in connection with the sale or transfer of assets to a potential successor in interest if the potential successor is a covered entity, or will become a covered entity, under HIPAA;

(3) “HIPAA” shall mean the Health Insurance Portability and Accountability Act of 1996 as amended from time to time.

(4) “Payment” shall mean any activities performed that involve making benefit determinations and payment. These activities include, but are not limited to, billing, reviews for medical necessity, claims management, coordination of benefits, adjudication of health benefits claims (including appeals and other payment-related disputes), subrogation, plan reimbursement, investigations of potential fraud, determining employee contributions, reviews of appropriateness of care, preauthorizations and utilization reviews;

(5) “Protected Health Information” or “PHI” shall mean individually identifiable information created or retained by the HIPAA Plan beginning on or after April 14, 2003 which pertains to a person’s past, present or future physical or mental health, the health care the person is receiving or has received in the past and all past, present or future Payments for the person’s health care;

(6) “Treatment” means the provision, coordination or management of health care and related services by one or more health care providers. This category includes, but is not limited to, consultations and referrals between health care providers, the coordination or management of health care by a health care provider with a third party and the referral of a patient for health care from one health care provider to another.

**11.3 Disclosure of De-Identified or Summary Health Information.** The HIPAA Plan, or, with respect to the HIPAA Plan, a health insurance issuer, may disclose de-identified or summary health information to the Plan Sponsor of the HIPAA Plan (and its affiliates) if such entity requests the de-identified or

summary health information for the purpose of:

- (1) Obtaining premium bids from health plans for providing health insurance coverage under the HIPAA Plan;
- (2) Modifying, amending or terminating the group health benefits under the HIPAA Plan;

In addition, the HIPAA Plan or a health insurance insurer with respect to the HIPAA Plan may disclose to the Plan Sponsor of the HIPAA Plan (or its affiliates) information on whether an individual is participating in the group health benefits provided by the HIPAA Plan or is enrolled in, or has ceased enrollment with health insurance offered by the HIPAA Plan.

**11.4 The HIPAA Plan Will Use and Disclose PHI as Required by Law or as Permitted by the Authorization of the Participant or Beneficiary.**

Upon submission of an authorization signed by a Participant, beneficiary, subscriber or personal representative that meets HIPAA requirements, the HIPAA Plan will disclose PHI to a Company (or affiliate) sponsored pension plan, long term care plan, disability plan or other benefit plan sponsored by the Company (or an affiliate) with a need to access this PHI for purposes related to such benefit plan's administration. Authorizations will also be honored when provided to the HIPAA Plan with respect to job accommodation requests, Family Medical Leave Act requests, drug/substance abuse testing, fitness for duty exams, and workers compensation claims.

In addition, PHI will be disclosed to the extent permitted or required by law, without the submission of an authorization form.

**11.5 Disclosure of PHI to the Plan Sponsor.** The HIPAA Plan will disclose information to the Plan Sponsor only upon certification from the Plan Sponsor that the HIPAA Plan documents have been amended to incorporate the assurances provided below.

The Plan Sponsor agrees to:

- (1) not use or further disclose PHI other than as permitted or required by the HIPAA Plan document or as required by law;
- (2) ensure that any affiliates or agents, including a subcontractor, to whom the Plan Sponsor provides PHI received from the HIPAA Plan, agrees to the same restrictions and conditions that apply to the Plan Sponsor with respect to such PHI;
- (3) not use or disclose PHI for employment-related actions and decisions unless authorized by the individual to whom the PHI

relates;

- (4) not use or disclose PHI in connection with any other benefits or employee benefit plan of the Plan Sponsor or its affiliates unless permitted by the Plan or authorized by an individual to whom the PHI relates;
- (5) report to the Plan any PHI use or disclosure that is inconsistent with the uses or disclosures provided for of which it becomes aware;
- (6) make PHI available to an individual in accordance with HIPAA's access rules;
- (7) make PHI available for amendment and incorporate any amendments to PHI in accordance with HIPAA;
- (8) make available the information required to provide an accounting of disclosures;
  - (9) make internal practices, books and records relating to the use and disclosure of PHI received from the HIPAA Plan available to the Secretary of the United States Department of Health and Human Resources for purposes of determining the Plan's compliance with HIPAA; and
  - (10) if feasible, return or destroy all PHI received from the HIPAA Plan that the Plan Sponsor still maintains in any form, and retain no copies of such PHI when no longer needed for the purpose for which disclosure was made (or if return or destruction is not feasible, limit further uses and disclosures to those purposes that make the return or destruction infeasible.)

**11.6 Separation Between the Plan Sponsor and the HIPAA Plan.** In accordance with HIPAA, only the following employees and Business Associate personnel shall be given access to PHI:

- (1) employees of the SBC Benefits and/or SBC Executive Compensation organizations responsible for administering group health plan benefits under the HIPAA Plan, including those employees whose functions in the regular course of business include Payment, Health Care Operations or other matters pertaining to the health care programs under a HIPAA Plan;
- (2) employees who supervise the work of the employees described in (1), above;

- (3) support personnel, including other employees outside of the SBC Benefits or SBC Executive Compensation organizations whose duties require them to rule on health plan-related appeals or perform functions concerning the HIPAA Plan;
- (4) investigatory personnel to the limited extent that such PHI is necessary to conduct investigations of possible fraud;
- (5) outside and in-house legal counsel providing counsel to the HIPAA Plan;
- (6) consultants providing advice concerning the administration of the HIPAA Plan; and
- (7) the employees of Business Associates charged with providing services to the HIPAA Plan.

The persons identified above shall have access to and use PHI to the extent that such access and use is necessary for the administration of group health benefits under a HIPAA Plan. If these persons do not comply with this Plan document, the Plan Sponsor shall provide a mechanism for resolving issues of noncompliance, including disciplinary sanctions.

**SBC COMMUNICATIONS INC.****STOCK SAVINGS PLAN**

As amended through December 31, 2004

**Article 1 - Statement of Purpose**

The purpose of the Stock Savings Plan ("Plan") is to increase stock ownership by, and to provide retirement and savings opportunities to, a select group of management employees consisting of Eligible Employees of SBC Communications Inc. ("SBC" or the "Company") and its Subsidiaries.

**Article 2 - Definitions**

For the purposes of this Plan, the following words and phrases shall have the meanings indicated, unless the context indicates otherwise:

**After-Tax Account.** The account maintained on an after-tax basis on the books of account of SBC for each Participant.

**Base Compensation.** The following types of cash-based compensation, in each case as determined by SBC, paid by an Employer (but not including payments made by a non-Employer, such as state disability payments), before reduction due to any contribution pursuant to this Plan or reduction pursuant to any deferral plan of an Employer, including but not limited to a plan that includes a qualified cash or deferral arrangement under Section 401(k) of the Internal Revenue Code, as amended ("Code"):

(a) annual base salary;

(b) commissions;

(c) Team Award (the annual award determined to be the "Team Award" by SBC together with the individual award determined by SBC to be the Individual Discretionary Award made in connection therewith) or comparable awards, if any, determined by SBC to be used in lieu of these awards. Unless otherwise provided by SBC, Team Award shall include, among other things, bonus awards under the Ameritech Management Incentive Plan or the Ameritech Senior Management Short Term Incentive Plan.

Payments by an Employer under a Disability plan made in lieu of any compensation described in (a), (b) or (c), above, shall be deemed to be a part of the respective form of compensation it replaces for purposes of this definition. Base Compensation does not include zone allowances or any other geographical differential and shall not include payments made in lieu of unused vacation or other paid days off, and such payments shall not be contributed to this Plan.

**Business Day.** Any day during regular business hours that SBC is open for business.

**Chairman.** The Chairman of the Board of Directors of SBC Communications Inc.

**Committee.** The Human Resources Committee of the Board of Directors of SBC Communications Inc.

**Disability.** Absence of an Employee from work with an Employer under the relevant Employer's disability plan.

**Eligible Employee.** An Employee who:

(a) is a full time, salaried Employee of SBC or an Employer in which SBC has a direct or indirect 100% ownership interest and who is on active duty, Disability (but only while such Employee is deemed by the Employer to be an Employee of such Employer) or Leave of Absence; and

(b) is, as determined by SBC, a member of Employer's "select group of management or highly compensated employees" within the meaning of the Employment Retirement Income Security Act of 1974, as amended, and regulations thereunder ("ERISA").

(c) is an officer level employee for compensation purposes as shown on the records of SBC or has an employment status which has been approved by SBC to be eligible to participate in this Plan.

Notwithstanding the foregoing, SBC may, from time to time, exclude any Employee or group of Employees from being deemed an "Eligible Employee" under this Plan.

In the event a court or other governmental authority determines that an individual was improperly excluded from the class of persons who would be considered Eligible Employees during a particular time for any reason, that individual shall not be an Eligible Employee for purposes of the Plan for the period of time prior to such determination.

Any Employee that holds options to acquire shares of AirTouch Communications, Inc. or ordinary shares or American Depositary Shares of Vodafone AirTouch plc (or any similar rights), under the Pacific Telesis Group Stock Option and Stock Appreciation Rights Plan or any other stock option plan of an Employer is not an Eligible Employee and may not participate in this Plan.

**Employee.** Any person employed by an Employer, excluding persons hired for a fixed maximum term and excluding persons who are neither citizens nor permanent residents of the United States, all as determined by SBC. For purposes of this Plan, a person on Leave of Absence who otherwise would be an Employee shall be deemed to be an Employee.



**Employer.** SBC Communications Inc. or any of its Subsidiaries.

**Exercise Price.** The price per share of Stock purchasable under an Option.

**Fair Market Value or FMV.** In valuing Stock or any other item subject to valuation under this Plan, the Committee may use such index or measurement as the Committee may reasonably determine from time to time, and such index or measurement shall be the FMV of such Stock or other item. In the absence of such action by the Committee, FMV means, with respect to Stock, the closing price on the New York Stock Exchange ("NYSE") of the Stock on the relevant date, or if on such date the Stock is not traded on the NYSE, then the closing price on the immediately preceding date such Stock is so traded.

**Leave of Absence.** Where a person is absent from employment with an Employer on a formally granted leave of absence (i.e., the absence is with formal permission in order to prevent a break in the continuity of term of employment, which permission is granted (and not revoked) in conformity with the rules of the Employer which employs the individual, as adopted from time to time). For purposes of this Plan, a Leave of Absence shall be deemed to also include a transfer by an Employer of a person to, and continuous employment by, an entity for a rotational work assignment. In the event a transfer to such an entity lasts more than 5 years or the rotational work assignment status is canceled by SBC, it shall be deemed a Termination of Employment with the Employer at that time for purposes of this Plan. To be a rotational work assignment, the Employer must have indicated in writing to the person that the person was to be rehired by the Employer on termination of the rotational work assignment.

**Options or Stock Options.** Options to purchase Stock issued pursuant to this Plan.

**Participant.** An Eligible Employee or former Eligible Employee who participates in this Plan.

**Pre-Tax Account.** The account maintained on a pre-tax basis on the books of account of SBC for each Participant.

**Retirement or Retire.** The Termination of Employment for any reason other than death or Disability on or after the earlier of the following dates, or as otherwise provided by the Committee: (1) for Officer Level Employees (Participants deemed officer level Employees for compensation purposes as indicated on the records of SBC), the date the Participant attains age 55 - individuals who become Officer Level Employees on or after January 1, 2002, must also have five (5) years of service; or (2) the date the Participant has attained one of the following combinations of age and Net Credited Service (as that term is used from time to time for the SBC Pension Benefit Plan), except Plans as otherwise indicated below:

Net Credited Service	Age
10 years or more	65 or older
20 years or more	55 or older
25 years or more	50 or older
30 years or more	Any age

With respect to an Employee who is granted an EMP Service Pension under and pursuant to the provisions of the SBC Pension Benefit Plan - Nonbargained Program upon Termination of Employment, the term "Retirement" shall include such Employee's Termination of Employment.

**Shares or Share Units.** An accounting entry representing the right to receive an equivalent number of shares of Stock.

**Short Term Incentive Award.** An award paid by an Employer (and not by a non-Employer, such as state disability payments) under the Short Term Incentive Plan; an award under a similar plan intended by the Committee to be in lieu of an award under such Short Term Incentive Plan; the Key Executive Officer Short Term Award paid under the 1996 Stock and Incentive Plan or the 2001 Incentive Plan; or any other award that the Committee designates as a Short Term Incentive Award specifically for purposes of this Plan (regardless of the purpose of the award).

**Stock.** The common stock of SBC Communications Inc.

**Subsidiary.** Any corporation, partnership, venture or other entity in which SBC holds, directly or indirectly, a 50% or greater ownership interest. The Committee may, at its sole discretion, designate any other corporation, partnership, venture or other entity a Subsidiary for the purpose of participating in this Plan.

**Termination of Employment.** References herein to "Termination of Employment, "Terminate Employment" or a similar reference, shall mean the event where the Employee ceases to be an Employee of any Employer, including but not limited to where the employing company ceases to be an Employer.

### **Article 3 - Administration of the Plan**

#### **3.1 The Committee.**

The Committee shall be the administrator of the Plan and will administer the Plan, interpret, construe and apply its provisions and determine entitlement to benefits, all in its discretion. The Committee may further establish, adopt or revise such rules and regulations as it may deem necessary or advisable for the administration of the Plan. References to determinations or other actions by SBC, herein, shall mean actions authorized by the Committee, the Chairman, the Senior Executive Vice President of SBC in charge of Human Resources, or their respective successors or duly authorized delegates, in each case in the discretion of such person. All decisions by SBC shall be final and binding.

#### **3.2 Authorized Shares of Stock.**

(a) Except as provided below, the number of shares of Stock which may be distributed pursuant to the Plan, exclusive of Article 8, is 21,000,000. The number of Stock Options and shares of Stock which may be issued pursuant to Article 8 of the Plan is 34,000,000 each. Of the foregoing Stock Options, the number of incentive Stock Options which may be issued pursuant to the Plan is 34,000,000. Conversions of stock awards into Share Units pursuant to Section 4.4 and their eventual distribution shall count only against the limits of the plans from which they are transferred or

contributed and shall not be applied against the limits in this Plan. To the extent Share Units are acquired through deferrals of Stock or contributions of cash where the payment of which would otherwise be deductible by SBC under Section 162(m) of the Code regardless of the size of the distribution, and such Share Units are available for distribution, they shall be distributed first. In the event SBC determines that continuing the purchase of Share Units under the Plan may cause the number of shares of Stock that are to be distributed under this Plan (which may take into account, among other things, the number of Share Units acquired and the number of Stock Options issued or required to be issued, reduced by the number of shares of Stock that would be withheld for income tax purposes) to exceed the number of authorized shares of Stock, then SBC may cancel further purchases of Share Units and require that any further dividend equivalents on Share Units be paid in cash to the Participants.

(b) In the event of a merger, reorganization, consolidation, recapitalization, separation, liquidation, stock dividend, stock split, share combination, or other change in the corporate structure of SBC affecting the shares of Stock, such adjustment shall be made to the number and class of the shares of Stock which may be delivered under the Plan (including but not limited to individual limits), and in the number and class of and/or price of shares of Stock subject to outstanding Options granted under the Plan, and/or in the number of outstanding Options and Share Units, in each case as may be determined to be appropriate and equitable by the Committee, in its sole discretion, to prevent dilution or enlargement of rights.

### **3.3 Claims Procedure.**

Subject to the authority of the Committee over the Plan, SBC shall appoint a Claims Board to adjudicate claims brought by or in respect to Participants and their beneficiaries relating to benefits under the Plan. A Participant may apply in writing to the Claims Board to make a claim under this Plan. The Claims Board shall provide written notice within 90 days to a Participant whose claim hereunder has been denied, setting forth reasons for such denial or explaining that an extension of the time for processing the claim is necessary, written in a manner calculated to be understood by such person. After receipt of such notice, or expiration of 90 days without any response from the Claims Board, the Participant may appeal the decision in writing to the Senior Executive Vice President of SBC in charge of Human Resources, or to the person's successor, within 90 days, except that if the Participant is an Insider, as that term is used in the 2001 Incentive Plan, then the Participant's appeal shall be to the Committee. The Participant shall receive a full and fair review of the decision denying the claim in accordance with the requirements of ERISA.

## **Article 4 - Contributions**

Notwithstanding anything in this Plan to the contrary, there shall be no Employee Contributions or deferral of other Stock awards to the Plan after December 31, 2004.

### **4.1 Election to Make Contributions.**

(a) An Eligible Employee may elect to purchase Share Units through payroll deductions contributed to the Plan as follows (such contributions to the Plan are "Employee Contributions"):

(i) An Eligible Employee may elect to contribute from 6% to 30% (in whole

percentage increments) of his or her monthly Base Compensation, as the same may change from time to time.

(ii) An Eligible Employee may elect to contribute up to 100% (in whole percentage increments) of a Short Term Incentive Award.

(b) An Eligible Employee may only make an election, change an election, or terminate an election to purchase Share Units with Employee Contributions as follows:

(i) An Employee who is an Eligible Employee as of September 30 may make an election on or prior to the last Business Day of the immediately following November with respect to the contribution of Base Compensation and/or Short Term Incentive Awards paid on or after the immediately following January 1.

(ii) An Employee who was not an Eligible Employee as of September 30 but who is an Eligible Employee the immediately following March 31 may make an election on or prior to the last Business Day of the immediately following May with respect to the contribution of Base Compensation and/or Short Term Incentive Awards paid on or after the immediately following July 1.

SBC may refuse or terminate any election to purchase Share Units in the Plan at any time; provided, however, only the Committee may take such action with respect to persons who are "officer level" Employees as shown on the records of SBC.

In the event the Participant takes a hardship withdrawal from a benefit plan qualified under the Code and sponsored by SBC or an Employer, any election to make Employee Contributions by such Participant shall be immediately cancelled, and the Participant shall not be permitted to make a new election with respect to Employee Contributions that would be contributed during the then current and immediately following calendar year.

#### **4.2 Purchase of Share Units.**

(a) Employee Contributions (as well as any corresponding SBC Matching Contribution) shall be made solely pursuant to a proper election and only during the Employee's lifetime and while the Employee remains an Eligible Employee (if the Employee ceases to be an Eligible Employee, his or her election to make Employee Contributions shall be cancelled); provided, however, Termination of Employment of an Eligible Employee shall not constitute loss of eligibility solely with respect to contribution of annual base salary earned prior to termination but paid within 60 days thereafter or with respect to a Short Term Incentive Award paid after Retirement (and such person shall be deemed an Eligible Employee for such contributions).

(b) The number of Share Units purchased by a Participant during a calendar month shall be found by dividing the Participant's Employee Contributions during the month by the FMV on the last day of such month.

(c) A contribution to the Plan shall be made when the compensation – from which the contribution is to be deducted – is paid using the "check date" shown on the related pay record (sometimes referred to as the "paycheck stub") as the contribution date (if no "check date" is shown,

then the date of the pay record). When there is an underpayment or delayed payment of gross compensation for any reason, the related contribution shall be determined and made when the underpayment or delayed payment is paid, again using the date on the pay record. Where there is an overpayment of gross compensation, the amount of the overpayment will not be considered in determining the contribution amount.

#### **4.3 Reinvestment of Dividends.**

In the month containing a record date for a regular cash dividend on SBC Stock, each Participant shall be credited with that number of Share Units equal to the declared dividend per share of Stock multiplied by the number of Share Units held by the Participant and divided by the FMV on the last day of the month containing the dividend record date.

#### **4.4 Deferral of Other Stock Awards.**

(a) An Eligible Employee who would receive from SBC a distribution of Stock (including but not limited to the removal of restrictions on restricted stock) pursuant to the 1996 Stock and Incentive Plan or the 2001 Incentive Plan (but not through the exercise of stock options granted under either such plan) or pursuant to any other plan or award specifically permitted to be contributed to this Plan by the Committee, may contribute all or part of such distribution that would not be recognized as income for Federal income tax purposes, upon conversion to Share Units under this Plan. To make this contribution, the Eligible Employee must make an election on or prior to the last Business Day of the calendar year prior to the calendar year such Stock would otherwise actually been paid (or, for restricted stock, the calendar year such restrictions would be removed and the stock recognized for Federal income tax purposes) to convert the part of the distribution that is not recognized as income for Federal income tax purposes into the number of Share Units under this Plan equal to the number of shares of Stock to which the Eligible Employee would be entitled; provided such person remains an Eligible Employee at the time of such conversion. Distribution of such Share Units shall be governed solely by the provisions of this Plan. SBC may refuse or terminate any election under this Section 4.4 to convert a distribution into Share Units in the Plan at any time.

(b) Effective January 1, 2001, except for persons who die prior to 2001, deferrals of Stock made prior thereto under the Salary and Incentive Award Deferral Plan will be converted into the number of Share Units equal to the number of shares of Stock or the equivalent thereof then held by the Participant through such Salary and Incentive Award Deferral Plan. Any such conversion shall not reduce or offset the number of authorized shares of Stock under this Plan. All elections made under such plan shall be terminated and the distribution of such Share Units shall be governed solely by the provisions of this Plan.

(c) The Committee may permit an Eligible Employee to purchase Share Units under this Plan with amounts other than Base Compensation or Short Term Incentive Awards on such terms and conditions as such Committee may permit from time to time.

(d) In no event shall an acquisition of Share Units pursuant to this Section 4.4 result in the crediting of an SBC Matching Contribution or Options.

### **Article 5 - SBC Matching Contributions**

#### **5.1 SBC Match.**

(a) SBC shall credit each Participant's account with the number of Share Units found by taking eighty percent (80%) of the Participant's Employee Contributions from no more than six percent (6%) of the Participant's Base Compensation made during the month and dividing the resulting figure by the FMV of the Stock on the last day of such month ("SBC Matching Contribution"). However, if during any month the Participant is concurrently participating in this Plan and (a) the match eligible portion of the SBC Savings Plan (which may be referred to as "basic contributions") or (b) the match eligible portion of any other tax qualified or nonqualified plan of an Employer, then the monthly SBC Matching Contribution under this Plan shall be reduced so that the total monthly matching contribution shall be paid with respect to no more than:

(A) six percent (6%) minus

(B) the Participant's match eligible percentage determined under such other plan,

of the Participant's monthly Base Compensation. In no event shall matching contributions under this Plan and all other plans of SBC and all Employers combined (including but not limited to the SBC Savings Plan) be paid with respect to more than six percent (6%) of Participant's monthly Base Compensation. SBC Matching Contributions shall only be paid on Base Compensation contributed to the Plan. The Committee, in its discretion, may reduce or eliminate the SBC Matching Contributions with respect to those Employee Contributions that have not then been made for which a Participant then has or will have an opportunity to change his or her Share Unit purchase election.

(b) In the sole discretion of the Committee, it may also provide for the contribution of a Bonus Matching Contribution. Such Bonus Matching Contribution may not exceed 20% of the Participant's Employee Contributions for the month. The Bonus Matching Contribution shall be subject to such terms and conditions as required by the Committee and, unless otherwise provided by the Committee, to the same vesting and distribution requirements as SBC Matching Contributions.

## **5.2 Vesting and Distribution of Share Units Acquired with Matching Contributions.**

A Participant's interest in Share Units purchased with SBC Matching Contributions, as well as earnings thereon, shall vest when a Participant shall have three (3) years of continuous service (regardless of any subsequent break in service) as reflected on the records of SBC. Share Units shall be available for distribution in accordance with the Plan's distribution provisions only upon becoming vested and only after the earlier of: (a) the Termination of Employment of the Participant, or (b) the beginning of the calendar year in which the Participant will reach age 55. Upon the Participant's Termination of Employment, all the Participant's unvested Share Units shall be forfeited and shall not be reinstated if Participant is re-Employed.

## **Article 6 - Distributions**

### **6.1 Distributions of Share Units.**

(a) Beginning March 10 (or such other date as determined by SBC) of the first (1st) calendar year following the calendar year of the Retirement of a Participant and on March 10 (or such other date as determined by SBC) of each of the successive 14 calendar years, SBC shall distribute that number of Share Units that is equal to the total number of Share Units then held by the Participant divided by the number of remaining installments. Notwithstanding the foregoing, if the Participant Retires prior to 2001, then any undistributed Share Units will be distributed in a lump sum on March 10 of the fifteenth (15th) calendar following the calendar year of the Retirement of the Participant.

(b) Beginning March 10 (or such other date as determined by SBC) of the calendar year following the calendar year of Termination of Employment which is not a Retirement and on March 10 (or such other date as determined by SBC) of each of the successive 2 calendar years, SBC shall distribute that number of Share Units that is equal to the total number of Share Units then held by the Participant divided by the number of remaining installments. Notwithstanding the foregoing, non-Retirement eligible Participants who Terminate Employment prior to January 1, 2001, shall receive all undistributed Share Units in a lump sum.

(c) Notwithstanding (a) or (b), above, to the contrary, in the event of the death of a Participant, all undistributed Share Units shall be promptly distributed to the Participant's beneficiary in accordance with the SBC Rules for Employee Beneficiary Designations, as the same may be amended from time to time.

(d) In the event a Participant Terminates Employment and is subsequently re-Employed, then beginning with the calendar year following such re-Employment, the Participant's undistributed Share Units shall no longer be subject to distribution under this Section 6.1 as a result of the prior Termination of Employment. For purposes of distribution of Share Units only, a subsequent Termination of Employment shall be deemed a Retirement if the Participant has previously Retired.

## **6.2 Accelerated Distribution.**

(a) On or before the last Business Day of a calendar year, a Participant may elect to receive a distribution of all or a specified number of the Participant's vested Share Units. Such distribution shall be made March 10 (or such other date as determined by SBC) of the immediately following calendar year. If the Participant will not be age 55 or older at any time during the calendar year of the distribution, then Share Units that were acquired with SBC Matching Contributions, as well as earnings thereon, may be distributed pursuant to an Accelerated Distribution election only if the Participant Terminated Employment prior to the calendar year of the distribution. This distribution shall be in addition to the number of Share Units to be distributed at the same time under Section 6.1, to the extent any remain available for distribution, which Distribution shall be calculated without regard to an election under this section. No distribution under this Section 6.2 (a) shall be made of Share Units acquired with Employee Contributions or SBC Matching Contributions in the same calendar year as the distribution.

(b) In the event the Participant Terminates Employment for reasons other than Retirement, SBC may, at its sole discretion, accelerate the distribution of all or part of the Share Units credited to the Participant to the date of SBC's choosing, without notice to, or the consent of, the Participant.

## **6.3 Small Distribution.**

Notwithstanding any election made by the Participant, after the Termination of Employment of the Participant for any reason, if at the time of a distribution the Participant's Share Units have a FMV of less than \$10,000, SBC may, in its discretion, convert and distribute all of the Participant's Share Units in the form of a lump sum distribution.

## **6.4 Determination by Internal Revenue Service.**

In the event that a final determination shall be made by the Internal Revenue Service or any court of competent jurisdiction that a Participant has recognized gross income for Federal income tax purposes in excess of the Share Units actually distributed by SBC, SBC shall promptly convert and distribute to the Participant those Share Units to which such additional gross income is attributable.

## **6.5 Emergency Distribution.**

In the event that SBC, upon written petition of the Participant, determines in its sole discretion that the Participant has suffered an unforeseeable financial emergency, SBC shall convert and distribute to the Participant, as soon as practicable following such determination, the number of Share Units determined by SBC in its sole discretion to meet the emergency (the "Emergency Distribution"), other than Share Units acquired with SBC Matching Contributions, as well as earnings thereon. For purposes of this Plan, an unforeseeable financial emergency is an unexpected need for cash arising from an illness, casualty loss, sudden financial reversal, or other such unforeseeable occurrence. Cash needs arising from foreseeable events such as the purchase of a house or education expenses for children shall not be considered to be the result of an unforeseeable financial emergency. Upon such distribution, any election to make Employee Contributions by such Participant shall be immediately cancelled, and the Participant shall not be permitted to make a new election with respect to Employee Contributions that would be contributed during the then current and immediately following calendar year.

## **6.6 Ineligible Participant.**

Notwithstanding any other provisions of this Plan to the contrary, if SBC receives an opinion from counsel selected by SBC, or a final determination is made by a Federal, state or local government or agency, acting within its scope of authority, to the effect that an individual is not, or was not at the time of his or her making Employee Contributions to this Plan, a member of Employer's "select group of management or highly compensated employees" within the meaning of ERISA, then such person will not be eligible to participate in this Plan and shall receive an immediate lump sum distribution of shares of Stock corresponding to the vested portion of the Share Units standing credited to his or her account. Upon such payment no other distribution shall thereafter be payable under this Plan either to the individual or any beneficiary of the individual, except as provided under Section 10.1 Additional Benefit.

## **6.7 Distribution Process.**

Share Units shall be distributed under this Plan by taking the number of Share Units to be distributed and converting them into an equal number of shares of Stock. (Once distributed, a Share Unit shall be canceled.)

## **Article 7 - Transition Provisions**

The transition rules of this Article 7 shall supercede all other terms of this Plan.

### **7.1 Effective Dates.**

Except as otherwise provided in this Article, the amendments to this Plan made March 31, 2000 (the "2000 Amendments") shall be effective March 31, 2000. No election to begin a Savings Unit nor an election regarding the distribution or further deferral of a distribution of a Savings Unit may be made on or after March 31, 2000. (As used herein, "Savings Units" shall have the same meaning as used in this Plan prior to such amendments.)

### **7.2 Combination of Share Units.**

(a) Effective January 1, 2001, all Share Units (previously referred to as "Shares") acquired under Savings Units by a Participant shall be combined in a single account regardless of date



acquired or the Savings Unit to which they were related, except for the Share Units to be distributed under (b), below.

(b) Share Units equal in value to, and constituting, a Participant's tax basis in the Share Units acquired on an after-tax basis shall be valued and distributed on or promptly after March 10, 2001, unless a later distribution is required by SBC.

(c) To the extent any Participant who retires before 2001 would, were it not for the 2000 Amendments, under valid elections made prior to March 31, 2000, receive a distribution under a Savings Unit(s) that would extend the Participant's distributions beyond 2015, then the Savings Unit(s) so affected shall not be combined with other Share Units and shall be distributed in accordance with such elections. Notwithstanding the foregoing, the Participant may, with the consent of SBC, elect to have all undistributed Shares in such Savings Unit(s) be governed by this Plan as in effect after March 31, 2000.

(d) In the event a Participant dies prior to 2001, the Participant's Savings Unit(s) shall not be combined with other Savings Units and shall be distributed in accordance with the Plan as it existed immediately prior to March 31, 2000, and deferrals under the Salary and Incentive Award Deferral Plan by such Participant will not be transferred to this Plan but will be paid out in accordance with the terms of that plan as it existed immediately prior to March 31, 2000.

### **7.3 Termination of Elections.**

(a) Distributions from the Plan that would be made in the year 2000 under the Plan as it existed immediately prior to March 31, 2000, based on elections made before March 31, 2000, shall continue to be made in the year 2000 as provided in the Plan immediately prior to March 31, 2000. All other distribution elections are cancelled, including but not limited to distributions which have already commenced, but only to the extent such elections call for distributions after the year 2000. All Share Units remaining undistributed after such distributions shall be held and distributed in accordance with the terms of the Plan as in effect after March 31, 2000.

(b) Contributions to the Plan that would be made in the year 2000 under the Plan as it existed immediately prior to March 31, 2000, based on elections made before March 31, 2000, shall continue to be made in the year 2000 as provided in the Plan immediately prior to March 31, 2000. Elections to participate in the Plan shall not automatically be renewed for the year 2001. Each Eligible Employee must make a new election after March 31, 2000, in order to purchase Share Units with Employee Contributions after 2000. Provided, however, valid elections made prior to March 31, 2000, to contribute Short Term Incentive Awards in 2001 shall be valid elections under this Plan.

### **7.4 Annual Base Salary Contribution Transition.**

Annual base salary earned prior to January 1, 2001, shall be contributed when earned, while annual base salary earned on or after such date shall be contributed when paid. In order to avoid any double contribution of annual base salary, that part of annual base salary earned in the year 2000 shall not be included in any determination of contributions to the Plan in a later calendar year, even though paid in such calendar year. This section shall not apply to employees of Ameritech Corporation or its direct or indirectly held subsidiaries or to Employees who did not make contributions to the Plan in 2000.

### **7.5 Stock Options.**

The August 2000 and February 2001 issuances of Options shall be determined and made as

the Plan was written immediately prior to March 31, 2000, so as not to enlarge or reduce the rights of Participants with Savings Units commencing in 2000.

## **Article 8 - Options**

### **8.1 Grants.**

The Committee shall determine at its discretion whether the Options issued pursuant to this Plan shall be non-qualified Stock Options or incentive Stock Options within the meaning of Section 422 of the Code. Any Options issued hereunder shall be non-qualified Options unless the Committee specifies prior to the issuance thereof that they shall be incentive Stock Options. Notwithstanding any other provision of the Plan, any incentive Stock Options issued under this Plan shall be issued and exercised in accordance with Section 422 of the Code. The Options may be issued in definitive form or recorded on the books and records of SBC for the account of the Participant, at the discretion of SBC. If SBC elects not to issue the Options in definitive form, they shall be deemed issued, and the Participants shall have all rights incident thereto as if they were issued on the dates provided herein, without further action on the part of SBC or the Participant. In addition to the terms herein, all Options shall be subject to such additional provisions and limitations as provided in any Administrative Procedures adopted by the Committee prior to the issuance of such Options. The number of Options issued to a Participant shall be reflected on the Participant's annual statement of account.

### **8.2 Term of Options.**

The Options may only be exercised: (a) after the earlier of (i) the expiration of one (1) year from date of issue or (ii) the Participant's Termination of Employment, and (b) no later than the tenth (10<sup>th</sup>) anniversary of their issue; and Options shall be subject to earlier termination as provided herein.

### **8.3 Exercise Price.**

The Exercise Price of an Option shall be the FMV of the Stock on the date of issuance of the Options.

### **8.4 Issuance of Options.**

(a) On each June 1 a Participant shall receive two (2) Options for each Share Unit acquired by the Participant during the immediately preceding January through April period with Employee Contributions of Base Compensation and/or Short Term Incentive Award. A fractional number of Options shall be rounded up to the next whole number.

(b) On each February 1 a Participant shall receive:

(i) two (2) Options for each Share Unit acquired by the Participant during the immediately preceding May through December with Employee Contributions of Base Compensation and/or Short Term Incentive Award; and

(ii) two (2) Options for each Share Unit acquired prior to such date by the Participant with dividend equivalents that were derived, directly or indirectly (such as dividend equivalents paid on Share Units acquired with dividend equivalents), from Share Units acquired with Employee Contributions during the immediately preceding January through December.

A fractional number of Options shall be rounded up to the next whole number.

(c) If Stock is not traded on the NYSE on any of the foregoing Option issuance dates, then the Options shall not be issued until the next such day on which Stock is so traded.

(d) If a Participant Terminates Employment other than (i) while Retirement eligible or (ii) because of death or Disability, no further Options shall be issued to or with respect to such Participant. In the event of re-Employment following a Termination of Employment, the preceding sentence shall not apply to those Options resulting from participation in the Plan after such re-Employment until a subsequent Termination of Employment.

(e) No more than 400,000 Options shall be issued to any individual under this Plan during a calendar year. No Share Unit may be counted more than once for the issuance of Options.

(f) The Committee may, in its sole discretion, at any time increase or lower the number of Options that are to be issued for each Share Unit acquired. However, if the Committee lowers the number of Options, then such change shall only be effective with respect to the next period in which a Participant may change his or her Share Unit purchase election.

(g) The Committee may also, at any time and in any manner, limit the number of Options which may be acquired as a result of the Short Term Incentive Award being contributed to the Plan. Further, except as otherwise provided by the Committee, in determining the number of Options to be issued to a Participant with respect to a Participant's contribution of a Short Term Incentive Award to the Plan and subsequent crediting of Share Units, Options may be issued only with respect to an amount which does not exceed the target amount of such award (or such other portion of the award as may be determined by the Committee).

(h) No options shall be issued to or in respect of a Participant for a particular issuance, unless at least 10 Options will be issued to that Participant.

#### **8.5 Exercise and Payment of Options.**

Options shall be exercised by providing notice to the designated agent selected by SBC (if no such agent has been designated, then to SBC), in the manner and form determined by SBC, which notice shall be irrevocable, setting forth the exact number of shares of Stock with respect to which the Option is being exercised and including with such notice payment of the Exercise Price. When Options have been transferred, SBC or its designated agent may require appropriate documentation that the person or persons exercising the Option, if other than the Participant, has the right to exercise the Option. No Option may be exercised with respect to a fraction of a share of Stock.

Exercises of Options may be effected only on days and during the hours that the New York Stock Exchange is open for regular trading or as otherwise provided or limited by SBC. If an Option expires on a day or at a time when exercises are not permitted, then the Options may be exercised no later than the immediately preceding date and time that the Options were exercisable.

The Exercise Price shall be paid in full at the time of exercise. No Stock shall be issued or transferred until full payment has been received therefor.

Payment may be made:

(a) in cash, or

(b) unless otherwise provided by the Committee at any time, and subject to such additional terms and conditions and/or modifications as SBC may impose from time to time, and further subject to suspension or termination of this provision by SBC at any time, by:

(i) delivery of Stock owned by the Participant in partial (if in partial payment, then together with cash) or full payment; provided, however, as a condition to paying any part of the Exercise Price in Stock, at the time of exercise of the Option, the Participant must establish to the satisfaction of SBC that the Stock tendered to SBC must have been held by the Participant for a minimum of six (6) months preceding the tender; or

(ii) if SBC has designated a stockbroker to act as SBC's agent to process Option exercises, issuance of an exercise notice to such stockbroker together with instructions irrevocably instructing the stockbroker: (A) to immediately sell (which shall include an exercise notice that becomes effective upon execution of a sell order) a sufficient portion of the Stock to pay the Exercise Price of the Options being exercised and the required tax withholding, and (B) to deliver on the settlement date the portion of the proceeds of the sale equal to the Exercise Price and tax withholding to SBC. In the event the stockbroker sells any Stock on behalf of a Participant, the stockbroker shall be acting solely as the agent of the Participant, and SBC disclaims any responsibility for the actions of the stockbroker in making any such sales. No Stock shall be issued until the settlement date and until the proceeds (equal to the Exercise Price and tax withholding) are paid to SBC.

If payment is made by the delivery of Stock, the value of the Stock delivered shall be equal to the FMV of the Stock on the day preceding the date of exercise of the Option.

Restricted Stock may not be used to pay the Option exercise price.

#### **8.6 Restrictions on Exercise and Transfer.**

No Option shall be transferable except: (a) upon the death of a Participant in accordance with SBC's Rules for Employee Beneficiary Designations, as the same may be amended from time to time; and (b) in the case of any holder after the Participant's death, only by will or by the laws of descent and distribution. During the Participant's lifetime, the Participant's Options shall be exercisable only by the Participant or by the Participant's guardian or legal representative. After the death of the Participant, an Option shall only be exercised by the holder thereof (including but not limited to an executor or administrator of a decedent's estate) or his or her guardian or legal representative.

#### **8.7 Termination of Employment.**

(a) *Not Retirement Eligible.* If a Participant Terminates Employment while not Retirement eligible, a Participant's Options may be exercised, to the extent then exercisable:

(i) if such Termination of Employment is by reason of death or Disability, then for a

period of three (3) years from the date of such Termination of Employment or until the expiration of the stated term of such Option, whichever period is shorter; or

(ii) if such Termination of Employment is for any other reason, then for a period of one (1) year (three (3) months for Options granted before August 1, 1998) from the date of such Termination of Employment or until the expiration of the stated term of such Option, whichever period is shorter.

(b) *Retirement Eligible.* If a Participant Terminates Employment while Retirement eligible, a Participant's Option may be exercised, to the extent then exercisable: (i) for a period of five (5) years (three (3) years for options granted before August 1, 1998) from the date of Retirement or (ii) until the expiration of the stated term of such Option, whichever period is shorter. If a Participant Terminated Employment because of death or Disability on or before March 31, 2000, the Participant will be deemed to have Terminated Employment while not Retirement eligible for purposes of this section.

(c) Re-Employment of a Participant after a Termination of Employment shall have no effect on the periods during which Options resulting from the prior Employment may be exercised. For example, if the Option exercise period has been shortened because of the prior Termination of Employment, it shall not be extended because of the re-Employment.

## **Article 9 - Discontinuation, Termination, Amendment.**

### **9.1 SBC's Right to Discontinue Offering Share Units.**

SBC may at any time discontinue offerings of Share Units under the Plan. Any such discontinuance shall have no effect upon existing Share Units or the terms or provisions of this Plan as applicable to such Share Units.

### **9.2 SBC's Right to Terminate Plan.**

The Committee may terminate the Plan at any time. Upon termination of the Plan, contributions shall no longer be made under the Plan.

After termination of the Plan, Participants shall continue to earn dividend equivalents in the form of Share Units on undistributed Share Units and shall continue to receive all distributions under this Plan at such time as provided in and pursuant to the terms and conditions of Participant's elections and this Plan.

### **9.3 Amendment.**

The Committee may at any time amend the Plan in whole or in part including but not limited to changing the formulas for determining the amount of SBC Matching Contributions under Article 5 or increasing or decreasing the number of Options to be issued under Article 8; provided, however, that no amendment, including but not limited to an amendment to this section, shall be effective, without the consent of a Participant, to alter, to the material detriment of such Participant, the distributions described in this Plan as applicable to Share Units of the Participant or to decrease the number of Share Units standing credited to such Participant's Accounts under the Plan. For purposes of this section, an alteration to the material detriment of a Participant shall mean a material reduction in the period of time over which Stock may be distributed to a Participant, any reduction in the Participant's number of vested Share Units or Options, or an increase in the Exercise Price or

decrease in the term of an Option. Any such consent may be in a writing, telecopy, or e-mail or in another electronic format. An election to acquire, or to modify an election to acquire, Share Units with Employee Contributions and the failure to terminate an election to acquire Share Units with Employee Contributions when able to do so shall each be conclusively deemed to be the consent of the Participant to any and all amendments to the Plan prior to such election or failure to terminate an election, and such consent shall be a condition to making any election with respect to Employee Contributions.

Notwithstanding anything to the contrary contained in this section of the Plan, the Committee may modify this Plan with respect to any person subject to the provisions of Section 16 of the Securities Exchange Act of 1934 as amended ("Exchange Act") to place additional restrictions on the exercise of any Option or the transfer of any Stock not yet issued under the Plan.

## **Article 10 - Miscellaneous**

### **10.1 Additional Benefit.**

The reduction of any benefit payable under the SBC Pension Benefit Plan (or comparable plan identified by SBC as a replacement therefor), which results from participation in this Plan, will be restored as an additional benefit ("make-up piece") under this Plan. The Participant shall elect prior to commencement of payment of the make-up piece whether to receive such benefit in cash in a lump sum (consisting of the present value equivalent of the pension retirement benefit (life annuity) make-up piece) or such benefit in an annuity form of payment. Notwithstanding the proceeding provisions of this section, if all or a portion of the make-up piece is paid pursuant to SRIP or another non-qualified plan, then such amount shall not be payable pursuant to this Plan.

### **10.2 Tax Withholding.**

Upon distribution of Stock, including but not limited to, shares of Stock issued upon the exercise of an Option, SBC shall withhold shares of Stock sufficient in value, using the FMV on the date determined by SBC to be used to value the Stock for tax purposes, to satisfy the minimum amount of Federal, state, and local taxes required by law to be withheld as a result of such distribution.

Any fractional share of Stock payable to a Participant shall be withheld as additional Federal withholding, or, at the option of SBC, paid in cash to the Participant.

Unless otherwise determined by the Committee, when the method of payment for the Exercise Price is from the sale by a stockbroker pursuant to Section 8.5(b)(ii), hereof, of the Stock acquired through the Option exercise, then the tax withholding shall be satisfied out of the proceeds. For administrative purposes in determining the amount of taxes due, the sale price of such Stock shall be deemed to be the FMV of the Stock.

### **10.3 Elections and Notices.**

Notwithstanding anything to the contrary contained in this Plan, all elections and notices of every kind shall be made on forms prepared by SBC or the General Counsel, Secretary or Assistant Secretary, or their respective delegates or shall be made in such other manner as permitted or required by SBC or the General Counsel, Secretary or Assistant Secretary, or their respective delegates, including through electronic means, over the Internet or otherwise. An election shall be deemed made when received by SBC (or its designated agent, but only in cases where the designated

agent has been appointed for the purpose of receiving such election), which may waive any defects in form. Unless made irrevocable by the electing person, each election with regard to making Employee Contributions or distributions of Share Units shall become irrevocable at the close of business on the last day to make such election. SBC may limit the time an election may be made in advance of any deadline.

If not otherwise specified by this Plan or SBC, any notice or filing required or permitted to be given to SBC under the Plan shall be delivered to the principal office of SBC, directed to the attention of the Senior Executive Vice President-Human Resources of SBC or his or her successor. Such notice shall be deemed given on the date of delivery.

Notice to the Participant shall be deemed given when mailed (or sent by telecopy) to the Participant's work or home address as shown on the records of SBC or, at the option of SBC, to the Participant's e-mail address as shown on the records of SBC. It is the Participant's responsibility to ensure that the Participant's addresses are kept up to date on the records of SBC. In the case of notices affecting multiple Participants, the notices may be given by general distribution at the Participants' work locations.

By participating in the Plan, each Participant agrees that SBC may provide any documents required or permitted under the Federal or state securities laws, including but not limited to the Securities Act of 1933 and the Securities Exchange Act of 1934 by e-mail, by e-mail attachment, or by notice by e-mail of electronic delivery through SBC's Internet Web site or by other electronic means.

#### **10.4 Unsecured General Creditor.**

Participants and their beneficiaries, heirs, successors, and assigns shall have no legal or equitable rights, interest, or claims in any property or assets of any Employer. No assets of any Employer shall be held under any trust for the benefit of Participants, their beneficiaries, heirs, successors, or assigns, or held in any way as collateral security for the fulfilling of the obligations of any Employer under this Plan. Any and all of each Employer's assets shall be, and remain, the general, unpledged, unrestricted assets of such Employer. The only obligation of an Employer under the Plan shall be merely that of an unfunded and unsecured promise of SBC to distribute shares of Stock corresponding to Share Units, and Options, under the Plan.

#### **10.5 Offset.**

SBC may offset against the amount of Stock otherwise distributable to a Participant, any amounts due an Employer by a Participant, including but not limited to overpayments under any compensation or benefit plans. In addition, SBC may also cancel a Stock Option to satisfy such an obligation to an Employer. For this purpose, each Stock Option shall be valued by subtracting the Exercise Price of the Stock Option from the FMV of the Stock on such date.

#### **10.6 Non-Assignability.**

Neither a Participant nor any other person shall have any right to commute, sell, assign, transfer, pledge, anticipate, mortgage, or otherwise encumber, transfer, hypothecate or convey in advance of actual receipt, shares of Stock corresponding to Share Units under the Plan, if any, or any part thereof, which are, and all rights to which are, expressly declared to be unassignable and non-transferable. No part of the Stock distributable shall, prior to actual distribution, be subject to seizure or sequestration for the payment of any debts, judgments, alimony or separate maintenance owed by a Participant or any other person, nor be transferable by operation of law in the event of a

Participant's or any other person's bankruptcy or insolvency.

**10.7 Employment Not Guaranteed.**

Nothing contained in this Plan nor any action taken hereunder shall be construed as a contract of employment or as giving any employee any right to be retained in the employ of an Employer or to serve as a director.

**10.8 Errors.**

At any time SBC may correct any error made under the Plan without prejudice to SBC. Such corrections may include, among other things, changing or revoking a Stock Option issuance, canceling Share Units and refunding contributions to a Participant with respect to any period he or she made Employee Contributions while not an Eligible Employee, or canceling the enrollment of a non-Eligible Employee.

**10.9 Captions.**

The captions of the articles, sections, and paragraphs of this Plan are for convenience only and shall not control nor affect the meaning or construction of any of its provisions.

**10.10 Governing Law.**

To the extent not preempted by Federal law, the Plan, and all awards and agreements hereunder, and any and all disputes in connection therewith, shall be governed by and construed in accordance with the substantive laws of the State of Texas, without regard to conflict or choice of law principles which might otherwise refer the construction, interpretation or enforceability of this Plan to the substantive law of another jurisdiction.

Because awards under the Plan are granted in Texas, records relating to the Plan and awards thereunder are located in Texas, and the Plan and awards thereunder are administered in Texas, the Company and the Participant to whom an award under this Plan is granted, for themselves and their successors and assigns, irrevocably submit to the exclusive and sole jurisdiction and venue of the state or federal courts of Texas with respect to any and all disputes arising out of or relating to this Plan, the subject matter of this Plan or any awards under this Plan, including but not limited to any disputes arising out of or relating to the interpretation and enforceability of any awards or the terms and conditions of this Plan. To achieve certainty regarding the appropriate forum in which to prosecute and defend actions arising out of or relating to this Plan, and to ensure consistency in application and interpretation of the Governing Law to the Plan, the parties agree that (a) sole and exclusive appropriate venue for any such action shall be an appropriate federal or state court in Bexar County, Texas, and no other, (b) all claims with respect to any such action shall be heard and determined exclusively in such Texas court, and no other, (c) such Texas court shall have sole and exclusive jurisdiction over the person of such parties and over the subject matter of any dispute relating hereto and (d) that the parties waive any and all objections and defenses to bringing any such action before such Texas court, including but not limited to those relating to lack of personal jurisdiction, improper venue or *forum non conveniens*.

**10.11 Validity.**

In the event any provision of this Plan is held invalid, void, or unenforceable, the same shall not affect, in any respect whatsoever, the validity of any other provision of this Plan.

**10.12 Successors and Assigns.**



This Plan shall be binding upon SBC and its successors and assigns.

**10.13 Participation in Predecessor Plans.**

Effective November 21, 1997, the plans of the Stock Savings Program were merged into the Stock Savings Plan. All Share Units under the Stock Based Savings Plan or the Management Stock Savings Plan were transferred to this Plan as of that date and are governed by the terms of this Plan.

**SBC COMMUNICATIONS INC.**  
**STOCK PURCHASE AND DEFERRAL PLAN**

Adopted November 19, 2004  
As amended through January 27, 2005

**Article 1 - Statement of Purpose**

The purpose of the Stock Purchase and Deferral Plan ("Plan") is to increase stock ownership by, and to provide savings opportunities to, a select group of management employees consisting of Eligible Employees of SBC Communications Inc. ("SBC") and its Subsidiaries.

**Article 2 - Definitions**

For the purpose of this Plan, the following words and phrases shall have the meanings indicated, unless the context indicates otherwise:

**Base Compensation.** The following types of cash-based compensation paid by an Employer (but not including payments made by a non-Employer, such as state disability payments), before reduction due to any contribution pursuant to this Plan or reduction pursuant to any deferral plan of an Employer, including but not limited to a plan that includes a qualified cash or deferral arrangement under Section 401(k) of the Code:

- (a) annual base salary;
- (b) lump sum payments in lieu of a salary increase; and
- (c) Team Award.

Payments by an Employer under a disability plan made in lieu of any compensation described above, shall be deemed to be a part of the respective form of compensation it replaces for purposes of this definition. Base Compensation does not include zone allowances or any other geographical differential and shall not include payments made in lieu of unused vacation or other paid days off, and such payments shall not be contributed to this Plan.

Determinations by SBC (the Committee with respect to Officer Level Employees) of the items that make up Base Compensation shall be final. The Committee may, from time to time, add or subtract types of compensation to or from the definition of "Base Compensation" provided, however, any addition to the definition of Base Compensation shall only be effective with respect to the next period in which a Participant may make an election to establish a Share Deferral Account.

**Business Day.** Any day during regular business hours that SBC is open for business.

**Chief Executive Officer.** The Chief Executive Officer of SBC Communications Inc.

**Cingular.** Cingular Wireless LLC, the successor thereto, or a direct or indirect majority owned subsidiary thereof.

**Code.**References to the Code shall be to provisions of the Internal Revenue Code, as amended, including regulations promulgated thereunder and successor provisions.

**Committee.** The Human Resources Committee of the Board of Directors of SBC Communications Inc.

**Disability.**Absence of an Employee from work with an Employer under the relevant Employer's disability plan.

**Disabled.** Where a person either (a) is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period for not less than 12 months or (b) is, by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, receiving income replacement benefits for a period of not less than 3 months under an accident and health plan covering Employees of the Participant's Employer. It is intended that "Disabled" have the same meaning in this Plan as in Section 409A of the Code.

**Eligible Employee.**An Employee who:

(a) is a full or part time, salaried Employee of SBC or an Employer in which SBC has a direct or indirect 100% ownership interest and who is on active duty, Disability (but only while such Employee is deemed by the Employer to be an Employee of such Employer) or Leave of Absence;

(b) is, as determined by SBC, a member of Employer's "select group of management or highly compensated employees" within the meaning of the Employee Retirement Income Security Act of 1974, as amended, and regulations thereunder ("ERISA"), which is deemed to include each Officer Level Employee; and

(c) has an employment status which has been approved by SBC to be eligible to participate in this Plan or is an Officer Level Employee.

Notwithstanding the foregoing, SBC (the Committee with respect to Officer Level Employees) may, from time to time, exclude any Employee or group of Employees from being deemed an "Eligible Employee" under this Plan.

In the event a court or other governmental authority determines that an individual was improperly excluded from the class of persons who would be considered Eligible Employees during a particular time for any reason, that individual shall not be an Eligible Employee for purposes of the Plan for the period of time prior to such determination.

**Employee.** Any person employed by an Employer and paid on an Employer's payroll system, excluding persons hired for a fixed maximum term and excluding persons who are neither citizens nor permanent residents of the United States, all as determined by SBC. For purposes of this Plan, a person on Leave of Absence who otherwise would be an Employee shall be deemed to be an Employee.

**Employer.** SBC Communications Inc. or any of its Subsidiaries.

**Exercise Price.** The price per share of Stock purchasable under an Option.

**Fair Market Value or FMV.** In valuing Stock or any other item subject to valuation under this Plan, the Committee may use such index or measurement as the Committee may reasonably determine from time to time, and such index or measurement shall be the FMV of such Stock or other item. In the absence of such action by the Committee, FMV means, with respect to Stock, the closing price on the New York Stock Exchange ("NYSE") of the Stock on the relevant date, or if on such date the Stock is not traded on the NYSE, then the closing price on the immediately preceding date such Stock is so traded.

**Leave of Absence.** Where a person is absent from employment with an Employer on a formally granted leave of absence (i.e., the absence is with formal permission in order to prevent a break in the continuity of term of employment, which permission is granted (and not revoked) in conformity with the rules of the Employer that employs the individual, as adopted from time to time). For purposes of this Plan, a Leave of Absence shall be deemed to also include a transfer by an Employer of a person to, and continuous employment by, an entity for a rotational work assignment. In the event a transfer to such an entity lasts more than 5 years or the rotational work assignment status is canceled by SBC, it shall be deemed a Termination of Employment with the Employer at that time for purposes of this Plan. To be a rotational work assignment, the Employer must have indicated in writing to the person that the person was to be rehired by the Employer upon termination of the rotational work assignment.

**Officer Level Employee.** Any executive officer of SBC, as that term is used under the Securities Exchange Act of 1934, as amended, and any Employee that is an "officer level" Employee for compensation purposes as shown on the records of SBC.

**Options or Stock Options.** Options to purchase Stock issued pursuant to this Plan.

**Participant.** An Eligible Employee or former Eligible Employee who participates in this Plan.

**Plan Year.** The period from January 16 through the following January 15.

**Retirement or Retire.** Termination of Employment on or after the earlier of the following dates, unless otherwise provided by the Committee: (a) for Officer Level Employees, the date the Participant is at least age 55 and has five (5) years of Net Credited Service; or (b) the date the Participant has attained one of the following combinations of age and Net Credited Service:

Net Credited Service	Age
10 years or more	65 or older
20 years or more	55 or older
25 years or more	50 or older
30 years or more	Any age

For purposes of this Plan only, Net Credited Service shall be calculated in the same manner as "Pension Eligibility Service" under the SBC Pension Benefit Plan – Nonbargained Program ("Pension Plan"), as that may be amended from time to time, except that service with an Employer

shall be counted as though the Employer were a "Participating Company" under the Pension Plan and the Employee was a participant in the Pension Plan.

**Shares or Share Units.** An accounting entry representing the right to receive an equivalent number of shares of Stock.

**Share Deferral Accountor Account.** The Account established annually by an election by a Participant to make Employee Contributions to the Plan over the Plan Year relating to such election. The Plan Year shall run from and including January 16 (the commencement date of the Share Deferral Account) through the following January 15. One Share Deferral Account is created by each yearly election, and all Share Units credited pursuant to such election, including through Employee Contributions, SBC Matching Contributions, conversions of right to receive Stock, earnings on Share Units, or otherwise, shall be part of the same Share Deferral Account. Each annual Account is a separate Share Deferral Account; only one Share Deferral Account will relate to a Plan Year.

**Short Term Incentive Award.** A cash award paid by an Employer (and not by a non-Employer, such as state disability payments) under the Short Term Incentive Plan or any successor plan; an award under a similar plan intended by the Committee to be in lieu of an award under such Short Term Incentive Plan, including, but not limited to, Performance Units granted under the 2001 Incentive Plan or any successor plan; or any other award that the Committee designates as a Short Term Incentive Award specifically for purposes of this Plan (regardless of the purpose of the award).

**Stock.** The common stock of SBC Communications Inc.

**Subsidiary.** Any corporation, partnership, venture or other entity in which SBC holds, directly or indirectly, a 50% or greater ownership interest. The Committee may, at its sole discretion, designate any other corporation, partnership, limited liability company, venture or other entity a Subsidiary for the purpose of participating in this Plan. Unless otherwise provided by the Committee, Cingular shall be deemed a Subsidiary so long as SBC holds a direct or indirect 25% interest in Cingular Wireless LLC or its successor.

**Team Award.** The annual award determined to be the "Team Award" by SBC, together with any individual award determined by SBC to be the Individual Discretionary Award made in connection therewith or comparable awards, if any, determined by SBC to be used in lieu of these awards.

**Termination of Employment.** References herein to "Termination of Employment," "Terminate Employment" or a similar reference, shall mean the event where the Employee ceases to be an Employee of any Employer, including but not limited to where the employing company ceases to be an Employer.

### **Article 3 - Administration of the Plan**

#### **3.1 The Committee.**

The Committee shall be the administrator of the Plan and will administer the Plan, interpret, construe and apply its provisions and determine entitlement to benefits, all in its discretion. The Committee may further establish, adopt or revise such rules and regulations and such additional terms and conditions regarding participation in the Plan as it may deem necessary or advisable for the

administration of the Plan. References to determinations or other actions by SBC, herein, shall mean actions authorized by the Committee, the Chief Executive Officer, the Senior Executive Vice President of SBC in charge of Human Resources, or their respective successors or duly authorized delegates, in each case in the discretion of such person. All decisions by SBC shall be final and binding.

### **3.2 Authorized Shares of Stock.**

(a) Except as provided below, the number of shares of Stock which may be distributed pursuant to the Plan, exclusive of Article 8, is 21,000,000. The number of shares of Stock which may be issued pursuant to the exercise of Stock Options is 34,000,000 (together with an equal number of Stock Options). Only the actual number of shares of Stock that are issued (shares issued would not include, for example, any reduction in shares to be issued as a result of tax withholding in connection with a distribution of Stock, exercise of options, or otherwise) shall be counted against the authorized number of shares of Stock. To the extent an Option issued under this Plan is canceled, terminates, expires, or lapses for any reason, such Option shall again be available for issuance under the Plan. Conversions of Stock awards into Share Units and their eventual distribution (excluding the effects of any dividends on such Share Units) shall count only against the limits of the plans from which they originated and shall not be applied against the limits in this Plan. To the extent Share Units are credited through deferrals of Stock or Employee Contributions where the distribution of which would be deductible by SBC under Section 162(m) of the Code without regard to the size of the distribution, and such deductible Share Units are available for distribution, such Share Units shall be distributed first.

(b) In the event the Committee determines that continuing the purchase of Share Units under the Plan may cause the number of shares of Stock that are to be distributed under this Plan (which may take into account, among other things, the number of Share Units acquired and the number of Stock Options issued or required to be issued, reduced by the number of shares of Stock that would be withheld for income tax purposes) to exceed the number of authorized shares of Stock, then the Committee may cancel further purchases of Share Units and require that any further dividend equivalents on Share Units be paid in cash to the Participants.

(c) In the event of a merger, reorganization, consolidation, recapitalization, separation, liquidation, stock dividend, stock split, share combination, or other change in the corporate structure of SBC affecting the shares of Stock (including a conversion of Stock into cash or other property), such adjustment shall be made to the number and class of the shares of Stock which may be delivered under the Plan (including but not limited to individual limits), and in the number and class of and/or price of shares of Stock subject to outstanding Options granted under the Plan, and/or in the number of outstanding Options and Share Units, or such other adjustment determined by the Committee, in each case as may be determined to be appropriate and equitable by the Committee, in its sole discretion, to prevent dilution or enlargement of rights.

### **3.3 Claims Procedure.**

Subject to the authority of the Committee over the Plan, SBC shall appoint a Claims Board to adjudicate claims brought by or in respect to Participants and their beneficiaries relating to benefits under the Plan. A Participant may apply in writing to the Claims Board to make a claim under this Plan. The Claims Board shall provide written notice within 90 days to a Participant whose claim hereunder has been denied, setting forth reasons for such denial or explaining that an extension of the time for processing the claim is necessary, written in a manner calculated to be understood by such person. After receipt of such notice, or expiration of 90 days without any response from the Claims

Board, the Participant may appeal the decision in writing to the Senior Executive Vice President of SBC in charge of Human Resources, or to the person's successor, within 90 days, except that if the Participant is an Insider, as that term is used in the 2001 Incentive Plan, then the Participant's appeal shall be to the Committee. The Participant shall receive a full and fair review of the decision denying the claim in accordance with the requirements of ERISA.

#### **Article 4 - Contributions**

##### **4.1 Election to Make Contributions.**

(a) The Committee shall establish dates and other conditions for participation in the Plan and making contributions as it deems appropriate. Except as otherwise provided by the Committee, each year:

(1) an Employee who is an Eligible Employee as of April 30 may thereafter make an election on or prior to the last Business Day of the immediately following June to establish a Share Deferral Account in order to elect any combination of the following:

(A) to make contributions to the Plan ("Employee Contributions"), through payroll deductions, during the immediately following Plan Year (which shall be the Plan Year of such Account), to acquire Share Units in such Account with any combination of the following:

(i) from 6% to 30% (in whole percentage increments) of the Participant's monthly Base Compensation, as the same may change from time to time (Participants who, at the time of the determination of their eligibility to participate in an Account, are paid through a "sales plan" involving the use of commissions) may contribute up to 40% of Base Compensation, provided that upon removal of a Participant from such "sales plan," the deferral election shall not exceed 30% for the rest of the Plan Year, beginning with the Employee Contributions relating to the first pay period following such change in status; or

(ii) up to 100% (in whole percentage increments or in dollars) of a Short Term Incentive Award (with any contribution of a discretionary award related thereto determined separately). If a Participant did not have a target Short Term Incentive Award on June 30, but was subsequently granted such an award before the end of such Plan Year, the Participant will be deemed to have made the same percentage contribution election for the Short Term Incentive Award as the Participant made for Base Compensation.

(B) to convert up to 100% (in whole percentage increments) of Stock that would be distributed under the 2001 Incentive Plan or any successor Plan (other than through the exercise of stock options or the removal of restrictions on restricted Stock) during such Plan Year into an equal number of Share Units in such Account; provided such election would not cause the recognition of income for Federal income tax purposes in respect of the Stock prior to payment under this Plan and so long as the Participant is an Employee or has Retired as of the conversion date.

(2) an Employee who was not an Eligible Employee as of April 30 but who is an Eligible Employee the immediately following September 30 may thereafter make an election on or prior to the last Business Day of the immediately following November to establish a Share Deferral Account in order to contribute Base Compensation, other than Team Award, in the same manner as if the Employee was an Eligible Employee as of such April 30.

(b) The Committee may permit an Eligible Employee to purchase Share Units under this Plan with amounts other than Base Compensation or Short Term Incentive Awards on such terms and conditions as such Committee may permit from time to time. In no event shall an acquisition of Share Units pursuant to this paragraph (b) or pursuant to the conversion of a right to receive Stock into Share Units (such as through a distribution of Stock under the 2001 Incentive Plan) result in the crediting of an SBC Matching Contribution or Options.

(c) No contribution of compensation, other than for performance-based compensation (as that term is defined under Section 409A of the Code), shall be made to the Plan out of compensation for services where such services are performed during or before the taxable year of the election to make such Employee Contributions. In the case of the above referenced performance-based compensation (based on services performed over a period of at least 12 months), such election may be made no later than 6 months before the end of the period.

(d) Notwithstanding anything to the contrary in this Plan, no election shall be effective to the extent it would permit an Employee Contribution or distribution to be made that is not in compliance with Section 409A of the Code. To the extent such election related to Employee Contributions that complied with such statute and regulations, that portion of the election shall remain valid, except as otherwise provided under this Plan.

(e) SBC may refuse or terminate, in whole or in part, any election to purchase Share Units in the Plan at any time; provided, however, only the Committee may take such action with respect to persons who are Officer Level Employees.

(f) In the event the Participant takes a hardship withdrawal from a benefit plan qualified under the Code and sponsored by an Employer, any election to make Employee Contributions by such Participant shall be cancelled on a prospective basis, and the Participant shall not be permitted to make a new election with respect to Employee Contributions that would be contributed during the then current and immediately following calendar year.

#### **4.2 Purchase of Share Units.**

(a) Employee Contributions (as well as any corresponding SBC Matching Contributions) shall be made solely pursuant to a proper election and only during the Employee's lifetime and while the Employee remains an Eligible Employee (if the Employee ceases to be an Eligible Employee, his or her election to make Employee Contributions shall be cancelled on a prospective basis); provided, however, Termination of Employment of an Eligible Employee shall not constitute loss of eligibility solely with respect to contribution of annual base salary earned prior to termination but paid within 60 days thereafter or with respect to a Short Term Incentive Award paid after Retirement (and such person shall be deemed an Eligible Employee for such contributions).

(b) The number of Share Units purchased by a Participant during a calendar month shall be found by dividing the Participant's Employee Contributions during the month by the FMV on the last day of such month.



(c) A contribution to the Plan shall be made when the compensation – from which the contribution is to be deducted – is paid (“paid,” as used in this Plan, includes amounts contributed to the Plan that would have been paid were it not for an election under this Plan) using the “check date” shown on the related pay record (sometimes referred to as the “paycheck stub”) as the contribution date (if no “check date” is shown, then the date of the pay record). When a payment is made to correct an underpayment, or as a delayed payment, of gross compensation for any reason, the related Employee Contribution to the Plan shall be made when such correcting or delayed payment is made, again using the date on the pay record. No correcting or delayed payment may be contributed to the Plan if it is made after the period for making contributions in Article 4 for the Share Deferral Account covering the payment to be corrected. For example, if an underpayment is made in June 2005, but not corrected until May 2006, regardless of the cause of such events, no part of the correcting payment may be contributed to the Plan. Where there has been an overpayment of gross compensation, the amount of the overpayment will not be considered in determining the contribution amount. In no event shall the Participant have any recourse against an Employer under this Plan for any underpayment, overpayment or delayed or correcting payment of compensation. In the event a pay period (the period over which services are rendered for the relevant compensation) relates to services rendered during or before the taxable year of the relevant election, then only the compensation relating to services performed in the calendar year following the calendar year of the election may be contributed to this Plan. The Committee may modify or change this paragraph (c) from time to time.

#### **4.3 Reinvestment of Dividends.**

In the month containing a record date for a cash dividend on Stock, each Share Deferral Account shall be credited with that number of Share Units equal to the declared dividend per share of Stock, multiplied by the sum of (a) the number of Share Units held in such Share Deferral Account as of such record date, plus (b) all Share Units purchased after such record date with contributions made on or prior to such record date, and dividing the product by the FMV on the last day of such month.

### **Article 5 - SBC Matching Contributions**

#### **5.1 SBC Match.**

(a) SBC shall credit each Participant's relevant Share Deferral Account with the number of Matching Share Units (defined below) found by taking eighty percent (80%) of the Participant's Employee Contributions (the “Match Rate”) from no more than six percent (6%) of the Participant's Base Compensation (the “Match Compensation Percentage”) contributions made during the month with respect to such Share Deferral Account and dividing the resulting figure by the FMV of the Stock on the last day of such month (“SBC Matching Contribution”). However, if during any month the Participant is concurrently participating in this Plan and (1) the match eligible portion of the SBC Savings Plan (which may be referred to as “Basic Allotments”) or (2) the match eligible portion of any other tax qualified or nonqualified plan of an Employer, then the monthly Match Compensation Percentage shall be reduced by the Participant's match eligible percentage determined under such other plan.

In no event shall matching contributions under this Plan and all other plans of SBC and all Employers combined (including but not limited to the SBC Savings Plan) be paid with respect to more than six percent (6%) of Participant's monthly Base Compensation, except as provided below.

SBC Matching Contributions shall only be paid on Base Compensation contributed to the Plan. The Committee, in its discretion, may reduce or eliminate the SBC Matching Contributions with respect to those Employee Contributions that have not been the subject of a contribution election by the Participant.

Notwithstanding the foregoing, in the event that the tax-qualified plan applicable to a Participant provides for a greater match rate and/or applies to a larger percentage of compensation than this Plan provides, the Committee may, to the extent it deems appropriate, raise the percentage of the Match Rate (set at 80%, above) and/or the Match Compensation Percentage (set at 6%, above) to approximate the matching benefit provided in such tax qualified plan for applicable Participants.

(b) In the sole discretion of the Committee, in the event the Committee reduces the number of Options that SBC issues for each Share Unit purchased, the Committee may provide for the contribution of a Bonus Matching Contribution on such terms as the Committee determines. Such Bonus Matching Contribution may not exceed 20% of the Participant's Employee Contributions for the month. The Bonus Matching Contribution shall be subject to such terms and conditions as required by the Committee and, unless otherwise provided by the Committee, to the same vesting and distribution requirements as SBC Matching Contributions.

## **5.2 Vesting and Distribution of Share Units Acquired with Matching Contributions.**

A Participant's interest in Share Units purchased with SBC Matching Contributions, as well as earnings thereon, (collectively, "Matching Share Units") shall vest when a Participant shall have three (3) years of Net Credited Service (regardless of any subsequent break in service after achieving vesting) as reflected on the records of SBC. Matching Share Units shall be distributed in a lump sum, in accordance with the Plan's distribution provisions only upon becoming vested, in the earlier of: (a) the calendar year following the calendar year of the Termination of Employment of the Participant, or (b) the calendar year in which the Participant reaches age 55.

Matching Share Units acquired as part of a Share Deferral Account that commences in or after the calendar year the Participant reaches age 55 will be distributed in the same manner and time as other Share Units in such Share Deferral Account.

Upon the Participant's Termination of Employment, all the Participant's unvested Share Units shall be forfeited and shall not be reinstated if Participant is re-Employed.

## **Article 6 - Distributions**

### **6.1 Distributions of Share Units.**

(a) Initial Election with Respect to a Share Deferral Account. At the time the Participant makes an election to make Employee Contributions with respect to a Share Deferral Account, the Participant shall also elect the calendar year the Share Deferral Account shall be distributed, which may be from one through five years after the calendar year the Account commenced. For example, if an Account commenced in 2005, the Participant may elect to commence the distribution in any calendar year from and including 2006 to and including 2010. If no timely distribution election is made by the Participant, then the Participant will be deemed to have made an election to have the Share Deferral Account distributed in a single installment in the first calendar year after the calendar year the Account commenced. However, for purposes of the Initial Election only, in the event the Participant Terminates Employment, the distribution of the Share Deferral Unit shall occur in the

calendar year following the calendar year of the Participant's Termination of Employment. If the Participant Terminates Employment but has a Share Deferral Account that commenced in the same year the Share Deferral Account would be distributed, then that Account would instead distribute in the calendar year following the year of the contribution. For example, if a Retirement eligible Employee Terminated Employment in 2005 after making an election with regard to an Incentive Award to be paid in 2006, the Share Deferral Account relating to that award would be distributed in 2007.

(b) Election to Delay a Scheduled Distribution. While an Employee, a Participant may elect to defer a scheduled distribution of a Share Deferral Account for five (5) additional calendar years beyond that previously elected. Unless otherwise provided by the Committee, the election to defer the distribution must be made before the last Business Day of the December that is at least one year before the scheduled distribution. An election to defer the distribution of a Share Deferral Account may not be made in the same calendar year that the election to establish the Share Deferral Account is made. Notwithstanding anything to the contrary in this Plan, (1) an election to defer the distribution of a Share Deferral Account must be made at least 12 months prior to the date of the first scheduled payment under the prior distribution election and (2) the election shall not take effect until at least 12 months after the date on which the election is made.

(c) A Participant's Share Deferral Account shall be distributed to the Participant on March 10 (or as soon thereafter as administratively practicable as determined by SBC) of the calendar year elected by the Participant. In the event the distribution is to be made to an Officer Level Employee or a "key employee" (as defined in Section 416(i) of the Code, without regard to paragraph (5) thereof) as a result of the Participant's Termination of Employment, the distribution shall not occur until the later of such March 10 or six (6) months after the Termination of Employment, except it shall be distributed promptly upon the Participant's earlier death.

## **6.2 Death of the Participant or if the Participant Becomes Disabled.**

In the event of the death of a Participant, all undistributed Share Deferral Accounts shall be distributed to the Participant's beneficiary in accordance with the SBC Rules for Employee Beneficiary Designations, as the same may be amended from time to time. In the event a Participant becomes Disabled and Terminates Employment, all undistributed Share Deferral Accounts shall be promptly distributed to the Participant.

## **6.3 Unforeseeable Emergency Distribution.**

In the event that SBC (the Committee in the case of Officer Level Employees), upon written petition of the Participant, determines in its sole discretion that the Participant has suffered an unforeseeable emergency, SBC shall make such distributions to the Participant from the Participant's Share Deferral Accounts (other than Matching Share Units), on a pro-rata basis, as it deems necessary, as soon as practicable following such determination, subject to the following. For purposes of this Plan, an unforeseeable emergency is a severe financial hardship to the Participant resulting from an illness or accident of the Participant, the Participant's spouse, or a dependent (as defined in Section 152(a) of the Code) of the Participant, loss of the Participant's property due to casualty, or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the Participant. The amounts distributed with respect to an emergency may not exceed the amounts necessary to satisfy such emergency plus amounts necessary to pay taxes reasonably anticipated as a result of the distribution, after taking into account the extent to which such hardship is or may be relieved through reimbursement or compensation by insurance or otherwise or by liquidation of the Participant's assets (to the extent the liquidation of such assets

would not itself cause severe financial hardship). It is the intent of this Plan that this provision comply with the Unforeseeable Emergency provisions of Section 409A of the Code. Upon such distribution, any election to make Employee Contributions by such Participant shall be immediately cancelled, and the Participant shall not be permitted to make a new election with respect to Employee Contributions that would be contributed during the then current and immediately following calendar year.

#### **6.4 Ineligible Participant.**

Notwithstanding any other provisions of this Plan to the contrary, if SBC receives an opinion from counsel selected by SBC, or a final determination is made by a Federal, state or local government or agency, acting within its scope of authority, to the effect that an individual is not, or was not at the time of his or her making Employee Contributions to this Plan, a member of Employer's "select group of management or highly compensated employees" within the meaning of ERISA, then such person will not be eligible to make further contributions to the Plan.

#### **6.5 Distribution Process.**

A Share Deferral Account shall be distributed under this Plan by taking the number of Share Units comprising the Account to be distributed and converting them into an equal number of shares of Stock. (Once distributed, a Share Unit shall be canceled.)

### **Article 7 - Transition Provisions**

#### **7.1 Stockholder Approval**

All acquisitions of Share Units under this Plan are subject to Stockholder approval of the Plan at the 2005 Annual Meeting of Stockholders. If the Stockholders fail to approve the Plan, further contributions will be terminated and all funds and Stock distributions contributed to the Plan by Participants and all funds contributed as SBC Matching Contributions will be promptly paid to the Participants, without interest, and, upon payment of such amounts to a Participant, the Participant shall have no further rights under the Plan.

#### **7.2 2005 Share Deferral Accounts.**

Notwithstanding Article 4 to the contrary, if an Employee is an Eligible Employee on September 30, 2004, the Employee may make an election under Article 4 on or prior to December 15, 2004, with respect to the establishment of a Stock Deferral Account for the (i) contribution of Base Compensation and/or Short Term Incentive Awards paid during the period from January 1, 2005, through January 15, 2006, which shall be the Plan Year for such Stock Deferral Account; and/or (ii) the conversion of a distribution of Stock that would be made during the same Plan Year pursuant to the 2001 Incentive Plan into an equal number of Share Units, so long as such conversion would not cause the recognition of income for Federal income tax purposes in respect of such distribution of Stock prior to distribution of Share Units under this Plan.

## **Article 8 - Options**

### **8.1 Grants.**

Options may be issued in definitive form or recorded on the books and records of SBC for the account of the Participant, at the discretion of SBC. If SBC elects not to issue the Options in definitive form, they shall be deemed issued, and the Participants shall have all rights incident thereto as if they were issued on the dates provided herein, without further action on the part of SBC or the Participant. In addition to the terms herein, all Options shall be subject to such additional provisions and limitations as provided in any Administrative Procedures adopted by the Committee prior to the issuance of such Options. The number of Options issued to a Participant shall be reflected on the Participant's annual statement of account.

### **8.2 Term of Options.**

The Options may only be exercised: (a) after the earlier of (i) the expiration of one (1) year from date of issue or (ii) the Participant's Termination of Employment, and (b) no later than the tenth (10<sup>th</sup>) anniversary of their issue; and Options shall be subject to earlier termination as provided herein.

### **8.3 Exercise Price.**

The Exercise Price of an Option shall be the FMV of the Stock on the date of issuance of the Options and Options may not be repriced.

### **8.4 Issuance of Options.**

(a) For each Share Deferral Account established by a Participant:

(1) on each June 15 the Participant shall receive two (2) Options for each Share Unit acquired by the Participant as part of such Share Deferral Account during the immediately preceding January through May period with Employee Contributions of Base Compensation and/or Short Term Incentive Award. A fractional number of Options shall be rounded up to the next whole number.

(2) on each February 15 a Participant shall receive:

(i) two (2) Options for each Share Unit acquired by the Participant as part of such Share Deferral Account during the immediately preceding June through January period with Employee Contributions of Base Compensation and/or Short Term Incentive Award; and

(ii) two (2) Options for each Share Unit acquired prior to such date by the Participant with dividend equivalents that were derived, directly or indirectly (such as dividend equivalents paid on Share Units acquired with dividend equivalents), from Share Units acquired with Employee Contributions as part of such Share Deferral Account during the immediately preceding thirteen (13) calendar months.

(b) A fractional number of Options shall be rounded up to the next whole number.

(c) If Stock is not traded on the NYSE on any of the foregoing Option issuance dates, then the Options shall not be issued until the next such day on which Stock is so traded.

(d) If a Participant Terminates Employment other than (i) while Retirement eligible or (ii) because of death or Disability, no further Options shall be issued to or with respect to such Participant. In the event of re-Employment following a Termination of Employment, the preceding sentence shall not apply to those Options resulting from participation in the Plan after such re-Employment until a subsequent Termination of Employment.

(e) No more than 400,000 Options shall be issued to any individual under this Plan during a calendar year. No Share Unit may be counted more than once for the issuance of Options.

(f) The Committee may, in its sole discretion, at any time, increase or lower the number of Options that are to be issued for each Share Unit acquired, not to exceed two (2) Options per Share Unit purchased. However, if the Committee lowers the number of Options, then such change shall only be effective with respect to the next Share Deferral Account a Participant may elect to establish.

(g) The Committee may also, at any time and in any manner, limit the number of Options which may be acquired as a result of the Short Term Incentive Award being contributed to the Plan. Further, except as otherwise provided by the Committee, in determining the number of Options to be issued to a Participant with respect to a Participant's contribution of a Short Term Incentive Award to the Plan and subsequent crediting of Share Units, Options may be issued only with respect to an amount which does not exceed the target amount of such award (or such other portion of the award as may be determined by the Committee).

(h) No options shall be issued to or in respect of a Participant for a particular issuance, unless at least ten (10) Options will be issued to that Participant.

## **8.5 Exercise and Payment of Options.**

Options shall be exercised by providing notice to the designated agent selected by SBC (if no such agent has been designated, then to SBC), in the manner and form determined by SBC, which notice shall be irrevocable, setting forth the exact number of shares of Stock with respect to which the Option is being exercised and including with such notice payment of the Exercise Price. When Options have been transferred, SBC or its designated agent may require appropriate documentation that the person or persons exercising the Option, if other than the Participant, has the right to exercise the Option. No Option may be exercised with respect to a fraction of a share of Stock.

Exercises of Options may be effected only on days and during the hours that the New York Stock Exchange is open for regular trading or as otherwise provided or limited by SBC. If an Option expires on a day or at a time when exercises are not permitted, then the Options may be exercised no later than the immediately preceding date and time that the Options were exercisable.

The Exercise Price shall be paid in full at the time of exercise. No Stock shall be issued or transferred until full payment has been received therefore.

Payment may be made:

(a) in cash, or

(b) unless otherwise provided by the Committee at any time, and subject to such additional terms and conditions and/or modifications as SBC may impose from time to time, and further subject to suspension or termination of this provision by SBC at any time, by:

(i) delivery of Stock owned by the Participant in partial (if in partial payment, then together with cash) or full payment; provided, however, as a condition to paying any part of the Exercise Price in Stock, at the time of exercise of the Option, the Participant must establish to the satisfaction of SBC that the Stock tendered to SBC must have been held by the Participant for a minimum of six (6) months preceding the tender; or

(ii) if SBC has designated a stockbroker to act as SBC's agent to process Option exercises, issuance of an exercise notice to such stockbroker together with instructions irrevocably instructing the stockbroker: (A) to immediately sell (which shall include an exercise notice that becomes effective upon execution of a sell order) a sufficient portion of the Stock to pay the Exercise Price of the Options being exercised and the required tax withholding, and (B) to deliver on the settlement date the portion of the proceeds of the sale equal to the Exercise Price and tax withholding to SBC. In the event the stockbroker sells any Stock on behalf of a Participant, the stockbroker shall be acting solely as the agent of the Participant, and SBC disclaims any responsibility for the actions of the stockbroker in making any such sales. No Stock shall be issued until the settlement date and until the proceeds (equal to the Exercise Price and tax withholding) are paid to SBC.

If payment is made by the delivery of Stock, the value of the Stock delivered shall be equal to the FMV of the Stock on the day preceding the date of exercise of the Option.

Restricted Stock may not be used to pay the Option exercise price.

#### **8.6 Restrictions on Exercise and Transfer.**

No Option shall be transferable except: (a) upon the death of a Participant in accordance with SBC's Rules for Employee Beneficiary Designations, as the same may be amended from time to time; and (b) in the case of any holder after the Participant's death, only by will or by the laws of descent and distribution. During the Participant's lifetime, the Participant's Options shall be exercisable only by the Participant or by the Participant's guardian or legal representative. After the death of the Participant, an Option shall only be exercised by the holder thereof (including but not limited to an executor or administrator of a decedent's estate) or his or her guardian or legal representative.

#### **8.7 Termination of Employment.**

(a) *Not Retirement Eligible.* Unless otherwise provided by the Committee, if a Participant Terminates Employment while not Retirement eligible, a Participant's Options may be exercised, to the extent then exercisable:

(i) if such Termination of Employment is by reason of death or Disability, then for a period of three (3) years from the date of such Termination of Employment or until the expiration of the stated term of such Option, whichever period is shorter; or

(ii) if such Termination of Employment is for any other reason, then for a period of one (1) year from the date of such Termination of Employment or until the expiration of the stated term of such Option, whichever period is shorter.

(b)*Retirement Eligible.* Unless otherwise provided by the Committee, if a Participant Terminates Employment while Retirement eligible, a Participant's Option may be exercised, to the extent then exercisable: (i) for a period of five (5) years from the date of Retirement or (ii) until the expiration of the stated term of such Option, whichever period is shorter.

(c) Re-Employment of a Participant after a Termination of Employment shall have no effect on the periods during which Options resulting from the prior Employment may be exercised. For example, if the Option exercise period has been shortened because of the prior Termination of Employment, it shall not be extended because of the re-Employment.

#### **Article 9 - Discontinuation, Termination, Amendment.**

##### **9.1 SBC's Right to Discontinue Offering Share Units.**

The Committee may at any time discontinue offerings of Share Units under the Plan. Any such discontinuance shall have no effect upon existing Share Units or the terms or provisions of this Plan as applicable to such Share Units.

##### **9.2 SBC's Right to Terminate Plan.**

The Committee may terminate the Plan at any time. Upon termination of the Plan, contributions shall no longer be made under the Plan.

After termination of the Plan, Participants shall continue to earn dividend equivalents in the form of Share Units on undistributed Share Units and shall continue to receive all distributions under this Plan at such time as provided in and pursuant to the terms and conditions of Participant's elections and this Plan.

##### **9.3 Amendment.**

The Committee may at any time amend the Plan in whole or in part including but not limited to changing the formulas for determining the amount of SBC Matching Contributions under Article 5 or decreasing the number of Options to be issued under Article 8; provided, however, that no amendment, including but not limited to an amendment to this section, shall be effective, without the consent of a Participant, to alter, to the material detriment of such Participant, a Share Deferral Account of the Participant. For purposes of this section, an alteration to the material detriment of a Participant shall include, but not be limited to, a material reduction in the period of time over which Stock may be distributed to a Participant, any reduction in the Participant's number of vested Share Units or Options, or an increase in the Exercise Price or decrease in the term of an Option. Any such consent may be in a writing, telecopy, or e-mail or in another electronic format. An election to acquire Share Units with Employee Contributions shall be conclusively deemed to be the consent of the Participant to any and all amendments to the Plan prior to such election, and such consent shall be a condition to making any election with respect to Employee Contributions.

Notwithstanding anything to the contrary contained in this section of the Plan, the Committee may modify this Plan with respect to any person subject to the provisions of Section 16 of the Securities Exchange Act of 1934, as amended ("Exchange Act") to place additional restrictions on the exercise of any Option or the transfer of any Stock not yet issued under the Plan.



## **Article 10 – Miscellaneous.**

### **10.1 Tax Withholding.**

Upon distribution of Stock, including but not limited to, shares of Stock issued upon the exercise of an Option, SBC shall withhold shares of Stock sufficient in value, using the FMV on the date determined by SBC to be used to value the Stock for tax purposes, to satisfy the minimum amount of Federal, state, and local taxes required by law to be withheld as a result of such distribution.

Any fractional share of Stock payable to a Participant shall be withheld as additional Federal withholding, or, at the option of SBC, paid in cash to the Participant.

Unless otherwise determined by the Committee, when the method of payment for the Exercise Price is from the sale by a stockbroker pursuant to Section 8.5, hereof, of the Stock acquired through the Option exercise, then the tax withholding shall be satisfied out of the proceeds. For administrative purposes in determining the amount of taxes due, the sale price of such Stock shall be deemed to be the FMV of the Stock.

### **10.2 Elections and Notices.**

Notwithstanding anything to the contrary contained in this Plan, all elections and notices of every kind under this Plan shall be made on forms prepared by SBC or the General Counsel, Secretary or Assistant Secretary, or their respective delegates or shall be made in such other manner as permitted or required by SBC or the General Counsel, Secretary or Assistant Secretary, or their respective delegates, including through electronic means, over the Internet or otherwise. An election shall be deemed made when received by SBC (or its designated agent, but only in cases where the designated agent has been appointed for the purpose of receiving such election), which may waive any defects in form. Unless made irrevocable by the electing person, each election with regard to making Employee Contributions or distributions of Share Deferral Accounts shall become irrevocable at the close of business on the last day to make such election. SBC may limit the time an election may be made in advance of any deadline.

If not otherwise specified by this Plan or SBC, any notice or filing required or permitted to be given to SBC under the Plan shall be delivered to the principal office of SBC, directed to the attention of the Senior Executive Vice President in charge of Human Resources for SBC or his or her successor. Such notice shall be deemed given on the date of delivery.

Notice to the Participant shall be deemed given when mailed (or sent by telecopy) to the Participant's work or home address as shown on the records of SBC or, at the option of SBC, to the Participant's e-mail address as shown on the records of SBC. It is the Participant's responsibility to ensure that the Participant's addresses are kept up to date on the records of SBC. In the case of notices affecting multiple Participants, the notices may be given by general distribution at the Participants' work locations.

By participating in the Plan, each Participant agrees that SBC may provide any documents required or permitted under the Federal or state securities laws, including but not limited to the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, by e-mail, by e-mail attachment, or by notice by e-mail or electronic delivery through SBC's Internet Web site or by other electronic means.

### **10.3 Unsecured General Creditor.**

Participants and their beneficiaries, heirs, successors, and assigns shall have no legal or equitable rights, interest, or claims in any property or assets of any Employer. No assets of any Employer shall be held under any trust for the benefit of Participants, their beneficiaries, heirs, successors, or assigns, or held in any way as collateral security for the fulfilling of the obligations of any Employer under this Plan. Any and all of each Employer's assets shall be, and remain, the general, unpledged, unrestricted assets of such Employer. The only obligation of an Employer under the Plan shall be merely that of an unfunded and unsecured promise of SBC to distribute shares of Stock corresponding to Share Units and Options, under the Plan.

### **10.4 Offset.**

SBC may offset against the amount of Stock otherwise distributable to a Participant, any amounts due an Employer by a Participant, including but not limited to overpayments under any compensation or benefit plans. In addition, SBC may also cancel a Stock Option to satisfy such an obligation to an Employer. For this purpose, each Stock Option shall be valued by subtracting the Exercise Price of the Stock Option from the FMV of the Stock on such date.

### **10.5 Non-Assignability.**

Neither a Participant nor any other person shall have any right to commute, sell, assign, transfer, pledge, anticipate, mortgage, or otherwise encumber, transfer, hypothecate or convey in advance of actual receipt, shares of Stock corresponding to Share Units under the Plan, if any, or any part thereof, which are, and all rights to which are, expressly declared to be unassignable and non-transferable. No part of the Stock distributable shall, prior to actual distribution, be subject to seizure or sequestration for the payment of any debts, judgments, alimony or separate maintenance owed by a Participant or any other person, nor be transferable by operation of law in the event of a Participant's or any other person's bankruptcy or insolvency.

### **10.6 Employment Not Guaranteed.**

Nothing contained in this Plan nor any action taken hereunder shall be construed as a contract of employment or as giving any employee any right to be retained in the employ of an Employer or to serve as a director.

### **10.7 Errors.**

At any time SBC or an Employer may correct any error made under the Plan without prejudice to SBC or any Employer. Such corrections may include, among other things, changing or revoking a Stock Option issuance, canceling Share Units and refunding contributions to a Participant with respect to any period he or she made Employee Contributions while not an Eligible Employee, or canceling the enrollment of a non-Eligible Employee. Neither SBC nor any Employer shall be liable for any damages resulting from failure to timely allow any contribution to be made to the Plan or for any damages resulting from the correction of, or a delay in correcting, any error made under the Plan. In no event shall SBC or any Employer be liable for consequential or incidental damages arising out of a failure to comply with the terms of the Plan.

### **10.8 Captions.**

The captions of the articles, sections, and paragraphs of this Plan are for convenience only and shall not control nor affect the meaning or construction of any of its provisions.

#### **10.9 Governing Law.**

To the extent not preempted by Federal law, the Plan, and all benefits and agreements hereunder, and any and all disputes in connection therewith, shall be governed by and construed in accordance with the substantive laws of the State of Texas, without regard to conflict or choice of law principles which might otherwise refer the construction, interpretation or enforceability of this Plan to the substantive law of another jurisdiction.

Because benefits under the Plan are granted in Texas, records relating to the Plan and benefits thereunder are located in Texas, and the Plan and benefits thereunder are administered in Texas, SBC and the Participant under this Plan, for themselves and their successors and assigns, irrevocably submit to the exclusive and sole jurisdiction and venue of the state or Federal courts of Texas with respect to any and all disputes arising out of or relating to this Plan, the subject matter of this Plan or any benefits under this Plan, including but not limited to any disputes arising out of or relating to the interpretation and enforceability of any benefits or the terms and conditions of this Plan. To achieve certainty regarding the appropriate forum in which to prosecute and defend actions arising out of or relating to this Plan, and to ensure consistency in application and interpretation of the Governing Law to the Plan, the parties agree that (a) sole and exclusive appropriate venue for any such action shall be an appropriate Federal or state court in Bexar County, Texas, and no other, (b) all claims with respect to any such action shall be heard and determined exclusively in such Texas court, and no other, (c) such Texas court shall have sole and exclusive jurisdiction over the person of such parties and over the subject matter of any dispute relating hereto and (d) that the parties waive any and all objections and defenses to bringing any such action before such Texas court, including but not limited to those relating to lack of personal jurisdiction, improper venue or *forum non conveniens*.

#### **10.10 Plan to Comply with Section 409A.**

In the event any provision of this Plan is held invalid, void, or unenforceable, the same shall not affect, in any respect whatsoever, the validity of any other provision of this Plan. Notwithstanding any provision to the contrary in this Plan, each provision in this Plan shall be interpreted to permit the deferral of compensation in accordance with Section 409A of the Code and any provision that would conflict with such requirements shall not be valid or enforceable.

#### **10.11 Successors and Assigns.**

This Plan shall be binding upon SBC and its successors and assigns.

**SBC COMMUNICATIONS INC.**

**CASH DEFERRAL PLAN**

Adopted November 19, 2004  
As amended through January 27, 2005

**Article 1 - Statement of Purpose**

The purpose of the Cash Deferral Plan ("Plan") is to provide savings opportunities to a select group of management employees consisting of Eligible Employees of SBC Communications Inc. ("SBC") and its Subsidiaries.

**Article 2 - Definitions**

For the purpose of this Plan, the following words and phrases shall have the meanings indicated, unless the context indicates otherwise:

**Base Compensation.** The following types of cash-based compensation paid by an Employer (but not including payments made by a non-Employer, such as state disability payments), before reduction due to any contribution pursuant to this Plan or reduction pursuant to any deferral plan of an Employer, including but not limited to a plan that includes a qualified cash or deferral arrangement under Section 401(k) of the Code:

- (a) annual base salary;
- (b) lump sum payments in lieu of a salary increase; and
- (c) Team Award.

Payments by an Employer under a disability plan made in lieu of any compensation described above, shall be deemed to be a part of the respective form of compensation it replaces for purposes of this definition. Base Compensation does not include zone allowances or any other geographical differential and shall not include payments made in lieu of unused vacation or other paid days off, and such payments shall not be contributed to this Plan.

Determinations by SBC (the Committee with respect to Officer Level Employees) of the items that make up Base Compensation shall be final. The Committee may, from time to time, add or subtract types of compensation to or from the definition of "Base Compensation" provided, however, any addition to the definition of Base Compensation shall only be effective with respect to the next period in which a Participant may make an election to establish a Cash Deferral Account.

**Business Day.** Any day during regular business hours that SBC is open for business.

**Cash Deferral AccountorAccount.** The Account established annually by an election by a Participant to make Employee Contributions over the Plan Year relating to such election. The Plan

Year shall run from and including January 16 (the commencement date of the Cash Deferral Account) through the following January 15. One Cash Deferral Account is created by each yearly election, and all contributions pursuant to such election, including through Employee Contributions, earnings on contributions, or otherwise shall be part of the same Cash Deferral Account. Each annual Account is a separate Cash Deferral Account; only one Cash Deferral Account will relate to a Plan Year.

**Chief Executive Officer.** The Chief Executive Officer of SBC Communications Inc.

**Cingular.** Cingular Wireless LLC, the successor thereto, or a direct or indirect majority owned subsidiary thereof.

**Code.**References to the Code shall be to provisions of the Internal Revenue Code, as amended, including regulations promulgated thereunder and successor provisions.

**Committee.** The Human Resources Committee of the Board of Directors of SBC Communications Inc.

**Disability.**Absence of an Employee from work with an Employer under the relevant Employer's disability plan.

**Disabled.** Where a person either (a) is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period for not less than 12 months or (b) is, by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, receiving income replacement benefits for a period of not less than 3 months under an accident and health plan covering Employees of the Participant's Employer. It is intended that "Disabled" have the same meaning in this Plan as in Section 409A of the Code.

**Eligible Employee.**An Employee who:

(a) is a full or part time, salaried Employee of SBC or an Employer in which SBC has a direct or indirect 100% ownership interest and who is on active duty, Disability (but only while such Employee is deemed by the Employer to be an Employee of such Employer) or Leave of Absence;

(b) is, as determined by SBC, a member of Employer's "select group of management or highly compensated employees" within the meaning of the Employee Retirement Income Security Act of 1974, as amended, and regulations thereunder ("ERISA"), which is deemed to include each Officer Level Employee; and

(c) has an employment status which has been approved by SBC to be eligible to participate in this Plan or is an Officer Level Employee.

Notwithstanding the foregoing, SBC (the Committee with respect to Officer Level Employees) may, from time to time, exclude any Employee or group of Employees from being deemed an "Eligible Employee" under this Plan.

In the event a court or other governmental authority determines that an individual was improperly excluded from the class of persons who would be considered Eligible Employees during

a particular time for any reason, that individual shall not be an Eligible Employee for purposes of the Plan for the period of time prior to such determination.

**Employee.** Any person employed by an Employer and paid on an Employer's payroll system, excluding persons hired for a fixed maximum term and excluding persons who are neither citizens nor permanent residents of the United States, all as determined by SBC. For purposes of this Plan, a person on Leave of Absence who otherwise would be an Employee shall be deemed to be an Employee.

**Employer.** SBC Communications Inc. or any of its Subsidiaries.

**Incentive Award.** A cash award paid by an Employer (and not by a non-Employer, such as state disability payments) under the Short Term Incentive Plan or any successor plan, the 2001 Incentive Plan or any successor plan, or any other award that the Committee specifically permits to be contributed to a Cash Deferral Account under this Plan (regardless of the purpose of the award).

**Leave of Absence.** Where a person is absent from employment with an Employer on a formally granted leave of absence (i.e., the absence is with formal permission in order to prevent a break in the continuity of term of employment, which permission is granted (and not revoked) in conformity with the rules of the Employer that employs the individual, as adopted from time to time). For purposes of this Plan, a Leave of Absence shall be deemed to also include a transfer by an Employer of a person to, and continuous employment by, an entity for a rotational work assignment. In the event a transfer to such an entity lasts more than 5 years or the rotational work assignment status is canceled by SBC, it shall be deemed a Termination of Employment with the Employer at that time for purposes of this Plan. To be a rotational work assignment, the Employer must have indicated in writing to the person that the person was to be rehired by the Employer upon termination of the rotational work assignment.

**Officer Level Employee.** Any executive officer of SBC, as that term is used under the Securities Exchange Act of 1934, as amended, and any Employee that is an "officer level" Employee for compensation purposes as shown on the records of SBC.

**Participant.** An Eligible Employee or former Eligible Employee who participates in this Plan.

**Plan Interest Rate.** An annual rate of interest equal to Moody's Long-Term Corporate Bond Yield Average for the September preceding the calendar year during which the interest rate will apply. The Committee may choose another method of calculating the Plan Interest Rate, but such other method may only apply to Cash Deferral Units that Participants have not yet elected to establish.

**Plan Year.** The period from January 16 through the following January 15.

**Retirement or Retire.** Termination of Employment on or after the earlier of the following dates, unless otherwise provided by the Committee: (a) for Officer Level Employees, the date the Participant is at least age 55 and has five (5) years of Net Credited Service; or (b) the date the Participant has attained one of the following combinations of age and Net Credited Service:

Net Credited Service	Age
10 years or more	65 or older
20 years or more	55 or older
25 years or more	50 or older
30 years or more	Any age

For purposes of this Plan only, Net Credited Service shall be calculated in the same manner as “Pension Eligibility Service” under the SBC Pension Benefit Plan – Nonbargained Program (“Pension Plan”), as that may be amended from time to time, except that service with an Employer shall be counted as though the Employer were a “Participating Company” under the Pension Plan and the Employee was a participant in the Pension Plan.

**Short Term Incentive Award.** A cash award paid by an Employer (and not by a non-Employer, such as state disability payments) under the Short Term Incentive Plan; an award under a similar plan intended by the Committee to be in lieu of an award under such Short Term Incentive Plan, including, but not limited to, Performance Units granted under the 2001 Incentive Plan or any successor plan; or any other award that the Committee designates as a Short Term Incentive Award specifically for purposes of this Plan (regardless of the purpose of the award).

**Subsidiary.** Any corporation, partnership, venture or other entity in which SBC holds, directly or indirectly, a 50% or greater ownership interest. The Committee may, at its sole discretion, designate any other corporation, partnership, limited liability company, venture or other entity a Subsidiary for the purpose of participating in this Plan. Unless otherwise provided by the Committee, Cingular shall be deemed a Subsidiary so long as SBC holds a direct or indirect 25% interest in Cingular Wireless LLC or its successor.

**Team Award.** The annual award determined to be the “Team Award” by SBC, together with any individual award determined by SBC to be the Individual Discretionary Award made in connection therewith or comparable awards, if any, determined by SBC to be used in lieu of these awards.

**Termination of Employment.** References herein to “Termination of Employment,” “Terminate Employment” or a similar reference, shall mean the event where the Employee ceases to be an Employee of any Employer, including but not limited to, where the employing company ceases to be an Employer.

### **Article 3 - Administration of the Plan**

#### **3.1 The Committee.**

The Committee shall be the administrator of the Plan and will administer the Plan, interpret, construe and apply its provisions and determine entitlement to benefits, all in its discretion. The Committee may further establish, adopt or revise such rules and regulations and such additional terms and conditions regarding participation in the Plan as it may deem necessary or advisable for the administration of the Plan. References to determinations or other actions by SBC, herein, shall mean actions authorized by the Committee, the Chief Executive Officer, the Senior Executive Vice President of SBC in charge of Human Resources, or their respective successors or duly authorized delegates, in each case in the discretion of such person. All decisions by SBC shall be final and binding.

### **3.2 Claims Procedure.**

Subject to the authority of the Committee over the Plan, SBC shall appoint a Claims Board to adjudicate claims brought by or in respect to Participants and their beneficiaries relating to benefits under the Plan. A Participant may apply in writing to the Claims Board to make a claim under this Plan. The Claims Board shall provide written notice within 90 days to a Participant whose claim hereunder has been denied, setting forth reasons for such denial or explaining that an extension of the time for processing the claim is necessary, written in a manner calculated to be understood by such person. After receipt of such notice, or expiration of 90 days without any response from the Claims Board, the Participant may appeal the decision in writing to the Senior Executive Vice President of SBC in charge of Human Resources, or to the person's successor, within 90 days, except that if the Participant is an Insider, as that term is used in the 2001 Incentive Plan, then the Participant's appeal shall be to the Committee. The Participant shall receive a full and fair review of the decision denying the claim in accordance with the requirements of ERISA.

## **Article 4 - Contributions**

### **4.1 Election to Make Contributions.**

(a) The Committee shall establish dates and other conditions for participation in the Plan and making contributions as it deems appropriate. Except as otherwise provided by the Committee, each year:

(1) an Employee who is an Eligible Employee as of April 30 may thereafter make an election on or prior to the last Business Day of the immediately following June to establish a Cash Deferral Account in order to make contributions to the Plan ("Employee Contributions"), through payroll deductions, during the immediately following Plan Year (which shall be the Plan Year of such Cash Deferral Account) through any combination of the following:

(A) from 1% to 50% (in whole percentage increments) of the Participant's monthly Base Compensation, as the same may change from time to time. Employees who are below the level of Senior Manager, as shown on the records of SBC at the time of the election, may contribute no more than 25% or such other amount as determined by SBC.

(B) up to 100% (in whole percentage increments or in dollars) of one or more Incentive Awards, with the contribution of each Incentive Award (a discretionary award being a separate Incentive Award) determined individually. If a Participant did not have a target Short Term Incentive Award on June 30 but was subsequently granted such an award before the end of such Plan Year, the Participant will be deemed to have made the same percentage contribution election for the Short Term Incentive Award as the Participant made for Base Compensation.

(2) an Employee who was not an Eligible Employee as of April 30 but who is an Eligible Employee the immediately following September 30 may thereafter make an election on or prior to the last Business Day of the immediately following November with respect to the establishment of a Cash Deferral Account for the contribution of Base Compensation, other



than Team Award, in the same manner as if the Employee was an Eligible Employee as of such April 30.

(b) The Committee may permit an Eligible Employee to make other contributions on such terms and conditions as such Committee may permit from time to time.

(c) No contribution of compensation, other than for performance-based compensation (as that term is defined under Section 409A of the Code), shall be made to the Plan out of compensation for services where such services are performed during or before the taxable year of the election to make such Employee Contributions. In the case of the above referenced performance-based compensation (based on services performed over a period of at least 12 months), such election may be made no later than 6 months before the end of the period.

(d) Notwithstanding anything to the contrary in this Plan, no election shall be effective to the extent it would permit an Employee Contribution or distribution to be made that is not in compliance with Section 409A of the Code. To the extent such election related to Employee Contributions that complied with such statute and regulations, that portion of the election shall remain valid, except as otherwise provided under this Plan.

(e) SBC may refuse or terminate, in whole or in part, any election to make contributions to the Plan at any time; provided, however, only the Committee may take such action with respect to persons who are Officer Level Employees.

(f) In the event the Participant takes a hardship withdrawal from a benefit plan qualified under the Code and sponsored by an Employer, any election to make Employee Contributions by such Participant shall be cancelled on a prospective basis, and the Participant shall not be permitted to make a new election with respect to Employee Contributions that would be contributed during the then current and immediately following calendar year.

(g) To the extent a Participant makes contributions to the Plan where the payment of which would be deductible by SBC under Section 162(m) of the Code without regard to the size of the distribution, such contributions and earnings thereon shall be distributed first.

(h) An Employee may elect to make contributions of Base Compensation to this Plan with respect to a Cash Deferral Account only if the Employee has previously or simultaneously made an election to establish a Stock Deferral Account under the Stock Purchase and Deferral Plan relating to substantially the same period for making Employee Contributions and has elected to contribute at least 15% of the Employee's Base Compensation during that period.

#### **4.2 Contributions to a Cash Deferral Account.**

(a) Employee Contributions shall be made solely pursuant to a proper election and only during the Employee's lifetime and while the Employee remains an Eligible Employee (if the Employee ceases to be an Eligible Employee, his or her election to make Employee Contributions shall be cancelled on a prospective basis); provided, however, Termination of Employment of an Eligible Employee shall not constitute loss of eligibility solely with respect to contribution of annual base salary earned prior to termination but paid within 60 days thereafter or with respect to Incentive Awards paid after Retirement (and such person shall be deemed an Eligible Employee for such contributions).

(b) A Participant's contributions shall be credited to the Participant's Cash Deferral Account on the day the compensation – from which the contribution is to be deducted – is paid ("paid," as used in this Plan, includes amounts contributed to the Plan that would have been paid were it not for an election under this Plan) using the "check date" shown on the related pay record (sometimes referred to as the "paycheck stub") as the contribution date (if no "check date" is shown, then the date of the pay record). Earnings on each Cash Deferral Account shall be recorded on Participant's statements quarterly. When a payment is made to correct an underpayment, or as a delayed payment, of gross compensation for any reason, the related Employee Contribution shall be made when such correcting or delayed payment is made, again using the date on the pay record. No correcting or delayed payment may be contributed to the Plan if it is made after the period for making contributions in Article 4 for the Cash Deferral Account covering the payment to be corrected. For example, if an underpayment is made in June 2005, but not corrected until May 2006, regardless of the cause of such events, no part of the correcting payment may be contributed to the Plan. Where there has been an overpayment of gross compensation, the amount of the overpayment will not be considered in determining the contribution amount. In no event shall the Participant have any recourse against an Employer under this Plan for any underpayment, overpayment or delayed or correcting payment of compensation. In the event a pay period (the period over which services are rendered for the relevant compensation) relates to services rendered during or before the taxable year of the relevant election, then only the compensation relating to services performed in the calendar year following the calendar year of the election may be contributed to this Plan. The Committee may modify or change this paragraph (b) from time to time.

#### **4.3 Earnings on Cash Deferral Accounts.**

During a calendar year, the Participant's Cash Deferral Account shall accrue interest on amounts held by such Account at the Plan Interest Rate for such year, compounded quarterly on the last day of each quarter. Interest will accrue on unpaid amounts in the Cash Deferral Account from the date credited to such Account.

### **Article 5 - Distributions**

#### **5.1 Distributions of Cash Deferral Accounts.**

(a) At the time the Participant makes an election to make Employee Contributions with respect to a Cash Deferral Account, the Participant shall also elect the calendar year of the distribution of the Cash Deferral Account and the number of installments. The Participant may elect either of the following:

(1) Specified Date Distribution. That the distribution of the Cash Deferral Account commence in the calendar year specified by the Participant in up to five (5) installments. In the event the Participant Terminates Employment prior to the calendar year of the distribution, the Cash Deferral Account must commence distribution the calendar year following the calendar year of the Termination of Employment, with the same number of installments. For example, if the Participant elected a 2010 distribution with five (5) installments, but Terminated Employment in 2007, the Cash Deferral Account would commence distribution in 2008.

(2) Retirement Distribution. That the distribution of the Cash Deferral Account commence the calendar year following the calendar year of Retirement in up to (10) installments. If the Participant Terminates Employment while not Retirement eligible, the distribution shall

commence the calendar year following the calendar year of Termination of Employment, but shall be limited to five (5) installments.

If no timely distribution election is made by the Participant, then the Participant will be deemed to have made an election to have the Cash Deferral Account distributed in a single installment in the first calendar year after the calendar year Employee Contributions were first made.

Regardless of the distribution election made, if the Participant Terminates Employment but has a Cash Deferral Account that commenced in the same year the Cash Deferral Account would commence distribution, then that Account would instead commence distribution in the calendar year following the year the Account commenced. For example, if a Retirement eligible Employee Terminated Employment in 2005 after making an election with regard to an Incentive Award to be paid in 2006, the Cash Deferral Account relating to that award would commence distribution in 2007.

(b) If an Employee elected a Specified Date Distribution for a Cash Deferral Account, the Employee may elect a new Specified Date Distribution commencement date and a new number of installments; provided, however, Termination of Employment will not accelerate the distribution, unlike the initial deferral election. Unless otherwise provided by the Committee, the Employee must elect the new distribution and new number of installments, if any, not later than the last Business Day of the December that is at least one year before commencement of the existing scheduled distribution. The new distribution election must delay commencement of the distribution by five (5) years. An election to create a new Specified Date Distribution and defer the commencement of the distribution of a Cash Deferral Account may not be made in the same calendar year the election to establish the Cash Deferral Account is made. Notwithstanding anything to the contrary in this Plan, (1) such election to create a new Specified Date Distribution must be made at least 12 months prior to the date of the first scheduled payment under the prior distribution election and (2) the election shall not take effect until at least 12 months after the date on which the election is made.

(c) A Participant's Cash Deferral Account shall be distributed to the Participant on March 10 (or as soon thereafter as administratively practicable, as determined by SBC) of the calendar year elected by the Participant. In the event the distribution is to be made to an Officer Level Employee or a "key employee" (as defined in Section 416(i) of the Code, without regard to paragraph (5) thereof) as a result of the Participant's Termination of Employment, the distribution shall not occur until the later of such March 10 or six (6) months after the Termination of Employment, except it shall be distributed promptly upon the Participant's earlier death. The distributions shall continue annually on each successive March 10 (or such other date as determined by SBC) until the number of installments elected by the Participant is reached. In each installment, SBC shall distribute to the Participant that portion of the Participant's Cash Deferral Account that is equal to the total dollar amount of the Participant's Account divided by the number of remaining installments.

(d) The Committee may establish other distribution alternatives from time to time, but such alternatives may be offered no earlier than the next period in which a Participant may make an election to establish a Cash Deferral Account.

## **5.2 Death of the Participant or if the Participant Becomes Disabled.**

In the event of the death of a Participant, all undistributed Cash Deferral Accounts shall be distributed to the Participant's beneficiary in accordance with the SBC Rules for Employee Beneficiary Designations, as the same may be amended from time to time. In the event a Participant

becomes Disabled and Terminates Employment, all undistributed Cash Deferral Accounts shall be promptly distributed to the Participant.

### **5.3 Unforeseeable Emergency Distribution.**

In the event that SBC (the Committee in the case of Officer Level Employees), upon written petition of the Participant, determines in its sole discretion that the Participant has suffered an unforeseeable emergency, SBC shall make such distributions to the Participant from the Participant's Cash Deferral Accounts, on a pro-rata basis, as it deems necessary, as soon as practicable following such determination, subject to the following. For purposes of this Plan, an unforeseeable emergency is a severe financial hardship to the Participant resulting from an illness or accident of the Participant, the Participant's spouse, or a dependent (as defined in Section 152(a) of the Code) of the Participant, loss of the Participant's property due to casualty, or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the Participant. The amounts distributed with respect to an emergency may not exceed the amounts necessary to satisfy such emergency plus amounts necessary to pay taxes reasonably anticipated as a result of the distribution, after taking into account the extent to which such hardship is or may be relieved through reimbursement or compensation by insurance or otherwise or by liquidation of the Participant's assets (to the extent the liquidation of such assets would not itself cause severe financial hardship). It is the intent of this Plan that this provision comply with the Unforeseeable Emergency provisions of Section 409A of the Code. Upon such distribution, any election to make Employee Contributions by such Participant shall be immediately cancelled, and the Participant shall not be permitted to make a new election with respect to Employee Contributions that would be contributed during the then current and immediately following calendar year.

### **5.4 Ineligible Participant.**

Notwithstanding any other provisions of this Plan to the contrary, if SBC receives an opinion from counsel selected by SBC, or a final determination is made by a Federal, state or local government or agency, acting within its scope of authority, to the effect that an individual is not, or was not at the time of his or her making Employee Contributions to this Plan, a member of Employer's "select group of management or highly compensated employees" within the meaning of ERISA, then such person will not be eligible to make further contributions to the Plan.

## **Article 6 - Transition Provisions**

### **6.1 2005 Cash Deferral Accounts.**

Notwithstanding Article 4 to the contrary, if an Employee is an Eligible Employee on September 30, 2004, the Employee may make an election under Article 4 on or prior to December 15, 2004, with respect to the establishment of a Cash Deferral Account for the contribution of Base Compensation and/or Incentive Awards that would otherwise be paid during the period from January 1, 2005, through January 15, 2006, which shall be the Plan Year for such Cash Deferral Account.

## **Article 7 - Discontinuation, Termination, Amendment.**

### **7.1 SBC's Right to Discontinue Offering Cash Deferral Accounts.**

The Committee may at any time discontinue offerings of Cash Deferral Accounts or contributions under the Plan. Any such discontinuance shall have no effect upon existing Cash Deferral Accounts or the terms or provisions of this Plan as applicable to such Accounts.

### **7.2 SBC's Right to Terminate Plan.**

The Committee may terminate the Plan at any time. Upon termination of the Plan, contributions shall no longer be made under the Plan.

After termination of the Plan, Participants shall continue to earn interest on undistributed amounts and shall continue to receive all distributions under this Plan at such time as provided in and pursuant to the terms and conditions of Participant's elections and this Plan.

### **7.3 Amendment.**

The Committee may at any time amend the Plan in whole or in part; provided, however, that no amendment, including but not limited to an amendment to this section, shall be effective, without the consent of a Participant, to alter, to the material detriment of such Participant, any of the Cash Deferral Accounts of the Participant. For purposes of this section, an alteration to the material detriment of a Participant shall include, but not be limited to, a material reduction in the period of time over which the Participant's Cash Deferral Account may be distributed to a Participant, any reduction in the amounts credited to the Participant's Cash Deferral Accounts, or any reduction in the Plan Interest Rate (other than as it may fluctuate in accordance with its terms) for Cash Deferral Accounts previously elected by the Participant. Any such consent may be in a writing, telecopy, or e-mail or in another electronic format. An election to make Employee Contributions shall be conclusively deemed to be the consent of the Participant to any and all amendments to the Plan prior to such election, and such consent shall be a condition to making any election with respect to Employee Contributions.

## **Article 8 - Miscellaneous**

### **8.1 Tax Withholding.**

Upon a distribution from a Participant's Cash Deferral Account, SBC shall withhold sufficient amounts to satisfy the minimum amount of Federal, state, and local taxes required by law to be withheld as a result of such distribution.

### **8.2 Elections and Notices.**

Notwithstanding anything to the contrary contained in this Plan, all elections and notices of every kind under this Plan shall be made on forms prepared by SBC or the General Counsel, Secretary or Assistant Secretary, or their respective delegates or shall be made in such other manner as permitted or required by SBC or the General Counsel, Secretary or Assistant Secretary, or their respective delegates, including through electronic means, over the Internet or otherwise. An election shall be deemed made when received by SBC (or its designated agent, but only in cases where the designated agent has been appointed for the purpose of receiving such election), which may waive any defects in form. Unless made irrevocable by the electing person, each election with regard to making Employee Contributions or distributions of Cash Deferral Accounts shall become irrevocable at the close of business on the last day to make such election. SBC may limit the time an election may be made in advance of any deadline.

If not otherwise specified by this Plan or SBC, any notice or filing required or permitted to be given to SBC under the Plan shall be delivered to the principal office of SBC, directed to the attention of the Senior Executive Vice President in charge of Human Resources for SBC or his or her successor. Such notice shall be deemed given on the date of delivery.

Notice to the Participant shall be deemed given when mailed (or sent by telecopy) to the Participant's work or home address as shown on the records of SBC or, at the option of SBC, to the

Participant's e-mail address as shown on the records of SBC. It is the Participant's responsibility to ensure that the Participant's addresses are kept up to date on the records of SBC. In the case of notices affecting multiple Participants, the notices may be given by general distribution at the Participants' work locations.

By participating in the Plan, each Participant agrees that SBC may provide any documents required or permitted under the Federal or state securities laws, including but not limited to the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, by e-mail, by e-mail attachment, or by notice by e-mail of electronic delivery through SBC's Internet Web site or by other electronic means.

### **8.3 Unsecured General Creditor.**

Participants and their beneficiaries, heirs, successors, and assigns shall have no legal or equitable rights, interest, or claims in any property or assets of any Employer. No assets of any Employer shall be held under any trust for the benefit of Participants, their beneficiaries, heirs, successors, or assigns, or held in any way as collateral security for the fulfilling of the obligations of any Employer under this Plan. Any and all of each Employer's assets shall be, and remain, the general, unpledged, unrestricted assets of such Employer. The only obligation of an Employer under the Plan shall be merely that of an unfunded and unsecured promise of SBC to make distributions under and in accordance with the terms of the Plan.

### **8.4 Offset.**

SBC may offset against the amount otherwise distributable to a Participant, any amounts due an Employer by a Participant, including but not limited to overpayments under any compensation or benefit plans.

### **8.5 Non-Assignability.**

Neither a Participant nor any other person shall have any right to commute, sell, assign, transfer, pledge, anticipate, mortgage, or otherwise encumber, transfer, hypothecate or convey in advance of actual receipt, any Cash Deferral Account under the Plan, if any, or any part thereof, which are, and all rights to which are, expressly declared to be unassignable and non-transferable. No part of a distributable Cash Deferral Account shall, prior to actual distribution, be subject to seizure or sequestration for the payment of any debts, judgments, alimony or separate maintenance owed by a Participant or any other person, nor be transferable by operation of law in the event of a Participant's or any other person's bankruptcy or insolvency.

### **8.6 Employment Not Guaranteed.**

Nothing contained in this Plan nor any action taken hereunder shall be construed as a contract of employment or as giving any employee any right to be retained in the employ of an Employer or to serve as a director.

### **8.7 Errors.**

At any time SBC or an Employer may correct any error made under the Plan without prejudice to SBC or any Employer. Such corrections may include, among other things, refunding contributions to a Participant with respect to any period he or she made Employee Contributions while not an Eligible Employee, or canceling the enrollment of a non-Eligible Employee. Neither SBC nor any Employer shall be liable for any damages resulting from failure to timely allow any contribution to be made to the Plan or for any damages resulting from the correction of, or a delay in correcting, any error made under the Plan. In no event shall SBC or any Employer be liable for

consequential or incidental damages arising out of a failure to comply with the terms of the Plan.

**8.8 Captions.**

The captions of the articles, sections, and paragraphs of this Plan are for convenience only and shall not control nor affect the meaning or construction of any of its provisions.

**8.9 Governing Law.**

To the extent not preempted by Federal law, the Plan, and all benefits and agreements hereunder, and any and all disputes in connection therewith, shall be governed by and construed in accordance with the substantive laws of the State of Texas, without regard to conflict or choice of law principles which might otherwise refer the construction, interpretation or enforceability of this Plan to the substantive law of another jurisdiction.

Because benefits under the Plan are granted in Texas, records relating to the Plan and benefits thereunder are located in Texas, and the Plan and benefits thereunder are administered in Texas, SBC and the Participant under this Plan, for themselves and their successors and assigns, irrevocably submit to the exclusive and sole jurisdiction and venue of the state or Federal courts of Texas with respect to any and all disputes arising out of or relating to this Plan, the subject matter of this Plan or any benefits under this Plan, including but not limited to any disputes arising out of or relating to the interpretation and enforceability of any benefits or the terms and conditions of this Plan. To achieve certainty regarding the appropriate forum in which to prosecute and defend actions arising out of or relating to this Plan, and to ensure consistency in application and interpretation of the Governing Law to the Plan, the parties agree that (a) sole and exclusive appropriate venue for any such action shall be an appropriate Federal or state court in Bexar County, Texas, and no other, (b) all claims with respect to any such action shall be heard and determined exclusively in such Texas court, and no other, (c) such Texas court shall have sole and exclusive jurisdiction over the person of such parties and over the subject matter of any dispute relating hereto and (d) that the parties waive any and all objections and defenses to bringing any such action before such Texas court, including but not limited to those relating to lack of personal jurisdiction, improper venue or *forum non conveniens*.

**8.10 Plan to Comply with Section 409A.**

In the event any provision of this Plan is held invalid, void, or unenforceable, the same shall not affect, in any respect whatsoever, the validity of any other provision of this Plan. Notwithstanding any provision to the contrary in this Plan, each provision in this Plan shall be interpreted to permit the deferral of compensation in accordance with Section 409A of the Code and any provision that would conflict with such requirements shall not be valid or enforceable.

**8.11 Successors and Assigns.**

This Plan shall be binding upon SBC and its successors and assigns.



SBC Communications Inc.

**2005  
SUPPLEMENTAL EMPLOYEE  
RETIREMENT PLAN**

Effective: November 19, 2004  
Revisions Effective: January 26, 2006



## 2005 SUPPLEMENTAL EMPLOYEE RETIREMENT PLAN

### 1. Purpose.

The purpose of the 2005 Supplemental Employee Retirement Plan (the "SERP" or the "Plan") is to provide Eligible Employees with retirement benefits to supplement benefits payable pursuant to SBC's qualified group pension plans. The Plan is a successor to the SBC Supplemental Retirement Income Plan ("SRIP") that was effective January 1, 1984 and which was amended, effective December 31, 2004, to provide that no additional compensation amounts shall be included in determining SRIP pension amounts and that the pension amounts payable thereunder shall be grandfathered and administered in accordance with the provisions of the SRIP in a manner that does not invoke Section 409A of the Code.

### 2 Definitions.

For purposes of this Plan, the following words and phrases shall have the meanings indicated, unless the context clearly indicates otherwise:

**Administrative Committee.** "Administrative Committee" means a Committee, consisting of SBC's Senior Executive VicePresident responsible for Human Resources matters and two or more other members designated by SBC's Senior Executive Vice President responsible for Human Resources matters, which shall administer the Plan.

**Agreement.** "Agreement" means the written agreement (substantially in the form attached to this Plan as Attachment A) that shall be entered into between SBC by its Senior Executive Vice President for Human Resources matters and a Participant prior to the accrual of Participant's benefits hereunder to carry out the Plan with respect to such Participant. The Agreement shall include the Participant's irrevocable distribution election. Entry into a new Agreement shall not be required upon amendment of the Plan except as otherwise provided herein. Entry into a new Agreement shall be required upon an increase in a Participant's Retirement Percent (which increase shall only be utilized to determine the Participant's benefits from and after the date of the Participant's new Agreement), and in the case of an amendment which alters, to the detriment of a Participant, the benefits described in this Plan as applicable to such Participant (See Section

7.5); provided, however, any new Agreement shall not be effective to the extent such new Agreement results in deferrals that would be subject to immediate taxation under the provisions of Code Section 409A. A new Agreement shall operate as the written consent required by Section 7.5 of the Participant to such amendment.

**Beneficiary.** "Beneficiary" shall mean any beneficiary or beneficiaries designated by the Eligible Employee pursuant to the SBC Rules for Employee Beneficiary Designations as may hereafter be amended from time-to-time ("Rules"). If a Participant fails to execute a Beneficiary designation form with respect to Plan benefits, his Beneficiary designation form with respect to his SRIP benefits shall apply with respect to his Plan benefits.

**CEO or Chief Executive Officer.** "CEO" or "Chief Executive Officer" shall mean the Chief Executive Officer of SBC Communications Inc.

**Disabled or Disability.** "Disabled" or "Disability" means any Termination of Employment prior to being Retirement Eligible (without regard to the 5 Years of Service requirement otherwise applicable to certain Participants age 55 or older) that results from the participant's Disability. A participant shall be considered Disabled if the participant (i) is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than twelve (12) months, or (ii) is, by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than twelve (12) months, receiving income replacement benefits for a period of not less than three (3) months under an accident or health plan covering employees of the Participant's employer. The Administrative Committee, in its complete and sole discretion, determines whether a Participant is Disabled. The Administrative Committee may require that the Participant submit to an examination by a competent physician or medical clinic selected by the Administrative Committee. On the basis of such medical evidence, the determination of the Administrative Committee as to whether or not a Participant is Disabled shall be conclusive.

**Earnings.** "Earnings" means for a given calendar year the Participant's: (1) bonus earned as a short term award during the calendar year but not exceeding 200% of the target amount of such bonus (or such other portion of the bonus or target bonus as may be determined by the Human Resources Committee of the Board of SBC), plus (2) base salary before reduction due to any contribution pursuant to any deferred compensation plan or agreement provided by SBC, including but not limited to compensation deferred in accordance with Section 401(k) of the Internal Revenue Code.

**Eligible Employee.** "Eligible Employee" means:

- (a) Any person who, as of close of business on December 31, 2004, was employed by a subsidiary of SBC and was a participant in the SRIP; and
- (b) Any person who was a participant in the SRIP, terminated employment in 2004 and receives Earnings in 2005; and
- (c) An Officer and any other individual who is participating in the Plan as of September 1, 2005.

Notwithstanding the foregoing, the CEO of SBC Communications Inc. may, from time to time, exclude any Officer or group of Officers from being deemed an "Eligible Employee" under this Plan. Further, an employee of a company acquired by SBC shall not be considered an Eligible Employee unless designated as eligible by the CEO.

**Final Average Earnings.** "Final Average Earnings" means the average of the Participant's Monthly Earnings for the thirty-six (36) consecutive months out of the one hundred twenty (120) months next preceding the Participant's Termination of Employment which yields the highest average earnings. If the Participant has fewer than thirty-six (36) months of employment, the average shall be taken over his or her period of employment.

**GAAP Rate.** "GAAP Rate" means the interest rate used for valuing Plan liabilities for purposes of SBC's financial statement reporting requirements for the referenced period.

**Immediate Annuity Value.** "Immediate Annuity Value" means the annual amount of annuity payments that would be paid out of a plan on a single life annuity basis if payment of

the Plan's benefit was commenced immediately upon Termination of Employment, notwithstanding the form of payment of the Plan's benefit actually made to the Participant (i.e., joint and survivor annuity, lump sum, etc.) and notwithstanding the actual commencement date of the payment of such benefit.

**Mid-Career Hire.** "Mid-Career Hire" means an individual (i) initially hired or rehired at age 35 or older into a position eligible for benefits under this Plan or (ii) initially hired or rehired at age 35 or older who is subsequently promoted to a position eligible for benefits under this Plan.

**Monthly Earnings.** "Monthly Earnings" means one-twelfth (1/12) of Earnings.

**Mortality Tables.** "Mortality Tables" means the mortality tables used for purposes of valuing Plan liabilities for SBC's financial statement reporting requirements for the referenced period.

**Officer.** "Officer" shall mean an individual who is designated as an officer level Employee for compensation purposes on the records of SBC.

**Participant.** A "Participant" means an Eligible Employee who has entered into an Agreement to participate in the Plan.

**Retire or Retirement.** "Retire" or "Retirement" shall mean the Termination of Employment of an Eligible Employee for reasons other than death, on or after the earlier of the following dates: (1) the date the Eligible Employee is Retirement Eligible or (2) the date the Eligible Employee has attained one of the following combinations of age and service at Termination of Employment:

<u>Net Credited Service</u>	<u>Age</u>
25 years or more	50 or older
30 years or more	Any age

**Retirement Eligible.** "Retirement Eligible" or "Retirement Eligibility" means that a Participant has attained age 55 and has five (5) Years of Service.

**Retirement Percent.** "Retirement Percent" means the percent specified in the Agreement with the Participant which establishes a Target Retirement Benefit (see Section 3.1) as a percentage of Final Average Earnings. For an individual who becomes an Eligible Employee on or after January 1, 2006, "Retirement Percent" means 50 percent unless otherwise provided by the Human Resources Committee of the Board of Directors of AT&T.

**SBC.** "SBC" means SBC Communications Inc.

**Supplemental Retirement Income Plan or SRIP.** "Supplemental Retirement Income Plan" or "SRIP" means the SBC Communications Inc. Supplemental Retirement Income Plan effective January 1, 1984, which was amended to cease benefit accruals after December 31, 2004.

**Service Factor.** "Service Factor" means, unless otherwise agreed in writing by the Participant and SBC, either (a) a deduction of 1.43 percent, or .715 percent for Mid-Career Hires, multiplied by the number by which (i) thirty-five (or thirty in the case of a Participant who is an Officer) exceeds (ii) the number of Years of Service of the Participant, or (b) a credit of 0.715 percent multiplied by the number by which (i) the number of Years of Service of the Participant exceeds (ii) thirty-five (or thirty in the case of a Participant who is an Officer). For purposes of the above computation, a deduction shall result in the Service Factor being subtracted from the Retirement Percent whereas a credit shall result in the Service Factor being added to the Retirement Percent.

**Termination of Employment.** "Termination of Employment" means the ceasing of the Participant's employment from the SBC controlled group of companies for any reason whatsoever, whether voluntarily or involuntarily.

**Year.** A "Year" is a period of twelve (12) consecutive calendar months.

**Years of Service.** "Years of Service" means the number of each complete Years of continuous, full-time service as an employee beginning on the date when a Participant first began such continuous employment with any SBC company and on each anniversary of such date, including service prior to the adoption of this Plan.

3. Plan ("SERP") Benefits.  
 3.1 SERP Benefit Formula.

With respect to (1) a Participant who was a participant in the SRIP prior to January 1, 1998, or (2) a Participant who, prior to January 1, 1998, was an officer of a Pacific Telesis Group ("PTG") company and became a participant in the SRIP after January 1, 1998, the amount of such Participant's SERP Benefit is calculated as follows:

$$\begin{array}{l}
 \text{Final Average Earnings} \\
 \times \text{ Revised Retirement Percentage} \\
 \hline
 = \text{Target Retirement Benefit} \\
 - \text{Immediate Annuity Value of any SBC or affiliate Qualified Pensions} \\
 - \text{Immediate Annuity Value of SRIP} \\
 - \text{Immediate Annuity Value of any other SBC or affiliate Non-Qualified} \\
 \text{Pensions other than the SERP} \\
 \hline
 = \text{Target Benefit} \\
 - \text{Age Discount} \\
 \hline
 = \text{Annual Value of Life with 10 Year Certain SERP Benefit immediately} \\
 \text{payable upon Termination of Employment}
 \end{array}$$

With respect to all other Participants, the amount of such Participant's SERP Benefit is calculated as follows:

$$\begin{array}{l}
 \text{Final Average Earnings} \\
 \times \text{ Revised Retirement Percentage} \\
 \hline
 = \text{Target Retirement Benefit} \\
 - \text{Age Discount} \\
 \hline
 = \text{Discounted Target Benefit} \\
 - \text{Immediate Annuity Value of any SBC or affiliate Qualified Pensions} \\
 - \text{Immediate Annuity Value of SRIP} \\
 - \text{Immediate Annuity Value of any SBC or affiliate Non-Qualified Pensions, other than SERP} \\
 \hline
 = \text{Annual Value of Life with 10 Year Certain SERP Benefit immediately payable upon Termination of Employment}
 \end{array}$$

Where in both of the above cases the following apply:

- (a) Revised Retirement Percentage = Retirement Percent + Service Factor
- (b) For purposes of determining the Service Factor, the Participant's actual Years of Service as of the date of Termination of Employment, to the day, shall be used.
- (c) For purposes of determining the Final Average Earnings, the Participant's Earnings history as of the date of Termination of Employment shall be used.

- (d) Age Discount means the Participant's SERP Benefit shall be decreased by five-tenths of one percent (.5%) for each month that the date of the Participant's Termination of Employment precedes the date on which the Participant will attain age 60.

Notwithstanding the foregoing, if at the time of Termination of Employment the Participant is, or has been within the one year period immediately preceding Participant's Termination of Employment, an Officer with 30 or more Years of Service such Participant's Age Discount shall be zero.

Except to true up for an actual short term award paid following Termination of Employment, there shall be no recalculation of the value of a Participant's SERP Benefit hereunder following a Participant's Termination of Employment.

3.2 Vesting.

Notwithstanding any other provision of this Plan, upon any Termination of Employment of the Participant for a reason other than death or Disability, SBC shall have no obligation to the Participant under this Plan if the Participant has less than 5 Years of Service at the time of Termination of Employment.

4 Form of Distribution of SERP Benefits.

4.1 Normal Form.

The normal form of a Participant's benefits hereunder shall be a Life with 10-Year Certain Benefit as described in Section 4.2(a). A Participant who fails to timely make (or is deemed to have failed to make) a distribution election with respect to his SERP Benefits shall be deemed to have made an election to receive his or her SERP benefits as described in Section 4.2(a).

4.2 Election Alternatives.

Notwithstanding the normal form for distribution of a Participant's SERP Benefits, a Participant may elect, in his or her timely filed Agreement, one of the following Benefit Payout Alternatives:

- (a) Life with a 10-Year Certain Benefit. An annuity payable during the longer of (i) the life of the Participant or (ii) the 10-year period commencing on the Participant's Termination of Employment and ending on the day next preceding the tenth anniversary of such date (the "Life With 10-Year Certain Benefit"). If a Participant who is receiving a Life with 10-Year Certain Benefit dies prior to the expiration of the 10-year period described in this Section 4.2(a), the Participant's Beneficiary shall be entitled to receive the remaining Life With 10-Year Certain Benefit installments which would have been paid to the Participant had the Participant survived for the entire such 10-year period.
- (b) Joint and 100% Survivor Benefit. A joint and one hundred percent (100%) survivor annuity payable for life to the Participant and at his or her death to his or her Beneficiary, in an amount equal to one hundred percent (100%) of the amount payable during the Participant's life, for life (the "Joint and 100% Survivor Benefit").
- (c) Joint and 50% Survivor Benefit. A joint and fifty percent (50%) survivor annuity payable for life to the Participant and at his or her death to his or her Beneficiary, in an amount equal to fifty percent (50%) of the amount payable during the Participant's life, for life (the "Joint and 50% Survivor Benefit").
- (d) Lump Sum Benefit. A Participant may elect a lump sum benefit in his or her Agreement, but his or her SERP benefit shall be paid in the form of a lump sum only if the Participant has attained the age of fifty-five (55) years as of his or her Termination of Employment. If a Participant elects a lump sum benefit in his or her Agreement but realizes a Termination of Employment prior to attaining age fifty-five (55), the Participant's SERP Benefit shall be paid as provided in Section



4.2(a), 4.2(b) or 4.2(c), as elected or deemed elected by the Participant.

The Benefit Payout Alternatives described in Section 4.2(b), 4.2(c) and 4.2(d) shall be the actuarially determined equivalent (as determined by the Administrative Committee in its complete and sole discretion) of the Life With 10-Year Certain Benefit that is converted by such election. The amount of a Participant's lump sum benefit shall be calculated as of the Participant's Termination of Employment by applying the Mortality Tables and the GAAP Rate, both as in effect as of the end of the calendar year immediately preceding the Participant's Termination of Employment, but using the Participant's age, Years of Service and other factors as of the Participant's Termination of Employment.

4.3 Distribution Election.

4.3.1 Eligible Employees Who Are SRIP Participants.

Any election made by an Eligible Employee who was a SRIP participant must be made in the Participant's timely filed SERP Agreement. Such Participant's SERP Agreement is timely filed only if it is delivered by the Participant, in writing, telecopy, email or in another electronic format, to the Administrative Committee no later than December 31, 2004.

4.3.2 Eligible Employees Who Are Not SRIP Participants.

Any election made by an Eligible Employee who was not a SRIP participant must be made in the Participant's timely filed Agreement. Such Participant's Agreement is timely filed only if it is delivered by the Participant, in writing, telecopy, email or in another electronic format, to the Administrative Committee immediately following his designation as an Eligible Employee by the CEO.

4.3.3 Failure to Timely File an Agreement.

If a Participant's Agreement is not timely filed or fails to show an election of a Benefit Payout Alternative, such Participant shall be deemed to have elected and such Participant's form of benefit shall

be the Life With 10-Year Certain Benefit which is described in Section 4.2(a).

**4.3.4 Death of or Divorce from Annuitant During Participant's Lifetime.**

Notwithstanding any other provision of this Plan to the contrary, in the event of the death of a designated annuitant during the life of the Participant, the Participant's election to have a Benefit Payout Alternative described in Section 4.2(b) or 4.2(c) shall, without any action by the Participant, be revoked, and the Participant's benefit, or remaining benefit, under the Plan, as the case may be, shall be paid as provided in Section 4.2(a). Any conversion of benefit from one form to another pursuant to the provisions of this paragraph shall be subject to actuarial adjustment (as determined by the Administrative Committee in its complete and sole discretion) such that the Participant's new benefit is the actuarial equivalent of the Participant's remaining prior form of benefit. Payments pursuant to Participant's new form of benefit shall be effective commencing with the first monthly payment for the month following the death of the annuitant.

Notwithstanding any other provision of this Plan to the contrary, in the event of the divorce or legal separation of the Participant, the Participant's election to have a Benefit Payout Alternative described in Section 4.2(b) or 4.2(c), with a survivor annuity for the benefit of the Participant's former spouse as Beneficiary, shall, without any action by the Participant, be revoked, and the Participant's benefit, or remaining benefit, under the Plan, as the case may be, shall be paid as provided in Section 4.2(a). In such event, the 10-Year period as described in Section 4.2(a) shall be the same 10-year period as if such form of benefit was the form of benefit originally selected and the expiration date of such period shall not be extended beyond its original expiration date. Payments pursuant to Participant's new form of benefit shall be effective commencing with the first monthly payment following notice from the Participant to the Administrative Committee after the divorce (or legal separation) becomes final.

4.3.5 Special Provisions for Lump Sum Benefit Election.

A Participant who elects a lump sum benefit under Section 4.2(d) must, contemporaneous with such Lump Sum Benefit election, elect a specific number of year(s), not to exceed twenty (20) years, following his or her Termination of Employment upon which the lump sum benefit (including any interest accrued thereon) shall be distributed;provided,however,

- (a) the Participant may not receive more than thirty percent (30%) of his or her lump sum benefit (excluding any interest thereon) until the third (3<sup>rd</sup>) anniversary of his or her Termination of Employment;provided,however, if the Participant is age sixty (60) or older as of his or her Termination of Employment, the Participant, if elected in his or her timely filed Agreement, may receive one hundred percent (100%) of his or her lump sum benefit upon the day that is six (6) months following his or her Termination of Employment if he or she agrees, in writing, substantially in the form provided in Attachment B, not to compete with an Employer Business within the meaning of Section 8.2 for a period of three (3) years from such Participant's Termination of Employment and further agrees that if he or she fails to abide by such agreement, the non-compete agreement is challenged or the non-compete agreement is unenforceable, he or she shall forfeit all benefits hereunder and repay the lump sum benefit to SBC; and
- (b) prior to distribution of the Participant's lump sum benefit, interest on such lump sum benefit shall accrue and shall be added to the Participant's lump sum benefit or distributed monthly, as elected by the Participant in his or her Agreement.

The lump sum benefit payment schedule elected by a Participant in his or her Agreement must comply with the rules for payment schedules as adopted by the Administrative Committee (as determined by the Administrative Committee in its sole and absolute discretion), which, for example, may require payment

of principal to be made no more frequently than once per calendar year.

If a Participant timely elected a lump sum benefit in his or her Agreement fails to timely elect a payment schedule or if such Participant's elected payment schedule does not comply with the rules for payment schedules, (i) thirty percent (30%) of such Participant's lump sum benefit shall be paid to the Participant upon the date that is six (6) months following the Participant's Termination of Employment, and (ii) the remaining seventy percent (70%) shall be paid to the Participant on the third (3<sup>rd</sup>) anniversary of such Participant's Termination of Employment.

4.3.6 Lump Sum Benefit Account Balance.

From and after a Participant's Termination of Employment, the Administrative Committee shall maintain a lump sum benefit account balance on its books and records for each Participant who elected a lump sum benefit. During such period of time that all or any portion of a Participant's lump sum benefit is not paid, interest shall be credited using the same methodology used by SBC for financial accounting purposes using the GAAP Rate that was used to calculate such Participant's lump sum benefit. Payments of principal and interest shall be deducted from the lump sum benefit account balance.

5. Death or Death or Disability Benefits.

5.1 Death Following Termination of Employment.

If a Participant who has commenced payment of his or her SERP benefit hereunder dies, his or her Beneficiary shall be entitled to receive the remaining SERP benefit in accordance with the Benefit Payout Alternative elected or deemed elected by the Participant.

5.2 Death Prior to Termination of Employment.

If a Participant dies prior to his or her Termination of Employment, a pre-retirement death benefit will be calculated as though the Participant had terminated employment (determined without regard to the 5 Years of Service requirement) on the day prior to the date of death. If the Participant made (or is deemed to

have made) an election under Section 4.2(a), the form of the death benefit shall be a Beneficiary Life Annuity(as such term is hereinafter described) With 10-Year Certain based on the life expectancy of the Beneficiary. If the Participant made an election under Section 4.2(b) or 4.2(c), the form of the death benefit shall be a Beneficiary Life Annuity (as such term is hereinafter described) based on the life expectancy of the Beneficiary. Notwithstanding anything herein to the contrary, if the participant made a Lump Sum Benefit election under Section 4.2(d), a Lump Sum Benefit (calculated in the manner described in this Section 5.2) shall be paid to the Participant's Beneficiary, whether or not the Participant was age fifty-five or older on the date of his or her death. If paid as a Beneficiary Life Annuity based on the life of the Beneficiary, either with or without a 10-year certain benefit, such benefit shall be the actuarially determined equivalent (as determined by the Administrative Committee in its complete and sole discretion) of the Life With 10-Year Certain Benefit that would have been paid to the Participant had he or she terminated employment on the day immediately prior to his or her death. For purposes of this Section 5.2, a Lump Sum Benefit shall be calculated in the same manner as provided in Section 4.2 as if the Participant were alive; e.g., calculated as of the Participant's death applying the Mortality Tables and the GAAP Rate, both as in effect as of the end of the calendar year immediately preceding the Participant's death, but using the Participant's age, Years of Service and other factors as of the Participant's date of death.

5.3            Disability.

Upon a Participant's Disability, the Participant will continue to accrue Years of Service during his or her Disability until the earliest of his or her:

- (a)            Recovery from Disability,
- (b)            Retirement (determined without regard to the 5 Years of Service requirement otherwise applicable to certain Participants age 55 or older), or
- (c)            Death.

Upon the occurrence of either (a) Participant's recovery from Disability prior to his or her Retirement Eligibility if Participant does not return to employment, or (b) Participant's Retirement (determined without regard to the 5 Years of Service requirement otherwise applicable to certain Participants age 55 or older), the Participant shall be entitled to receive a SERP Benefit as if he or she realized a Termination of Employment as of the date of such occurrence.

For purposes of calculating the foregoing benefit, the Participant's Final Average Earnings shall be determined using his or her Earnings history as of the date of his or her Disability.

If a Participant who continues to have a Disability dies prior to his or her Retirement Eligibility (without regard to the 5 Years of Service requirement otherwise applicable to certain Participants age 55 or older), the Participant will be treated in the same manner as if he or she had died while in employment (See Section 5.2).

6. Payment of Benefits.

6.1 Commencement of Payments.

- (a) Benefit payments shall commence pursuant to the Benefit Payout Alternative elected by the Participant in his or her Agreement on the date that is six (6) months following his or her Termination of Employment. If a Participant elected (or is deemed to have elected) an annuity form of benefit under Section 4.2(a), 4.2(b) or 4.2(c), the aggregate monthly amount that would be paid between the Participant's Termination of Employment through the date that benefit payments actually commence, shall be paid in a lump sum on the date that benefit payments actually commence hereunder. In addition, during the period of time between a Participant's Termination of Employment and the date that annuity payments hereunder actually commence, interest shall be credited on the withheld annuity amounts for such period of time that each annuity payment is withheld. The credited interest shall be paid in a lump sum on the date that payments hereunder actually commence. Interest shall be credited using the GAAP Rate in effect as of the end of

the calendar year immediately preceding the Participant's Termination of Employment.

- (b) Notwithstanding the designation of a specific date for payment of a distribution hereunder, commencement of payments under this Plan may be delayed for administrative reasons in the discretion of the Administrative Committee, but shall begin not later than sixty (60) days following the occurrence of an event which entitles a Participant (or a Beneficiary) to payments under this Plan.

6.2 Withholding; Unemployment Taxes.

To the extent required by the law in effect at the time payments are made hereunder, any taxes required to be withheld by the Federal or any state or local government shall be withheld from payments made hereunder.

6.3 Recipients of Payments; Designation of Beneficiary.

All payments to be made under the Plan shall be made to the Participant during his or her lifetime, provided that if the Participant dies prior to the completion of such payments, then all subsequent payments under the Plan shall be made to the Participant's Beneficiary or Beneficiaries.

In the event of the death of a Participant, distributions/benefits under this Plan shall pass to the Beneficiary (ies) designated by the Participant in accordance with the this Plan and the Rules.

6.4 No Other Benefits.

No benefits shall be paid hereunder to the Participant or his or her Beneficiary except as specifically provided herein.

6.5 Small Benefit.

Notwithstanding any election made by the Participant, the Administrative Committee in its sole discretion may pay any benefit in the form of a lump sum payment if the lump sum equivalent amount is or would be less than \$10,000 when payment of such benefit would otherwise commence.

7. Conditions Related to Benefits.  
7.1 Administration of Plan.

The Administrative Committee shall be the sole administrator of the Plan and will, in its discretion, administer, interpret, construe and apply the Plan in accordance with its terms. The Administrative Committee shall further establish, adopt or revise such rules and regulations as it may deem necessary or advisable for the administration of the Plan. All decisions of the Administrative Committee shall be final and binding unless the Board of Directors should determine otherwise.

7.2 No Right to SBC Assets.

Neither a Participant nor any other person shall acquire by reason of the Plan any right in or title to any assets, funds or property of any SBC company whatsoever including, without limiting the generality of the foregoing, any specific funds or assets which SBC, in its sole discretion, may set aside in anticipation of a liability hereunder, nor in or to any policy or policies of insurance on the life of a Participant owned by SBC. No trust shall be created in connection with or by the execution or adoption of this Plan or any Agreement, and any benefits which become payable hereunder shall be paid from the general assets of SBC. A Participant shall have only a contractual right to the amounts, if any, payable hereunder unsecured by any asset of SBC.

7.3 Trust Fund.

SBC shall be responsible for the payment of all benefits provided under the Plan. At its discretion, SBC may establish one or more trusts, for the purpose of providing for the payment of such benefits. Such trust or trusts may be irrevocable, but the assets thereof shall be subject to the claims of SBC's creditors. To the extent any benefits provided under the Plan are actually paid from any such trust, SBC shall have no further obligation with respect thereto, but to the extent not so paid, such benefits shall remain the obligation of, and shall be paid by SBC.

7.4 No Employment Rights.

Nothing herein shall constitute a contract of continuing employment or in any manner obligate any SBC company to



continue the service of a Participant, or obligate a Participant to continue in the service of any SBC company and nothing herein shall be construed as fixing or regulating the compensation paid to a Participant.

7.5 Modification or Termination of Plan.

This Plan may be modified or terminated at any time in accordance with the provisions of SBC's Schedule of Authorizations. A modification may affect present and future Eligible Employees. SBC also reserves the sole right to terminate at any time any or all Agreements. In the event of termination of the Plan or of a Participant's Agreement, a Participant shall be entitled to benefits hereunder, if prior to the date of termination of the Plan or of his or her Agreement, such Participant has attained 5 Years of Service, in which case, regardless of the termination of the Plan/Participant's Agreement, such Participant shall be entitled to benefits at such time as provided in and as otherwise in accordance with the Plan and his or her Agreement, provided, however, Participant's benefit shall be computed as if Participant had terminated employment as of the date of termination of the Plan or of his or her Agreement; provided further, however, Participant's service subsequent to Plan/Agreement termination shall be recognized for purposes of reducing or eliminating the Age discount provided for by Section 3.1(d). No amendment, including an amendment to this Section 7.5, shall be effective, without the written consent of a Participant, to alter, to the detriment of such Participant, the benefits described in this Plan as applicable to such Participant as of the effective date of such amendment. For purposes of this Section 7.5, an alteration to the detriment of a Participant shall mean a reduction in the amount payable hereunder to a Participant to which such Participant would be entitled if such Participant terminated employment at such time, or any change in the form of benefit payable hereunder to a Participant to which such Participant would be entitled if such Participant terminated employment at such time. Any amendment which reduces a Participant's benefit hereunder to adjust for a change in his or her pension benefit resulting from an amendment to any company-sponsored defined benefit pension plan which changes the pension benefits payable to all employees, shall not require the Participant's consent. Written notice of any amendment shall be given to each Participant.

7.6        Offset.

If at the time payments or installments of payments are to be made hereunder, a Participant or his or her Beneficiary or both are indebted to any SBC company, then the payments remaining to be made to the Participant or his or her Beneficiary or both may, at the discretion of the Board of Directors, be reduced by the amount of such indebtedness; provided, however, that an election by the Board of Directors not to reduce any such payment or payments shall not constitute a waiver of such SBC company's claim for such indebtedness.

7.7        Change in Status.

In the event of a change in the employment status of a Participant to a status in which he is no longer an Eligible Employee, the Participant shall immediately cease to be eligible for any benefits under this Plan except such benefits as had previously vested. Only Participant's Years of Service and Earnings history prior to the change in his employment status shall be taken into account for purposes of determining Participant's vested benefits hereunder. Notwithstanding any other provision of this Plan, the SERP benefit of an Eligible Employee who was a participant in SRIP and whose SRIP benefit is limited by Section 6.7 of SRIP ("Change in Status") shall be calculated based on his or her Years of Service and Earnings history prior to the change in his or her employment status.

8.        Miscellaneous.

8.1        Nonassignability.

Neither a Participant nor any other person shall have any right to commute, sell, assign, transfer, pledge, anticipate, mortgage or otherwise encumber, transfer, hypothecate or convey in advance of actual receipt of the amounts, if any, payable hereunder, or any part thereof, which are, and all rights to which are, expressly declared to be unassignable and non-transferable. No part of the amounts payable shall, prior to actual payment, be subject to seizure or sequestration for the payment of any debts, judgments, alimony or separate maintenance owed by a Participant or any other person, nor be transferable by operation of law in the event of a Participant's or any other person's bankruptcy or insolvency.

8.2 Non-Competition.

Notwithstanding any other provision of this Plan, all benefits provided under the Plan with respect to a Participant shall be forfeited and canceled in their entirety if the Participant, without the consent of SBC and while employed by SBC or any subsidiary thereof or within three (3) years after termination of such employment, engages in competition with SBC or any subsidiary thereof or with any business with which SBC or a subsidiary or affiliated company has a substantial interest (collectively referred to herein as "Employer business") and fails to cease and desist from engaging in said competitive activity within 120 days following receipt of written notice from SBC to Participant demanding that Participant cease and desist from engaging in said competitive activity. For purposes of this Plan, engaging in competition with any Employer business shall mean engaging by the Participant in any business or activity in the same geographical market where the same or substantially similar business or activity is being carried on as an Employer business. Such term shall not include owning a nonsubstantial publicly traded interest as a shareholder in a business that competes with an Employer business. However, engaging in competition with an Employer business shall include representing or providing consulting services to, or being an employee of, any person or entity that is engaged in competition with any Employer business or that takes a position adverse to any Employer business. Accordingly, benefits shall not be provided under this Plan if, within the time period and without the written consent specified, Participant either engages directly in competitive activity or in any capacity in any location becomes employed by, associated with, or renders service to any company, or parent or affiliate thereof, or any subsidiary of any of them, if any of them is engaged in competition with an Employer business, regardless of the position or duties the Participant takes and regardless of whether or not the employing company, or the company that Participant becomes associated with or renders service to, is itself engaged in direct competition with an Employer business.

8.3 Notice.

Any notice required or permitted to be given to the Administrative Committee under the Plan shall be sufficient if in writing and hand delivered, or sent by certified mail, to the principal office of SBC, directed to the

attention of SBC's Senior Executive Vice President responsible for Human Resources matters. Any notice required or permitted to be given to a Participant shall be sufficient if in writing and hand delivered, or sent by certified mail, to Participant at Participant's last known mailing address as reflected on the records of his or her employing company or the company from which the Participant incurred a Termination of Employment, as applicable. Notice shall be deemed given as of the date of delivery or, if delivery is made by mail, as of the date shown on the postmark or on the receipt for certification.

8.4 Validity.

In the event any provision of this Plan is held invalid, void or unenforceable, the same shall not affect, in any respect whatsoever, the validity of any other provision of this plan.

8.5 Applicable Law.

This Plan shall be governed and construed in accordance with the laws of the State of Texas to the extent not preempted by the Employee Retirement Income Security Act of 1974, as amended, and regulations thereunder ("ERISA").

8.6 Plan Provisions in Effect Upon Termination of Employment.

The Plan provisions in effect upon a Participant's Termination of Employment shall govern the provision of benefits to such Participant.

## SUPPLEMENTAL EMPLOYEE RETIREMENT PLAN AGREEMENT

THIS AGREEMENT is made and entered into at San Antonio, Texas as of this \_\_\_\_ day of \_\_\_\_\_, by and between SBC Communications Inc. ("SBC") and \_\_\_\_\_ ("Participant").

WHEREAS, SBC has adopted the 2005 SBC Supplemental Employee Retirement Plan (the "Plan"); and

WHEREAS, the Participant has been determined to be eligible to participate in the Plan; and

WHEREAS, the Plan requires that an agreement be entered into between SBC and Participant setting out certain terms and benefits of the Plan as they apply to the Participant;

NOW, THEREFORE, SBC and the Participant hereby agree as follows:

1. The Plan is hereby incorporated into and made a part of this Agreement as though set forth in full herein. The parties shall be bound by, and have the benefit of, each and every provision of the Plan as set forth in the Plan.
2. The Participant was born on \_\_\_\_\_, and his or her present employment began on \_\_\_\_\_,
3. The Participant's "Retirement Percent" which is described in the Plan shall be \_\_\_\_\_ percent (\_\_\_%)
4. Election as to Form of Benefits. The Participant elects the Benefit Payout Alternative as shown on the 2005 Supplemental Employee Retirement Plan (SERP) Benefit Election form attached hereto and incorporated herein for all purposes (the "Form"). The Participant's election in the Form is irrevocable, and the Participant's election will control the distribution of benefit under the Plan. If the Participant has not elected a Benefit Payout Alternative in the Form, the Participant's form of benefit under the Plan shall be the Life With 10-Year Certain Benefit.

This Agreement supersedes all prior Supplemental Employee Retirement Plan Agreements between SBC and Participant,

and any amendments thereto, and shall inure to the benefit of, and be binding upon, SBC, its successors and assigns, and the Participant and his or her Beneficiaries.  
IN WITNESS WHEREOF, the parties hereto have signed and entered into this Agreement on and as of the date first above written.

SBC COMMUNICATIONS INC.:

By: \_\_\_\_\_  
Senior Executive Vice President-Human Resources  
and Communications

PARTICIPANT:

\_\_\_\_\_

Due Date:

Form SERP-4  
(11/04)

**Supplemental Employee Retirement Plan (SERP) Benefit Election Payout Form**

**Payment Election**

Name: \_\_\_\_\_ Social Security Number: \_\_\_\_\_

**1. Form of Payment**

I hereby elect the following form of benefit for my SERP benefit in accordance with and subject to the terms of the Plan:

- a. \_\_\_\_\_ Life with 10-Year Certain Benefit. Complete Section 5.
- b. \_\_\_\_\_ Joint and 100% Survivor Benefit. Complete Section 5.
- c. \_\_\_\_\_ Joint and 50% Survivor Benefit. Complete Section 5.
- d. \_\_\_\_\_ Lump Sum. Complete Sections 2, 3, 4, & 5. (Only available if age 55 or older at termination of employment).

**Default Distribution:** If a valid payment election is not on file, the form for payment of your benefit shall be the Life with 10-Year Certain Benefit.

**2. Default Form of Payment if Lump Sum Elected but Termination of Employment Prior to Attaining Age 55**

If I elected a lump sum payment, above (option 1(d)) and I am NOT age 55 or over at my Termination of Employment, I hereby elect the following form of benefit for my SERP benefit in accordance with and subject to the terms of the Plan:

- a. \_\_\_\_\_ Life with 10-Year Certain Benefit. Complete Section 5.
- b. \_\_\_\_\_ Joint and 100% Survivor Benefit. Complete Section 5.
- c. \_\_\_\_\_ Joint and 50% Survivor Benefit. Complete Section 5.

**3. Amount of Lump Sum Benefit Paid Upon Termination of Employment**

You may elect to receive between 0% and 30% of your lump sum benefit six months following your Termination of Employment, and the remainder at any time up to the twentieth (20<sup>th</sup>) anniversary of your Termination of Employment. Please indicate below the portion of your lump sum that you wish to receive six months following your Termination of Employment:

I wish to receive \_\_\_\_\_% (not more than 30%) six months following my Termination of Employment.

Any portion of your unpaid balance will accrue interest. Complete Section 4.

**Additional Lump Sum Election if I Retire at age 60 or Older**

(I wish to receive 100% of my lump sum benefit six months following my retirement at age 60 or older and agree in writing, by signing Attachment B provided as part of this election, not to compete with an Employer Business within the meaning of Section 8.2 of the Plan for a period of three (3) years from my Termination of Employment.

Complete and Sign Attachment B and Complete Section 5.

**4. Distribution Election for Unpaid Lump Sum and Accrued Interest ("Unpaid Balance")**

Please indicate how you would like your unpaid balance distributed.

- Complete Section 4a if you wish to receive monthly interest only payments. You must also complete Section 4b to elect how to receive your remaining deferred balance.
- Complete Section 4b to specify distribution of your unpaid balance. You may not elect to receive more than 30% of your SERP benefit prior to the third anniversary of your termination of employment.
- The unpaid balance must be distributed no later than the 20th anniversary of your retirement.

- If applicable, the dates you complete in Section a and b cannot overlap.

a. **Interest Paid Monthly**

Please distribute interest on my unpaid balance, paid monthly commencing \_\_\_\_\_(month/year) through \_\_\_\_\_(month/year); provided, however, no distributions will be made prior to the 6 month anniversary of my termination of employment.

**Note: Also complete Section 4b to elect payment of unpaid balance.**

b. **Ratable Distribution Over a Period of Years**

Please make an annual payment of my unpaid balance on March 1<sup>st</sup> of each year paid for \_\_\_\_\_ (insert number from 1 through 20) year(s) commencing \_\_\_\_\_(insert year). Please choose one distribution method as follows:

- Paid ratably for the period(s) selected in 4b. (e.g. 1/20<sup>th</sup>, 1/19<sup>th</sup>, 1/18<sup>th</sup> .... assuming payment is requested over 20 years).
- Paid in equal annual installments for the period(s) selected in 4b.

***Note: You may not request more than 30% of your lump sum within 36 months following retirement.***

Complete Section 5.

**5. Authorization**

I hereby authorize and make the above elections.

Signature\_\_\_\_\_

Date\_\_\_\_\_

Please return to Executive Compensation Staff  
175 E. Houston, 3-N-1, San Antonio, Texas 78205



## LUMP SUM DISTRIBUTION AGREEMENT

This Lump Sum Distribution Agreement is made as of the \_\_\_\_ day of \_\_\_\_\_, 2004 by and between SBC Communications Inc. ("SBC" or the "Company") and **[NAME OF PARTICIPANT]**. Unless otherwise indicated herein, capitalized words used herein shall have the same meaning ascribed to such words in the 2005 Supplemental Employee Retirement Plan (the "Plan" or "SERP").

WHEREAS, **[NAME OF PARTICIPANT]** is a Participant in the Plan, which is sponsored by the Company;

WHEREAS, pursuant to the Plan, **[NAME OF PARTICIPANT]** executed an Agreement, governing **[NAME OF PARTICIPANT]**'s benefits in the Plan;

WHEREAS, **[NAME OF PARTICIPANT]**'s Agreement provides for the distribution of **[his/her]** benefits in the form of a lump sum, payable one hundred percent (100%) upon the six (6) month anniversary of **[his/her]** Termination of Employment provided that **[NAME OF PARTICIPANT]** is age sixty (60) or older as of the date of **[his/her]** Termination of Employment and **[NAME OF PARTICIPANT]** agrees not to compete with an Employer Business;

NOW, THEREFORE, the parties hereto, for good and valuable consideration, the sufficiency of which is hereby acknowledged, hereby agree as follows:

1. If **[NAME OF PARTICIPANT]** is age sixty (60) or over as of the date of his Termination of Employment, Company shall pay to **[NAME OF PARTICIPANT]** **[his/her]** benefits under the Plan in the form of a lump sum distribution, one hundred percent (100%) of which shall be paid upon the six (6) month anniversary of **[NAME OF PARTICIPANT]**'s Termination of Employment.
2. In exchange for the right to receive the payment described in Paragraph 1, above, **[NAME OF PARTICIPANT]** acknowledges and agrees that **[he/she]** shall not without the written consent of Company, within three (3) years after Termination of Employment, engage in competition with SBC or with any business with which SBC or a subsidiary of SBC or an affiliated company has a substantial interest (collectively referred to herein as "Employer business"). For purposes of this Lump Sum Distribution Agreement, engaging in competition with any Employer business shall mean **[NAME OF PARTICIPANT]**'s engaging in any business or activity in the same geographical market where the same or substantially similar business or activity is being carried on as an Employer business. Such term shall not include owning a nonsubstantial publicly traded interest as a shareholder in a business that competes with an Employer business. However, it is hereby specifically agreed that engaging in competition with an Employer business shall include representing or providing consulting services to, or being an employee of, any person or entity that is engaged in competition with any Employer business or that takes a position adverse to any Employer business. **[NAME OF PARTICIPANT]** hereby specifically agrees not to engage in any such conduct. **[NAME OF PARTICIPANT]** also specifically agrees that a breach of this provision would result if, within the time period and without the written consent specified, **[NAME OF PARTICIPANT]** either engages directly in competitive activity or in any capacity in

any location becomes employed by, associated with, or renders service to any company, or parent or affiliate thereof, or any subsidiary of any of them, if any of them is engaged in competition with an Employer business, regardless of the position or duties [NAME OF PARTICIPANT] takes and regardless of whether or not the employing company, or the company that [NAME OF PARTICIPANT] becomes associated with or renders service to, is itself engaged in direct competition with an Employer business.

3. [NAME OF PARTICIPANT] acknowledges and agrees that he shall promptly return to the Company and forfeit all consideration previously received pursuant to this Lump Sum Distribution Agreement, specifically the payment referred to in Paragraph 1, if he engages in competition with an Employer business in violation of the provisions of Paragraph 2.
4. [NAME OF PARTICIPANT] may submit a description of any proposed activity in writing to SBC and SBC shall advise [NAME OF PARTICIPANT] in writing within ten business days whether such proposed activity would constitute engaging in competition with an Employer business, within the meaning of this Lump Sum Distribution Agreement.
5. It is hereby specifically agreed that the terms of this Lump Sum Distribution Agreement shall be kept strictly confidential and that neither party shall, except as necessary for performance of the terms hereof or as specifically required by law, disclose the existence of this Lump Sum Distribution Agreement or any of its terms to third persons without the express consent of the other party.

[NAME OF PARTICIPANT] agrees that for any breach or threatened breach of any of the provisions of this Lump Sum Distribution Agreement by [NAME OF PARTICIPANT], the Company shall have no adequate legal remedy, and in addition to any other remedies available, including the repayment and forfeiture remedies described in Paragraph 3, a restraining order and/or an injunction may be issued against [NAME OF PARTICIPANT] to prevent or restrain any such breach.

6. Any notice required hereunder to be given by either party will be in writing and will be deemed effectively given upon personal delivery to the party to be notified, or five (5) days after deposit with the United States Post Office by certified mail, postage prepaid, to the other party at the address set forth below, or to such other address as either party may from time to time designate by ten (10) days advance written notice pursuant to this Paragraph.
7. In the event any provision of this Lump Sum Distribution Agreement is held invalid, void, or unenforceable, the same shall not affect in any respect whatsoever the validity of any other provision of this Lump Sum Distribution Agreement, except that should any part of the non-compete provisions of Paragraph 2 of this Agreement be held invalid, void, or unenforceable as applicable to and as asserted by [NAME OF PARTICIPANT], this Lump Sum Distribution Agreement, at the Company's option, may be declared by the Company null and void. If this Lump Sum Distribution Agreement is declared null and void by Company pursuant to the provisions of this Paragraph, [NAME OF PARTICIPANT] shall return to

Company all consideration previously received pursuant to this Lump Sum Distribution Agreement.

SBC Communications Inc.

\_\_\_\_\_  
By: \_\_\_\_\_  
\_\_\_\_\_  
175 E. Houston, Suite \_\_\_\_\_  
San Antonio, Texas 78205

\_\_\_\_\_  
[NAME OF PARTICIPANT]

\_\_\_\_\_  
Date

\_\_\_\_\_  
Date



**AT&T 1997 LONG TERM INCENTIVE PROGRAM**  
 (as amended May 19, 1999 and March 14, 2000)

**SECTION 1. PURPOSE.** The purposes of the AT&T 1997 Long Term Incentive Program (the "Plan") are to encourage selected employees and Non-Employee Directors of AT&T Corp. (the "Company") and its Affiliates to acquire a proprietary and vested interest in the growth and performance of the Company, to generate an increased incentive to contribute to the Company's future success and prosperity, thus enhancing the value of the Company for the benefit of shareholders, and to enhance the ability of the Company and its Affiliates to attract and retain individuals of exceptional managerial talent upon whom, in large measure, the sustained progress, growth and profitability of the Company depends.

**SECTION 2. DEFINITIONS.** As used in the Plan, the following terms shall have the meanings set forth below:

- (a) "Affiliate" shall mean (i) any Person that directly, or through one or more intermediaries, controls, or is controlled by, or is under common control with, the Company or (ii) any entity in which the Company has a significant equity interest, as determined by the Committee.
- (b) "Award" shall mean any Option, Stock Appreciation Right, Restricted Stock Award, Performance Share, Performance Unit, Dividend Equivalent, Other Stock Unit Award, or any other right, interest, or option relating to Shares or other property granted pursuant to the provisions of the Plan.
- (c) "Award Agreement" shall mean any written agreement, contract, or other instrument or document evidencing any Award granted by the Committee hereunder, which may, but need not, be executed or acknowledged by both the Company and the Participant.
- (d) "Board" shall mean the Board of Directors of the Company.
- (e) "Change in Control" shall mean the happening of any of the following events:
  - (i) An acquisition by any individual, entity or group (within the meaning of Section 13 (d) (3) or 14 (d) (2) of the Exchange Act) (an "Entity") of beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of 20% or more of either (A) the then outstanding AT&T Shares (the "Outstanding Company Common Stock") or (B) the combined voting power of the then outstanding voting securities of the Company entitled to vote generally in the election of directors (the "Outstanding Company Voting Securities"); excluding, however, the following: (1) any acquisition directly from the Company, other than an acquisition by virtue of the exercise of a conversion privilege unless the security being so converted was itself acquired directly from the Company, (2) any acquisition by the Company, (3) any acqui-

sition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company, or (4) any acquisition by any corporation pursuant to a transaction which complies with clauses (A), (B) and (C) of subsection (iii) of this Section 2(e);

(ii) A change in the composition of the Board such that the individuals who, as of the effective date of the Plan, constitute the Board (such Board shall be hereinafter referred to as the "Incumbent Board") cease for any reason to constitute at least a majority of the Board;provided, however, that for purposes of this definition, any individual who becomes a member of the Board subsequent to the effective date of the Plan, whose election, or nomination for election, by the Company's stockholders was approved by a vote of at least a majority of those individuals who are members of the Board and who were also members of the Incumbent Board (or deemed to be such pursuant to this proviso) shall be considered as though such individual were a member of the Incumbent Board; andprovided, further however, that any such individual whose initial assumption of office occurs as a result of or in connection with either an actual or threatened election contest (as such terms are used in Rule 14a-11 of Regulation 14A promulgated under the Exchange Act) or other actual or threatened solicitation of proxies or consents by or on behalf of an Entity other than the Board shall not be so considered as a member of the Incumbent Board;

(iii) The approval by the stockholders of the Company of a merger, reorganization or consolidation or sale or other disposition of all or substantially all of the assets of the Company (each, a "Corporate Transaction") or, if consummation of such Corporate Transaction is subject, at the time of such approval by stockholders, to the consent of any government or governmental agency, the obtaining of such consent (either explicitly or implicitly by consummation); excluding however, such a Corporate Transaction pursuant to which (A) all or substantially all of the individuals and entities who are the beneficial owners, respectively, of the Outstanding Company Common Stock and Outstanding Company Voting Securities immediately prior to such Corporate Transaction will beneficially own, directly or indirectly, more than 60% of, respectively, the outstanding shares of common stock, and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of the corporation resulting from such Corporate Transaction (including, without limitation, a corporation or other Person which as a result of such transaction owns the Company or all or substantially all of the Company's assets either directly or through one or more subsidiaries (a "Parent Company")) in substantially the same proportions as their ownership, immediately prior to such Corporate Transaction, of the Outstanding Company Common Stock and Outstanding Company Voting Securities, as the case may be, (B) no Entity (other than the Company, any employee benefit plan (or related trust) of the Company, such corporation resulting from such Corporate Transaction or, if reference was made to equity ownership of any Parent Company for purposes of determining whether clause (A) above is satisfied in connection with the applicable Corporate Transaction, such Parent Company) will beneficially own, directly or indirectly, 20% or more of, respectively, the outstanding shares of common stock of the corporation resulting from such Corporate Transaction or the combined voting power of the outstanding voting securities of such corporation entitled to vote generally in the election of directors unless such ownership resulted solely from ownership of securities of the Company prior to the Corporate Transaction, and (C) individuals who were members of the Incumbent Board will immediately after the consummation of the Corporate Transaction constitute at least a majority of the members of the board of directors of the corporation resulting from such Corporate Transaction (or, if reference was made to equity ownership of any Parent Company for purposes

of determining whether clause (A) above is satisfied in connection with the applicable Corporate Transaction, of the Parent Company); or

(iv) The approval by the stockholders of the Company of a complete liquidation or dissolution of the Company.

(f) "Change in Control Price" means, with respect to an AT&T Share or a Wireless Group Share, as the case may be, the higher of (A) the highest reported sales price, regular way, of such Share in any transaction reported on the New York Stock Exchange Composite Tape or other national exchange on which such Shares are listed or on NASDAQ during the 60-day period prior to and including the date of a Change in Control or (B) if the Change in Control is the result of a tender or exchange offer or a Corporate Transaction, the highest price per such Share paid in such tender or exchange offer or Corporate Transaction; ~~provided however~~, that in the case of Incentive Stock Options and Stock Appreciation Rights relating to Incentive Stock Options, the Change in Control Price shall be the Fair Market Value of such Share on the date such Incentive Stock Option or Stock Appreciation Right is exercised or deemed exercised pursuant to Section 11(b). To the extent that the consideration paid in any such transaction described above consists all or in part of securities or other noncash consideration, the value of such securities or other noncash consideration shall be determined in the sole discretion of the Board.

(g) "Code" shall mean the Internal Revenue Code of 1986, as amended from time to time, and any successor thereto.

(h) "Committee" shall mean the Compensation and Employee Benefits Committee of the Board, or any successor to such committee, composed of no fewer than two directors each of whom is a Non-Employee Director and an "outside director" within the meaning of Section 162(m) of the Code, or any successor provision thereto.

(i) "Company" shall mean AT&T Corp., a New York corporation.

(j) "Covered Employee" shall mean a "covered employee" within the meaning of Section 162(m)(3) of the Code, or any successor provision thereto.

(k) "Employee" shall mean any employee of the Company or of any Affiliate. Unless otherwise determined by the Committee in its sole discretion, for purposes of the Plan, an employee shall be considered to have terminated employment and to have ceased to be an Employee if his or her employer ceases to be an Affiliate, even if he or she continues to be employed by such employer.

(l) "Exchange Act" shall mean the Securities Exchange Act of 1934, as amended.

(m) "Fair Market Value" shall mean, with respect to any property, the market value of such property determined by such methods or procedures as shall be established from time to time by the Committee.

(n) "Incentive Stock Option" shall mean an Option granted under Section 6 hereof that is intended to meet the requirements of Section 422 of the Code or any successor provision thereto.

(o) "Non-Employee Director" shall have the meaning set forth in Rule 16b-3(b)(3) promulgated by the Securities and Exchange Commission under the Exchange Act, or any successor definition adopted by the Securities and Exchange Commission.

(p) "Nonstatutory Stock Option" shall mean an Option granted under Section 6 hereof that is not intended to be an Incentive Stock Option.

(q) "Option" shall mean any right granted to a Participant under the Plan allowing such Participant to purchase Shares at such price or prices and during such period or periods as the Committee shall determine.

(r) "Other Stock Unit Award" shall mean any right granted to a Participant by the Committee pursuant to Section 10 hereof.

(s) "Participant" shall mean an Employee or Non-Employee Director who is selected by the Committee to receive an Award under the Plan.

(t) "Performance Award" shall mean any Award of Performance Shares or Performance Units pursuant to Section 9 hereof.

(u) "Performance Period" shall mean that period established by the Committee at the time any Performance Award is granted or at any time thereafter during which any performance goals specified by the Committee with respect to such Award are to be measured.

(v) "Performance Share" shall mean any grant pursuant to Section 9 hereof of a unit valued by reference to a designated number of Shares, which value may be paid to the Participant by delivery of such property as the Committee shall determine, including, without limitation, cash, Shares, or any combination thereof, upon achievement of such performance goals during the Performance Period as the Committee shall establish at the time of such grant or thereafter.

(w) "Performance Unit" shall mean any grant pursuant to Section 9 hereof of a unit valued by reference to a designated amount of property other than Shares, which value may be paid to the Participant by delivery of such property as the Committee shall determine, including, without limitation, cash, Shares, or any combination thereof, upon achievement of such performance goals during the Performance Period as the Committee shall establish at the time of such grant or thereafter.

(x) "Person" shall mean any individual, corporation, partnership, association, joint-stock company, trust, unincorporated organization, or government or political subdivision thereof.

(y) "Restricted Stock" shall mean any Share issued with the restriction that the holder may not sell, transfer, pledge, or assign such Share and with such other restrictions as the Committee, in its sole discretion, may impose (including, without limitation, any restriction on the right to vote such Share, and the right to receive any cash dividends), which restrictions may lapse separately or in combination at such time or times, in installments or otherwise, as the Committee may deem appropriate.

(z) "Restricted Stock Award" shall mean an award of Restricted Stock under Section 8 hereof.

(Aa) "Senior Manager" shall mean any Employee of the Company or any Affiliate holding a position above E band or any future salary band that is the equivalent thereof.

(Bb) "Shares" shall mean, collectively or as the case may be, (i) the shares of AT&T Common Stock of the Company, \$1.00 par value ("AT&T Shares"), and (ii) the shares of Wireless Group Common Stock of the Company, \$1.00 par value ("Wireless Group Shares"). "Outstanding Wireless Group Shares" shall mean, as at any date of determination, the sum of (i) the total issued and outstanding Wireless Group Shares, plus (ii) the number of Wireless Group Shares represented by the inter-group interest held by the "AT&T Common Stock Group" (as described the Company's Proxy Statement dated January 26, 2000). The numbers of AT&T Shares referred to in the Plan have been adjusted to reflect the Company's 3 for 2 stock split effective April 15, 1999.

(Cc) "Stock Appreciation Right" shall mean any right granted to a Participant pursuant to Section 7 hereof to receive, upon exercise by the Participant, the excess of (i) the Fair Market Value of one Share on the date of exercise or, if the Committee shall so determine in the case of any such right other than one related to any Incentive Stock Option, at any time during a specified period before the date of exercise over (ii) the grant price of the right on the date of grant, or if granted in connection with an outstanding Option on the date of grant of the related Option, as specified by the Committee in its sole discretion, which, except in the case of Substitute Awards or in connection with an adjustment provided in Section 4(e), shall not be less than the Fair Market Value of one Share on such date of grant of the right or the related Option, as the case may be. Any payment by the Company in respect of such right may be made in cash, Shares, other property, or any combination thereof, as the Committee, in its sole discretion, shall determine.

(Dd) "Subsidiary" shall mean any corporation (other than the Company) in an unbroken chain of corporations beginning with the Company if, at the time of the granting of the Award, each of the corporations other than the last corporation in the unbroken chain owns stock possessing 50 percent or more of the total combined voting power of all classes of stock in one of the other corporations in the chain.

(Ee) "Substitute Awards" shall mean Awards granted or Shares issued by the Company in assumption of, or in substitution or exchange for, awards previously granted, or the right or obligation to make future awards, by a company acquired by the Company or with which the Company combines.

**SECTION 3. ADMINISTRATION.** The Plan shall be administered by the Committee. The Committee shall have full power and authority, subject to such orders or resolutions not inconsistent with the provisions of the Plan as may from time to time be adopted by the Board, to: (i) select the Employees of the Company and its Affiliates and Non-Employee Directors of the Company to whom Awards may from time to time be granted hereunder; (ii) determine the type or types of Award to be granted to each Participant hereunder; (iii) determine the number of Shares to be covered by each Award granted hereunder; (iv) determine the terms and conditions,



not inconsistent with the provisions of the Plan, of any Award granted hereunder; (v) determine whether, to what extent and under what circumstances Awards may be settled in cash, Shares or other property or canceled or suspended; (vi) determine whether, to what extent and under what circumstances cash, Shares and other property and other amounts payable with respect to an Award under this Plan shall be deferred either automatically or at the election of the Participant; (vii) interpret and administer the Plan and any instrument or agreement entered into under the Plan; (viii) establish such rules and regulations and appoint such agents as it shall deem appropriate for the proper administration of the Plan; and (ix) make any other determination and take any other action that the Committee deems necessary or desirable for administration of the Plan. Decisions of the Committee shall be final, conclusive and binding upon all persons, including the Company, any Participant, any shareholder, and any employee of the Company or of any Affiliate. A majority of the members of the Committee may determine its actions and fix the time and place of its meetings. Notwithstanding the foregoing or anything else to the contrary in the Plan, any action or determination by the Committee specifically affecting or relating to an Award to a Non-Employee Director shall be approved and ratified by the Board.

#### **SECTION 4. SHARES SUBJECT TO THE PLAN.**

(a) Subject to adjustment as provided in Section 4(e), a total of twenty-two and one half (22.5) million AT&T Shares shall be available for a one time grant of Options to substantially all Employees during 1997. Shares available for such one time grant of Options, but not used for such Options, shall be available for other Awards under the Plan, in 1997 or later years.

(b) In addition to the number of AT&T Shares available under Section 4(a), and subject to adjustment as provided in Section 4(e), a total of (i) one hundred twenty-seven and one half (127.5) million AT&T Shares, and (ii) a number of Wireless Group Shares equal to 5.00% of the number of Outstanding Wireless Group Shares shall be available for Awards granted under the Plan; ~~provided that~~, commencing on January 1, 2000 and on each subsequent January 1 throughout the term of the Plan, an additional number of AT&T Shares shall be added to the number of AT&T Shares available for Awards granted under the Plan, which additional number of AT&T Shares shall be calculated by multiplying (x) the number of AT&T Shares outstanding on such January 1, by (y) 1.75%; ~~provided, further~~, that the number of AT&T Shares available for Awards other than Options and/or Stock Appreciation Rights shall not exceed thirty-seven and one half (37.5) million; and provided further that, commencing on January 1, 2001 and on each subsequent January 1 throughout the term of the Plan, an additional number of Wireless Group Shares shall be added to the number of Wireless Group Shares available for Awards granted under the Plan, which additional number of Wireless Group Shares shall be calculated by multiplying (x) the number of Outstanding Wireless Group Shares on such January 1, by (y) 2.00%; ~~provided, further~~, that the number of Wireless Group Shares available for Awards other than Options and/or Stock Appreciation Rights shall not exceed 1.25% of the number of Outstanding Wireless Group Shares; and ~~provided, further~~, that if any Shares subject to an Award or to an award under the Company's 1987 Long Term Incentive Program or 1984 Stock Option Plan (the "Prior Plans") are forfeited or if any Award or award under the Prior Plans based on Shares is settled for cash, or expires or otherwise is terminated without issuance of such Shares, the Shares subject to such Award shall to the extent of such cash settlement, forfeiture or termination again be available for Awards under the Plan. In the event that any Option or other Award granted hereunder is exercised through the delivery of Shares or in the event that

withholding tax liabilities arising from such Option or other Award are satisfied by the withholding of Shares by the Company, the number of Shares available for Awards under the Plan shall be increased by the number of Shares so surrendered or withheld. In addition, Substitute Awards shall not reduce the Shares available for grants under the Plan or to a Participant in any calendar year.

(c) In addition to the number of Wireless Group Shares available under Section 4(b), and subject to adjustment as provided in Section 4(e), such additional number of Wireless Group Shares as are required for Awards as an adjustment to existing Awards under the Plan based upon AT&T Shares as the result of any distribution of Wireless Group Shares to holders of AT&T Shares as more fully described in the Company's Proxy Statement dated January 26, 2000.

(d) Any Shares issued hereunder may consist, in whole or in part, of authorized and unissued shares, treasury shares, or shares purchased in the open market or otherwise.

(ed) In the event of any merger, reorganization, consolidation, recapitalization, stock dividend, stock split, reverse stock split, spin-off or similar transaction or other change in corporate structure affecting the Shares, such adjustments and other substitutions shall be made to the Plan and to Awards as the Committee in its sole discretion deems equitable or appropriate, including without limitation such adjustments in the aggregate number, class and kind of securities which may be delivered under the Plan, in the aggregate or to any one Participant, in the number, class, kind and option or exercise price of securities subject to outstanding Options, Stock Appreciation Rights or other Awards granted under the Plan, and in the number, class and kind of securities subject to Awards granted under the Plan (including, if the Committee deems appropriate, the substitution of similar options to purchase the shares of, or other awards denominated in the shares of, another company) as the Committee may determine to be appropriate in its sole discretion, provided that the number of Shares subject to any Award shall always be a whole number.

**SECTION 5. ELIGIBILITY.** Any Employee or Non-Employee Director shall be eligible to be selected as a Participant, provided, however, that Incentive Stock Options shall only be awarded to Employees of the Company.

**SECTION 6. STOCK OPTIONS.** Options may be granted hereunder to Participants either alone or in addition to other Awards granted under the Plan. Any Option granted under the Plan shall be evidenced by an Award Agreement in such form as the Committee may from time to time approve. Any such Option shall be subject to the following terms and conditions and to such additional terms and conditions, not inconsistent with the provisions of the Plan, as the Committee shall deem desirable:

(a) **OPTION PRICE.** The purchase price per Share purchasable under an Option shall be determined by the Committee in its sole discretion; provided that, except in the case of Substitute Awards or in connection with an adjustment provided for in Section 4(e), such purchase price shall not be less than the Fair Market Value of the Share on the date of the grant of the Option.

(b) **OPTION PERIOD.** The term of each Option shall be fixed by the Committee in its sole discretion;provided that no Option shall be exercisable after the expiration of ten years from the date the Option is granted.

(c) **EXERCISABILITY.** Options shall be exercisable at such time or times as determined by the Committee at or subsequent to grant.

(d) **METHOD OF EXERCISE.** Subject to the other provisions of the Plan, any Option may be exercised by the Participant in whole or in part at such time or times, and the Participant may make payment of the option price in such form or forms, including, without limitation, payment by delivery of cash, Shares or other consideration (including, where permitted by law and the Committee, Awards) having a Fair Market Value on the exercise date equal to the total option price, or by any combination of cash, Shares and other consideration as the Committee may specify in the applicable Award Agreement.

(e) **INCENTIVE STOCK OPTIONS.** In accordance with rules and procedures established by the Committee, and except as otherwise provided in Section 11, the aggregate Fair Market Value (determined as of the time of grant) of the Shares with respect to which Incentive Stock Options held by any Participant which are exercisable for the first time by such Participant during any calendar year under the Plan (and under any other benefit plans of the Company or any Subsidiary) shall not exceed \$100,000 or, if different, the maximum limitation in effect at the time of grant under Section 422 of the Code, or any successor provision, and any regulations promulgated thereunder. Incentive Stock Options shall be granted only to participants who are employees of the Company or a Subsidiary of the Company. The terms of any Incentive Stock Option granted hereunder shall comply in all respects with the provisions of Section 422 of the Code, or any successor provision, and any regulations promulgated thereunder. The aggregate number of Shares with respect to which Incentive Stock Options may be granted under the Plan shall not exceed (i) seventy-five (75) million in the case of AT&T Shares, and (ii) 50.00% of the aggregate number of all Wireless Group Shares available for Awards under the Plan in the case of Wireless Group Shares.

(f) **FORM OF SETTLEMENT.** In its sole discretion, the Committee may provide, at the time of grant, that the Shares to be issued upon an Option's exercise shall be in the form of Restricted Stock or other similar securities, or may reserve the right so to provide after the time of grant.

**SECTION 7. STOCK APPRECIATION RIGHTS.** Stock Appreciation Rights may be granted hereunder to Participants either alone or in addition to other Awards granted under the Plan and may, but need not, relate to a specific Option granted under Section 6. The provisions of Stock Appreciation Rights need not be the same with respect to each recipient. Any Stock Appreciation Right related to a Nonstatutory Stock Option may be granted at the same time such Option is granted or at any time thereafter before exercise or expiration of such Option. Any Stock Appreciation Right related to an Incentive Stock Option must be granted at the same time such Option is granted. In the case of any Stock Appreciation Right related to any Option, the Stock Appreciation Right or applicable portion thereof shall terminate and no longer be exercisable upon the termination or exercise of the related Option, except that a Stock Appreciation Right granted with respect to less than the full number of Shares covered by a related Option shall not be reduced until the exercise or termination of the related Option exceeds

the number of Shares not covered by the Stock Appreciation Right. Any Option related to any Stock Appreciation Right shall no longer be exercisable to the extent the related Stock Appreciation Right has been exercised. The Committee may impose such conditions or restrictions on the exercise of any Stock Appreciation Right as it shall deem appropriate, provided that no Stock Appreciation Right shall have a term that is longer than ten (10) years.

#### **SECTION 8. RESTRICTED STOCK.**

(a) **ISSUANCE.** A Restricted Stock Award shall be subject to restrictions imposed by the Committee during a period of time specified by the Committee (the "Restriction Period"). Restricted Stock Awards may be issued hereunder to Participants, for no cash consideration or for such minimum consideration as may be required by applicable law, either alone or in addition to other Awards granted under the Plan. The provisions of Restricted Stock Awards need not be the same with respect to each recipient.

(b) **REGISTRATION.** Any Restricted Stock issued hereunder may be evidenced in such manner as the Committee in its sole discretion shall deem appropriate, including, without limitation, book-entry registration or issuance of a stock certificate or certificates. In the event any stock certificate is issued in respect of shares of Restricted Stock awarded under the Plan, such certificate shall be registered in the name of the Participant, and shall bear an appropriate legend referring to the terms, conditions, and restrictions applicable to such Award.

(c) **FORFEITURE.** Except as otherwise determined by the Committee at the time of grant or thereafter, upon termination of employment for any reason during the restriction period, all Shares of Restricted Stock still subject to restriction shall be forfeited by the Participant and reacquired by the Company. Unrestricted Shares, evidenced in such manner as the Committee shall deem appropriate, shall be issued to the grantee promptly after the period of forfeiture, as determined or modified by the Committee, shall expire.

(d) **MINIMUM VESTING CONDITION.** The minimum Restriction Period applicable to any Restricted Stock Award that is not subject to performance conditions restricting transfer shall be three (3) years from the date of grant; provided, however, that a Restriction Period of less than three (3) years may be approved under the Plan for such Awards with respect to (i) up to twelve (12) million AT&T Shares, and (ii) up to 0.50% of the Outstanding Wireless Group Shares.

**SECTION 9. PERFORMANCE AWARDS.** Performance Awards may be issued hereunder to Participants, for no cash consideration or for such minimum consideration as may be required by applicable law, either alone or in addition to other Awards granted under the Plan. The performance criteria to be achieved during any Performance Period and the length of the Performance Period shall be determined by the Committee upon the grant of each Performance Award. Except as provided in Section 11, Performance Awards will be distributed only after the end of the relevant Performance Period. Performance Awards may be paid in cash, Shares, other property or any combination thereof, in the sole discretion of the Committee at the time of payment. The performance levels to be achieved for each Performance Period and the amount of the Award to be distributed shall be conclusively determined by the Committee. Performance Awards may be paid in a lump sum or in installments following the close of the Performance Period or, in accordance with procedures established by the Committee, on a deferred basis.

#### **SECTION 10. OTHER STOCK UNIT AWARDS.**

(a) **STOCK AND ADMINISTRATION.** Other Awards of Shares and other Awards that are valued in whole or in part by reference to, or are otherwise based on, Shares or other property ("Other Stock Unit Awards") may be granted hereunder to Participants, either alone or in addition to other Awards granted under the Plan. Other Stock Unit Awards may be paid in Shares, cash or any other form of property as the Committee shall determine. Subject to the provisions of the Plan, the Committee shall have sole and complete authority to determine the Employees of the Company and its Affiliates and Non-Employee Directors to whom and the time or times at which such Awards shall be made, the number of Shares to be granted pursuant to such Awards, and all other conditions of the Awards. The provisions of Other Stock Unit Awards need not be the same with respect to each recipient.

(b) **TERMS AND CONDITIONS.** Subject to the provisions of this Plan and any applicable Award Agreement, Awards and Shares subject to Awards made under this Section 10, may not be sold, assigned, transferred, pledged or otherwise encumbered prior to the date on which the Shares are issued, or, if later, the date on which any applicable restriction, performance or deferral period lapses. For any Award or Shares subject to any Award made under this Section 10 the transferability of which is conditioned only on the passage of time, such restriction period shall be a minimum of three (3) years. Shares (including securities convertible into Shares) subject to Awards granted under this Section 10 may be issued for no cash consideration or for such minimum consideration as may be required by applicable law. Shares (including securities convertible into Shares) purchased pursuant to a purchase right awarded under this Section 10 shall be purchased for such consideration as the Committee shall in its sole discretion determine, which, except in the case of Substitute Awards, shall not be less than the Fair Market Value of such Shares or other securities as of the date such purchase right is awarded.

#### **SECTION 11. CHANGE IN CONTROL PROVISIONS.**

(a) **IMPACT OF EVENT.** Notwithstanding any other provision of the Plan to the contrary, unless the Committee shall determine otherwise at the time of grant with respect to a particular Award, in the event of a Change in Control:

(i) any Options and Stock Appreciation Rights outstanding as of the date such Change in Control is determined to have occurred, and which are not then exercisable and vested, shall become fully exercisable and vested to the full extent of the original grant;

(ii) the restrictions and deferral limitations applicable to any Restricted Stock shall lapse, and such Restricted Stock shall become free of all restrictions and limitations and become fully vested and transferable to the full extent of the original grant;

(iii) all Performance Awards shall be considered to be earned and payable in full, and any deferral or other restriction shall lapse and such Performance Awards shall be immediately settled or distributed; and

(iv) The restrictions and deferral limitations and other conditions applicable to any Other Stock Unit Awards or any other Awards shall lapse, and such Other Stock Unit Awards or such other Awards shall become free of all restrictions, limitations or conditions and become fully vested and transferable to the full extent of the original grant.

(b) CHANGE IN CONTROL CASH-OUT. Notwithstanding any other provision of the Plan, during the 60-day period from and after a Change in Control (the "Exercise Period"), if the Committee shall determine at, or at any time after, the time of grant, a Participant holding an Option or Stock Appreciation Right shall have the right, whether or not the Option or Stock Appreciation Right is fully exercisable and in lieu of the payment of the purchase price for the Shares being purchased under the Option or Stock Appreciation Right and by giving notice to the Company, to elect (within the Exercise Period) to surrender all or part of the Option or Stock Appreciation Right to the Company and to receive cash, within 30 days of such notice, in an amount equal to the amount by which the Change in Control Price per Share on the date of such election shall exceed the purchase price per Share under the Option or Stock Appreciation Right (the "Spread") multiplied by the number of Shares granted under the Option or Stock Appreciation right as to which the right granted under this Section 11(b) shall have been exercised.

(c) Notwithstanding any other provision of this Plan, if any right granted pursuant to this Plan would make a Change in Control transaction ineligible for pooling-of-interests accounting under APB No. 16, that (after giving effect to any other actions taken to cause such transaction to be eligible for such pooling-of-interests accounting treatment) but for the nature of such right would otherwise be eligible for such accounting treatment, the Committee shall have the ability to substitute for the cash payable pursuant to such right Shares with a Fair Market Value equal to the cash that would otherwise be payable pursuant thereto.

## **SECTION 12. CODE SECTION 162(m) PROVISIONS.**

(a) Notwithstanding any other provision of this Plan, if the Committee determines at the time Restricted Stock, a Performance Award or an Other Stock Unit Award is granted to a Participant who is then a Senior Manager or an E band employee that such Participant is, or is likely to be as of the end of the tax year in which the Company would claim a tax deduction in connection with such Award, a Covered Employee, then the Committee may provide that this Section 12 is applicable to such Award.

(b) If an Award is subject to this Section 12, then the lapsing of restrictions thereon and the distribution of cash, Shares or other property pursuant thereto, as applicable, shall be subject to the achievement of one or more objective performance goals established by the Committee, which shall be based on the attainment of specified levels of one or any combination of the following: net cash provided by operating activities, earnings per share from continuing operations, operating income, revenues, gross margin, return on operating assets, return on equity, economic value added, stock price appreciation, total stockholder return, or cost control, of the Company or the Affiliate or division of the Company for or within which the Participant is primarily employed. Such performance goals also may be based upon the achievement of specified levels of Company performance (or performance of applicable Affiliate or division of the Company) under one or more of the measures described above relative to the performance of

other corporations. Such performance goals shall be set by the Committee within the time period prescribed by, and shall otherwise comply with the requirements of, Section 162(m) of the Code, or any successor provision thereto, and the regulations thereunder.

(c) Notwithstanding any provision of this Plan other than Section 11, with respect to any Award that is subject to this Section 12, the Committee may adjust downwards, but not upwards, the amount payable pursuant to such Award, and the Committee may not waive the achievement of the applicable performance goals except in the case of the death or disability of the Participant.

(d) The Committee shall have the power to impose such other restrictions on Awards subject to this Section 12 as it may deem necessary or appropriate to ensure that such Awards satisfy all requirements for "performance-based compensation" within the meaning of Section 162(m) (4) (C) of the Code, or any successor provision thereto.

(e) Notwithstanding any provision of this Plan other than Section 4(e), commencing with calendar year 1999, no Participant may be granted Options and/or SARs in any calendar year period with respect to more than three million (3,000,000) AT&T Shares, or more than three million (3,000,000) Wireless Group Shares and the maximum dollar value payable with respect to Performance Units and/or Other Stock Unit Awards that are valued with reference to property other than Shares and granted to any Participant in any one calendar year is \$10,000,000.

**SECTION 13. AMENDMENTS AND TERMINATION.** The Board may amend, alter, suspend, discontinue or terminate the Plan or any portion thereof at any time; provided that no such amendment, alteration, suspension, discontinuation or termination shall be made without (i) shareholder approval if such approval is necessary to qualify for or comply with any tax or regulatory requirement for which or with which the Board deems it necessary or desirable to qualify or comply or (ii) the consent of the affected Participant, if such action would impair the rights of such Participant under any outstanding Award. Notwithstanding anything to the contrary herein, the Committee may amend the Plan in such manner as may be necessary so as to have the Plan conform to local rules and regulations in any jurisdiction outside the United States.

The Committee may amend the terms of any Award theretofore granted, prospectively or retroactively, but no such amendment shall impair the rights of any Participant without his or her consent. Notwithstanding any provision of this plan, the Committee may not amend the terms of any Option to reduce the option price nor may the Committee, without prior shareholder approval, cancel any outstanding Option and replace it with a new Option with a lower option price, where the economic effect would be the same as reducing the option price of the canceled Option.

#### **SECTION 14. GENERAL PROVISIONS.**

(a) Unless the Committee determines otherwise at the time the Award is granted or thereafter: (i) no Award, and no Shares subject to Awards described in Section 10 which have not been issued or as to which any applicable restriction, performance or deferral period has not lapsed, may be sold, assigned, transferred, pledged or otherwise encumbered, except by will or by the laws of descent and distribution; provided that, if so determined by the Committee, a Participant may, in the manner established by the Committee, designate a beneficiary to exercise the rights

of the Participant with respect to any Award upon the death of the Participant; and (ii) each Award shall be exercisable, during the Participant's lifetime, only by the Participant or, if permissible under applicable law, by the Participant's guardian or legal representative.

(b) The term of each Award shall be for such period of months or years from the date of its grant as may be determined by the Committee; provided that in no event shall the term of any Stock Option or any Stock Appreciation Right exceed a period of ten (10) years from the date of its grant.

(c) No Employee or Participant shall have any claim to be granted any Award under the Plan and there is no obligation for uniformity of treatment of Employees or Participants under the Plan.

(d) The prospective recipient of any Award under the Plan shall not, with respect to such Award, be deemed to have become a Participant, or to have any rights with respect to such Award, until and unless such recipient shall have executed an agreement or other instrument evidencing the Award and delivered a copy thereof to the Company, and otherwise complied with the then applicable terms and conditions.

(e) Except as provided in Section 12, the Committee shall be authorized to make adjustments in performance award criteria or in the terms and conditions of other Awards in recognition of unusual or nonrecurring events affecting the Company or its financial statements or changes in applicable laws, regulations or accounting principles. The Committee may correct any defect, supply any omission or reconcile any inconsistency in the Plan or any Award in the manner and to the extent it shall deem desirable to carry it into effect. In the event the Company shall assume outstanding employee benefit awards or the right or obligation to make future such awards in connection with the acquisition of or combination with another corporation or business entity, the Committee may, in its discretion, make such adjustments in the terms of Awards under the Plan as it shall deem appropriate.

(f) The Committee shall have full power and authority to determine whether, to what extent and under what circumstances any Award shall be canceled or suspended. In addition, all outstanding Awards to any Participant shall be canceled if the Participant, without the consent of the Company, while employed by the Company or after termination of such employment, establishes a relationship with a competitor of the Company or engages in activity which is in conflict with or adverse to the interest of the Company, as determined under the AT&T Non-Competition Guideline.

(g) All certificates for Shares delivered under the Plan pursuant to any Award shall be subject to such stock-transfer orders and other restrictions as the Committee may deem advisable under the rules, regulations, and other requirements of the Securities and Exchange Commission, any stock exchange upon which the Shares are then listed, and any applicable Federal or state securities law, and the Committee may cause a legend or legends to be put on any such certificates to make appropriate reference to such restrictions.

(h) No Award granted hereunder shall be construed as an offer to sell securities of the Company, and no such offer shall be outstanding, unless and until the Committee in its sole



discretion has determined that any such offer, if made, would be in compliance with all applicable requirements of the U.S. federal securities laws and any other laws to which such offer, if made, would be subject.

(i) The Committee shall be authorized to establish procedures pursuant to which the payment of any Award may be deferred. Subject to the provisions of the Plan and any Award Agreement, the recipient of an Award (including, without limitation, any deferred Award) may, if so determined by the Committee, be entitled to receive, currently or on a deferred basis, cash dividends, or cash payments in amounts equivalent to cash dividends on Shares ("dividend equivalents"), with respect to the number of Shares covered by the Award, as determined by the Committee, in its sole discretion, and the Committee may provide that such amounts (if any) shall be deemed to have been reinvested in additional Shares or otherwise reinvested.

(j) Except as otherwise required in any applicable Award Agreement or by the terms of the Plan, recipients of Awards under the Plan shall not be required to make any payment or provide consideration other than the rendering of services.

(k) The Committee may delegate to one or more Senior Managers or a committee of Senior Managers the right to grant Awards to Employees who are not officers or directors of the Company and to cancel or suspend Awards to Employees who are not officers or directors of the Company.

(l) The Company shall be authorized to withhold from any Award granted or payment due under the Plan the amount of withholding taxes due in respect of an Award or payment hereunder and to take such other action as may be necessary in the opinion of the Company to satisfy all obligations for the payment of such taxes. The Committee shall be authorized to establish procedures for election by Participants to satisfy such obligations for the payment of such taxes by delivery of or transfer of Shares to the Company, or by directing the Company to retain Shares otherwise deliverable in connection with the Award.

(m) Nothing contained in this Plan shall prevent the Board from adopting other or additional compensation arrangements, subject to shareholder approval if such approval is required; and such arrangements may be either generally applicable or applicable only in specific cases.

(n) The validity, construction, and effect of the Plan and any rules and regulations relating to the Plan shall be determined in accordance with the laws of the State of New York and applicable Federal law.

(o) If any provision of this Plan is or becomes or is deemed invalid, illegal or unenforceable in any jurisdiction, or would disqualify the Plan or any Award under any law deemed applicable by the Committee, such provision shall be construed or deemed amended to conform to applicable laws or if it cannot be construed or deemed amended without, in the determination of the Committee, materially altering the intent of the Plan, it shall be stricken and the remainder of the Plan shall remain in full force and effect.

(p) Awards may be granted to Participants who are foreign nationals or employed outside the United States, or both, on such terms and conditions different from those applicable to Awards to

Employees employed in the United States as may, in the judgment of the Committee, be necessary or desirable in order to recognize differences in local law or tax policy. The Committee also may impose conditions on the exercise or vesting of Awards in order to minimize the Company's obligation with respect to tax equalization for Employees on assignments outside their home country.

**SECTION 15. EFFECTIVE DATE OF PLAN.**The Plan shall be effective as of June 1, 1997.

**SECTION 16. TERM OF PLAN.**No Award shall be granted pursuant to the Plan after May 31, 2004, but any Award theretofore granted may extend beyond that date.



## AT&T 2004 LONG TERM INCENTIVE PROGRAM

### SECTION 1. PURPOSE

The purposes of the AT&T 2004 Long Term Incentive Program (the "Plan") are to encourage selected employees and Non-Employee Directors of AT&T Corp. (the "Company") and its Affiliates to acquire a proprietary and vested interest in the growth and performance of the Company, to generate an increased incentive to contribute to the Company's future success and prosperity, thus enhancing the value of the Company for the benefit of shareowners, and to enhance the ability of the Company and its Affiliates to attract and retain individuals of exceptional managerial talent upon whom, in large measure, the sustained progress, growth and profitability of the Company depends.

### SECTION 2. DEFINITIONS

As used in the Plan, the following terms shall have the meanings set forth below:

- (a) "Affiliate" shall mean (i) any Person that directly, or through one or more intermediaries, controls, or is controlled by, or is under common control with, the Company or (ii) any entity in which the Company has a significant equity interest, as determined by the Committee.
- (b) "Award" shall mean any Option, Stock Appreciation Right, Restricted Stock Award, Performance Share, Performance Unit or Other Stock Unit Award.
- (c) "Award Agreement" shall mean any written or electronic agreement, contract, or other instrument or document evidencing any Award granted by the Committee hereunder, which may, but need not, be executed or acknowledged by both the Company and the Participant.
- (d) "Board" shall mean the Board of Directors of the Company.
- (e) "Change in Control" shall mean the happening of any of the following events:
  - (i) An acquisition by any individual, entity or group (within the meaning of Section 13 (d) (3) or 14 (d) (2) of the Exchange Act) (an "Entity") of beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of 20% or more of either (A) the then outstanding AT&T Shares (the "Outstanding Company Common Stock") or (B) the combined voting power of the then outstanding voting securities of the Company entitled to vote generally in the election of directors (the "Outstanding Company Voting Securities"); excluding, however, the following: (1) any acquisition directly from the Company, other than an acquisition by virtue of the exercise of a conversion privilege unless the security being so converted was itself acquired directly from the Company, (2) any acquisition by the Company, (3) any acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company, or (4) any acquisition by any corporation pursuant to a transaction which complies with clauses (A), (B) and (C) of subsection (iii) of this Section 2 (e);
  - (ii) A change in the composition of the Board such that the individuals who, as of the effective date of the Plan, constitute the Board (such Board shall be hereinafter referred to as the "Incumbent Board") cease for any reason to constitute at least a majority of the Board; provided,

however, that for purposes of this definition, any individual who becomes a member of the Board subsequent to the effective date of the Plan, whose election, or nomination for election, by the Company's stockholders was approved by a vote of at least a majority of those individuals who are members of the Board and who were also members of the Incumbent Board (or deemed to be such pursuant to this proviso) shall be considered as though such individual were a member of the Incumbent Board; and provided, further however, that any such individual whose initial assumption of office occurs as a result of or in connection with either an actual or threatened election contest (as such terms are used in Rule 14a-11 of Regulation 14A promulgated under the Exchange Act) or other actual or threatened solicitation of proxies or consents by or on behalf of an Entity other than the Board shall not be so considered as a member of the Incumbent Board;

(iii) Consummation of a merger, reorganization or consolidation or sale or other disposition of all or substantially all of the assets of the Company (each, a "Corporate Transaction"); excluding however, such a Corporate Transaction pursuant to which (A) all or substantially all of the individuals and entities who are the beneficial owners, respectively, of the Outstanding Company Common Stock and Outstanding Company Voting Securities immediately prior to such Corporate Transaction will beneficially own, directly or indirectly, more than 60% of, respectively, the outstanding shares of common stock, and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of the corporation resulting from such Corporate Transaction (including, without limitation, a corporation or other Person which as a result of such transaction owns the Company or all or substantially all of the Company's assets either directly or through one or more subsidiaries (a "Parent Company")) in substantially the same proportions as their ownership, immediately prior to such Corporate Transaction, of the Outstanding Company Common Stock and Outstanding Company Voting Securities, as the case may be, (B) no Entity (other than the Company, any employee benefit plan (or related trust) of the Company, such corporation resulting from such Corporate Transaction or, if reference was made to equity ownership of any Parent Company for purposes of determining whether clause (A) above is satisfied in connection with the applicable Corporate Transaction, such Parent Company) will beneficially own, directly or indirectly, 20% or more of, respectively, the outstanding shares of common stock of the corporation resulting from such Corporate Transaction or the combined voting power of the outstanding voting securities of such corporation entitled to vote generally in the election of directors unless such ownership resulted solely from ownership of securities of the Company prior to the Corporate Transaction, and (C) individuals who were members of the Incumbent Board at the time of the execution of the initial agreement or of the action of the Board providing for such Corporate Transaction will immediately after the consummation of such Corporate Transaction constitute at least a majority of the members of the board of directors of the corporation resulting from such Corporate Transaction (or, if reference was made to equity ownership of any Parent Company for purposes of determining whether clause (A) above is satisfied in connection with the applicable Corporate Transaction, of the Parent Company); or

(iv) The approval by the stockholders of the Company of a complete liquidation or dissolution of the Company.

(f) "Code" shall mean the Internal Revenue Code of 1986, as amended from time to time, and any successor thereto.

(g) "Committee" shall mean the Compensation and Employee Benefits Committee of the Board, or any successor to such committee, composed of no fewer than two directors each of whom is a Non-Employee Director and an "outside director" within the meaning of Section 162(m) of the Code, or any successor provision thereto, and each of whom is "independent" as set forth in the applicable rules and regulations of the Securities and Exchange Commission and the New York Stock Exchange.

- (h) "Company" shall mean AT&T Corp., a New York corporation.
- (i) "Covered Employee" shall mean a "covered employee" within the meaning of Section 162(m)(3) of the Code, or any successor provision thereto.
- (j) "Director Level Employee" shall mean any employee of the Company or of any Affiliate holding a position classified at the salary grade level of E-Band, or its equivalent, in a banded environment or Manager E, or its equivalent, in a non-banded environment.
- (k) "Employee" shall mean any employee of the Company or of any Affiliate. Unless otherwise determined by the Committee in its sole discretion, for purposes of the Plan, an employee shall be considered to have terminated employment and to have ceased to be an Employee if his or her employer ceases to be an Affiliate, even if he or she continues to be employed by such employer.
- (l) "Exchange Act" shall mean the Securities Exchange Act of 1934, as amended.
- (m) "Fair Market Value" shall mean, unless the Committee determines otherwise, as at any date the average of the highest and lowest sale prices on the New York Stock Exchange for the Shares on such date.
- (n) "Incentive Stock Option" shall mean an Option granted under Section 6 hereof that is intended to meet the requirements of Section 422 of the Code or any successor provision thereto.
- (o) "Non-Employee Director" shall have the meaning set forth in Rule 16b-3(b)(3) promulgated by the Securities and Exchange Commission under the Exchange Act, or any successor definition adopted by the Securities and Exchange Commission.
- (p) "Nonstatutory Stock Option" shall mean an Option granted under Section 6 hereof that is not intended to be an Incentive Stock Option.
- (q) "Officer" shall mean any Employee of the Company or any Affiliate holding a position classified as a "Manager O" or higher level in a non-banded environment, or at a salary grade level above "E-band", or its equivalent, in a banded environment (formerly referred to as a "Senior Manager").
- (r) "Option" shall mean any right granted to a Participant under Section 6 of the Plan allowing such Participant to purchase Shares at such price or prices and during such period or periods, as the Committee shall determine.
- (s) "Other Stock Unit Award" shall mean any right granted to a Participant by the Committee pursuant to Section 10 hereof.
- (t) "Participant" shall mean an Employee or Non-Employee Director who is selected by the Committee to receive an Award under the Plan.
- (u) "Performance Award" shall mean any Award of Performance Shares or Performance Units pursuant to Section 9 hereof.
- (v) "Performance Period" shall mean that period established by the Committee at the time any Award is granted or at any time thereafter during which any performance goals specified by the Committee with respect to such Award are to be measured.

(w) "Performance Share" shall mean any grant pursuant to Section 9 hereof of a unit valued by reference to a designated number of Shares, which value may be paid to the Participant by delivery of such property as the Committee shall determine, including, without limitation, cash, Shares, or any combination thereof, upon achievement of such performance goals during the Performance Period as the Committee shall establish at the time of such grant or thereafter.

(x) "Performance Unit" shall mean any grant pursuant to Section 9 hereof of a unit valued by reference to a designated amount of property other than Shares, which value may be paid to the Participant by delivery of such property as the Committee shall determine, including, without limitation, cash, Shares, or any combination thereof, upon achievement of such performance goals during the Performance Period as the Committee shall establish at the time of such grant or thereafter.

(y) "Person" shall mean any individual, corporation, partnership, association, joint-stock company, trust, unincorporated organization, or government or political subdivision thereof.

(z) "Restricted Stock" shall mean any Share issued with the restriction that the holder may not sell, transfer, pledge, or assign such Share and with such other restrictions as the Committee, in its sole discretion, may impose (including, without limitation, any forfeiture condition or any restriction on the right to vote such Share, and the right to receive any cash dividends), which restrictions may lapse separately or in combination at such time or times, in installments or otherwise, as the Committee may deem appropriate.

(Aa) "Restricted Stock Award" shall mean an award of Restricted Stock under Section 8 hereof.

(Bb) "Shares" shall mean, the shares of AT&T Common Stock of the Company, \$1.00 par value ("AT&T Shares").

(Cc) "Stock Appreciation Right" shall mean any right granted to a Participant pursuant to Section 7 hereof to receive, upon exercise by the Participant, the excess of (i) the Fair Market Value of one Share on the date of exercise or, if the Committee shall so determine in the case of any such right other than one related to any Incentive Stock Option, at any time during a specified period before the date of exercise over (ii) the grant price of the right on the date of grant, or if granted in connection with an outstanding Option on the date of grant of the related Option, as specified by the Committee in its sole discretion, which, except in the case of Substitute Awards or in connection with an adjustment provided in Section 4(c), shall not be less than the Fair Market Value of one Share on such date of grant of the right or the related Option, as the case may be. Any payment by the Company in respect of such right may be made in cash, Shares, other property, or any combination thereof, as the Committee, in its sole discretion, shall determine.

(Dd) "Subsidiary" shall mean any corporation (other than the Company) in an unbroken chain of corporations beginning with the Company if, at the time of the granting of the Award, each of the corporations other than the last corporation in the unbroken chain owns stock possessing 50 percent or more of the total combined voting power of all classes of stock in one of the other corporations in the chain.

(Ee) "Substitute Awards" shall mean Awards granted or Shares issued by the Company in assumption of, or in substitution or exchange for, awards previously granted, or the right or obligation to make future awards, by a company acquired by the Company or with which the Company combines.

### **SECTION 3. ADMINISTRATION**

The Plan shall be administered by the Committee. The Committee shall have full power and authority, subject to such orders or resolutions not inconsistent with the provisions of the Plan as may from time to time be adopted by the Board, to: (i) select the Employees of the Company and its Affiliates and Non-Employee Directors of the Company to whom Awards may from time to time be granted hereunder; (ii) determine the type or types of Award to be granted to

each Participant hereunder; (iii) determine the number of Shares to be covered by each Award granted hereunder; (iv) determine the terms and conditions, not inconsistent with the provisions of the Plan, of any Award granted hereunder; (v) determine whether, to what extent and under what circumstances Awards may be settled in cash, Shares or other property or canceled or suspended; (vi) determine whether, to what extent and under what circumstances cash, Shares and other property and other amounts payable with respect to an Award under this Plan shall be deferred either automatically or at the election of the Participant; (vii) interpret and administer the Plan and any instrument or agreement entered into under the Plan; (viii) establish such rules and regulations and appoint such agents as it shall deem appropriate for the proper administration of the Plan; and (ix) make any other determination and take any other action that the Committee deems necessary or desirable for administration of the Plan. Decisions of the Committee shall be final, conclusive and binding upon all persons, including the Company, any Participant, any shareowner, and any employee of the Company or of any Affiliate. A majority of the members of the Committee may determine its actions and fix the time and place of its meetings. Notwithstanding the foregoing or anything else to the contrary in the Plan, any action or determination by the Committee specifically affecting or relating to an Award to a Non-Employee Director shall be approved and ratified by the Board.

#### **SECTION 4. SHARES SUBJECT TO THE PLAN**

(a) Subject to adjustment as provided in Section 4(c), a total of thirty-six (36) million Shares shall be available for Awards granted under the Plan; provided, that if any Shares subject to an Award under the Plan are forfeited or if any Award under the Plan based on Shares is settled for cash, or expires or otherwise is terminated without issuance of such Shares, the Shares subject to such Award shall to the extent of such cash settlement, forfeiture or termination be available for Awards under the Plan. In the event that any Option or other Award granted hereunder is exercised through the delivery of Shares or in the event that withholding tax liabilities arising from such Option or other Award are satisfied by the withholding of Shares by the Company, the number of Shares available for Awards under the Plan shall be increased by the number of Shares so surrendered or withheld. In addition, Substitute Awards shall not reduce the Shares available for grants under the Plan or to a Participant in any calendar year.

(b) Any Shares issued hereunder may consist, in whole or in part, of authorized and unissued shares, treasury shares, or shares purchased in the open market or otherwise.

(c) In the event of any merger, reorganization, consolidation, recapitalization, stock dividend, stock split, reverse stock split, spin-off or similar transaction or other change in corporate structure affecting the Shares, such adjustments and other substitutions shall be made to the Plan and to Awards as the Committee in its sole discretion deems equitable or appropriate, including without limitation such adjustments (i) in the aggregate number, class and kind of securities which may be delivered under the Plan, in the aggregate or to any one Participant, (ii) in the number, class, kind and exercise price of securities or other property subject to outstanding Options, Stock Appreciation Rights or other Awards granted under the Plan, and (iii) in the number, class and kind of securities or other property subject to Awards granted under the Plan (including, if the Committee deems appropriate, the substitution of similar options to purchase the shares of, or other awards denominated in the shares of, another company, or the cancellation of outstanding Awards in exchange for payments of cash, property or a combination thereof, or, in connection with the disaffiliation with the Company of a Subsidiary, arranging for the assumption or replacement with new Awards (by such Subsidiary or by an entity controlling such Subsidiary following such disaffiliation) of Awards held by Participants employed by the affected Subsidiary), as the Committee may determine to be appropriate in its sole discretion provided that the number of Shares subject to any Award shall always be a whole number.

#### **SECTION 5. ELIGIBILITY**

Any Employee or Non-Employee Director shall be eligible to be selected as a Participant, provided, however, that Incentive Stock Options shall be granted only to participants who are employees of the Company or a Subsidiary of the Company, and provided that no Non-Employee Director shall receive Awards with an aggregate Fair Market Value in excess of \$150,000 in any calendar year.

## SECTION 6. STOCK OPTIONS

Options may be granted hereunder to Participants either alone or in addition to other Awards granted under the Plan. Any Option granted under the Plan shall be evidenced by an Award Agreement in such form as the Committee may from time to time approve. Any such Option shall be subject to the following terms and conditions and to such additional terms and conditions, not inconsistent with the provisions of the Plan, as the Committee shall deem desirable:

- (a) **OPTION PRICE.** The purchase price per Share purchasable under an Option shall be determined by the Committee in its sole discretion; provided that, such purchase price shall not be less than the Fair Market Value of the Share on the date of the grant of the Option. Substitute Awards or Awards granted in connection with an adjustment provided for in Section 4(c) shall have a purchase price per Share that is intended to preserve the economic value of the Award which was replaced or adjusted.
- (b) **OPTION PERIOD.** The term of each Option shall be fixed by the Committee in its sole discretion; provided that no Option shall be exercisable after the expiration of ten years from the date the Option is granted.
- (c) **EXERCISABILITY.** Options shall be exercisable at such time or times as determined by the Committee at or subsequent to grant; provided that, no Option will vest in full prior to three (3) years from the grant date.
- (d) **METHOD OF EXERCISE.** Subject to the other provisions of the Plan, any Option may be exercised by the Participant in whole or in part at such time or times, and the Participant may make payment of the option price in such form or forms, including, without limitation, payment by delivery of cash, Shares or other consideration (including, where permitted by law and the Committee, Awards) having a Fair Market Value on the exercise date equal to the total option price, or by any combination of cash, Shares and other consideration as the Committee may specify in the applicable Award Agreement.
- (e) **INCENTIVE STOCK OPTIONS.** In accordance with rules and procedures established by the Committee, and except as otherwise provided in Section 11, the aggregate Fair Market Value (determined as of the time of grant) of the Shares with respect to which Incentive Stock Options held by any Participant which are exercisable for the first time by such Participant during any calendar year under the Plan (and under any other benefit plans of the Company or any Subsidiary) shall not exceed \$100,000 or, if different, the maximum limitation in effect at the time of grant under Section 422 of the Code, or any successor provision, and any regulations promulgated thereunder. Incentive Stock Options shall be granted only to participants who are employees of the Company or a Subsidiary of the Company. The terms of any Incentive Stock Option granted hereunder shall comply in all respects with the provisions of Section 422 of the Code, or any successor provision, and any regulations promulgated thereunder. The expiration date of any Incentive Stock Option granted shall not exceed the period of nine years and 364 days from the grant date. No more than four (4) million shares can be issued as Incentive Stock Options.
- (f) **FORM OF SETTLEMENT.** In its sole discretion, the Committee may provide, at the time of grant, that the Shares to be issued upon an Option's exercise shall be in the form of Restricted Stock or other similar securities, or may reserve the right so to provide after the time of grant.

## SECTION 7. STOCK APPRECIATION RIGHTS

Stock Appreciation Rights may be granted hereunder to Participants either alone or in addition to other Awards granted under the Plan and may, but need not, relate to a specific Option granted under Section 6. The provisions of Stock Appreciation Rights need not be the same with respect to each recipient. Any Stock Appreciation Right related to a Nonstatutory Stock Option may be granted at the same time such Option is granted or at any time thereafter before exercise or expiration of such Option. Any Stock Appreciation Right related to an Incentive Stock Option must be granted at the same time such Option is granted. In the case of any Stock Appreciation Right related to any Option, the Stock Appreciation Right or applicable portion thereof shall terminate and no longer be exercisable upon the termination or exercise of the related Option, except that a Stock Appreciation Right granted with respect to less than the full



number of Shares covered by a related Option shall not be reduced until the exercise or termination of the related Option exceeds the number of Shares not covered by the Stock Appreciation Right. Any Option related to any Stock Appreciation Right shall no longer be exercisable to the extent the related Stock Appreciation Right has been exercised. The Committee may impose such conditions or restrictions on the exercise of any Stock Appreciation Right as it shall deem appropriate, provided that no Stock Appreciation Right shall have a term that is longer than ten (10) years.

## **SECTION 8. RESTRICTED STOCK**

(a) **ISSUANCE.** A Restricted Stock Award shall be subject to restrictions imposed by the Committee during a period of time specified by the Committee (the "Restriction Period"). Restricted Stock Awards may be issued hereunder to Participants, for no cash consideration or for such minimum consideration as may be required by applicable law, either alone or in addition to other Awards granted under the Plan. The provisions of Restricted Stock Awards need not be the same with respect to each recipient.

(b) **REGISTRATION.** Any Restricted Stock issued hereunder may be evidenced in such manner as the Committee in its sole discretion shall deem appropriate, including, without limitation, book-entry registration or issuance of a stock certificate or certificates, unless otherwise specified by the Committee. In the event any stock certificate is issued in respect of shares of Restricted Stock awarded under the Plan, such certificate shall be registered in the name of the Participant, and shall bear an appropriate legend referring to the terms, conditions, and restrictions applicable to such Award.

(c) **FORFEITURE.** Except as otherwise determined by the Committee at the time of grant or thereafter, upon termination of employment for any reason during the Restriction Period, all Shares of Restricted Stock still subject to forfeiture shall be forfeited by the Participant and reacquired by the Company. Unrestricted Shares, evidenced in such manner as the Committee shall deem appropriate, shall be issued to the grantee promptly after the period of forfeiture, as determined or modified by the Committee, shall expire.

(d) **MINIMUM VESTING CONDITION.** The minimum Restriction Period applicable to any Restricted Stock Award that is not subject to performance conditions restricting the grant size, the transfer of the shares, or the vesting of the award shall be three (3) years from the date of grant; *provided, however*, that a Restriction Period of less than three (3) years may be approved under the Plan for such Awards with respect to up to four (4) million Shares.

## **SECTION 9. PERFORMANCE AWARDS**

Performance Awards may be issued hereunder to Participants, for no cash consideration or for such minimum consideration as may be required by applicable law, either alone or in addition to other Awards granted under the Plan. The performance criteria to be achieved during any Performance Period and the length of the Performance Period shall be determined by the Committee upon the grant of each Performance Award. Except as provided in Section 11, Performance Awards will be distributed only after the end of the relevant Performance Period. Performance Awards may be paid in cash, Shares, other property or any combination thereof, in the sole discretion of the Committee at the time of payment. The performance levels to be achieved for each Performance Period and the amount of the Award to be distributed shall be conclusively determined by the Committee. Performance Awards may be paid in a lump sum or in installments following the close of the Performance Period or, in accordance with procedures established by the Committee, on a deferred basis.

## **SECTION 10. OTHER STOCK UNIT AWARDS**

(a) **STOCK AND ADMINISTRATION.** Other Awards of Shares and other Awards that are valued in whole or in part by reference to, or are otherwise based on, Shares or other property ("Other Stock Unit Awards") may be granted hereunder to Participants, either alone or in addition to other Awards granted under the Plan. Other Stock Unit Awards may be paid in Shares, cash or any other form of property as the Committee shall determine. Subject to the provisions of the Plan, the Committee shall have sole and complete authority to determine the Employees of the

Company and its Affiliates and Non-Employee Directors to whom and the time or times at which such Awards shall be made, the number of Shares to be granted pursuant to such Awards, and all other conditions of the Awards. The provisions of Other Stock Unit Awards need not be the same with respect to each recipient.

(b) **TERMS AND CONDITIONS.** Subject to the provisions of this Plan and any applicable Award Agreement, Awards and Shares subject to Awards made under this Section 10, may not be sold, assigned, transferred, pledged or otherwise encumbered prior to the date on which the Shares are issued, or, if later, the date on which any applicable restriction, performance or deferral period lapses. For any Award or Shares subject to any Award made under this Section 10 the transferability and vesting of which are conditioned only on the passage of time, such restriction period shall be a minimum of three (3) years for full vesting. Shares (including securities convertible into Shares) subject to Awards granted under this Section 10 may be issued for no cash consideration or for such minimum consideration as may be required by applicable law.

#### **SECTION 11. CHANGE IN CONTROL PROVISIONS**

Notwithstanding any other provision of the Plan to the contrary, unless the Committee shall determine otherwise at the time of grant with respect to a particular Award, in the event of a Change in Control, as of the date such Change in Control is determined to have occurred

(a) any Options and Stock Appreciation Rights outstanding as of the date such Change in Control is determined to have occurred which are not then exercisable and vested shall become fully exercisable and vested;

(b) any Options and Stock Appreciation Rights outstanding which are then vested and exercisable, including newly vested Options and Stock Appreciation Rights as a result of (a) above, shall remain exercisable as provided in the Award Agreement;

(c) the restrictions and deferral limitations applicable to any Restricted Stock shall lapse, and such Restricted Stock shall become free of all restrictions and limitations and become fully vested and transferable;

(d) all Performance Awards shall be considered to be prorated, and any deferral or other restriction shall lapse and such Performance Awards shall be immediately settled or distributed in accordance with policies established by the Committee; and

(e) the restrictions and deferral limitations and other conditions applicable to any Other Stock Unit Awards or any other Awards shall lapse, and such Other Stock Unit Awards or such other Award shall become free of all restrictions, limitations or conditions and become fully vested and transferable to the full extent of the Award not previously forfeited or vested.

#### **SECTION 12. CODE SECTION 162(m) PROVISIONS**

(a) Notwithstanding any other provision of this Plan, if the Committee determines at the time Restricted Stock, a Performance Award or an Other Stock Unit Award is granted to a Participant who is then an Officer or Director Level Employee that such Participant is, or may be as of the end of the tax year in which the Company would claim a tax deduction in connection with such Award, a Covered Employee, then the Committee may provide that this Section 12 is applicable to such Award.

(b) If an Award is subject to this Section 12, then the lapsing of restrictions thereon and the distribution of cash, Shares or other property pursuant thereto, as applicable, shall be subject to the achievement of one or more objective performance goals established by the Committee, which shall be based on the attainment of specified levels of one or any combination of the following: net cash provided by operating activities, earnings per share from continuing

operations, operating income, revenues, gross margin, return on operating assets, return on equity, economic value added, stock price appreciation, total stockholder return, or cost control, of the Company or the Affiliate or division of the Company for or within which the Participant is primarily employed. Such performance goals also may be based upon the achievement of specified levels of Company performance (or performance of applicable Affiliate or division of the Company) under one or more of the measures described above relative to the performance of other corporations. Such performance goals shall be set by the Committee within the time period prescribed by, and shall otherwise comply with the requirements of, Section 162(m) of the Code, or any successor provision thereto, and the regulations thereunder.

(c) Notwithstanding any provision of this Plan other than Section 11, with respect to any Award that is subject to this Section 12, the Committee may adjust downwards, but not upwards, the amount payable pursuant to such Award, and the Committee may not waive the achievement of the applicable performance goals except in the case of the death or disability of the Participant.

(d) The Committee shall have the power to impose such other restrictions on Awards subject to this Section 12 as it may deem necessary or appropriate to ensure that such Awards satisfy all requirements for "performance-based compensation" within the meaning of Section 162(m) (4) (C) of the Code, or any successor provision thereto.

(e) Notwithstanding any provision of this Plan other than Section 4(c), commencing with calendar year 2004, (i) no Participant may be granted in any twelve (12) month period an aggregate amount of Options and/or Stock Appreciation Rights with respect to more than two and one-half million (2.5M) Shares, and (ii) no Participant may be granted in any twelve (12) month period an aggregate amount of Restricted Stock, Performance Awards or Other Stock Unit Awards, with respect to more than one and one-half million (1.5M) Shares (or cash amounts based on the value of more than one and one-half million (1.5M) Shares); except that an external hire may be granted up to an aggregate amount of Performance Awards or Other Stock Unit Awards with respect to no more than two and one-half million (2.5M) Shares (or cash amounts based on the value of no more than two and one-half million (2.5M) Shares).

### **SECTION 13. AMENDMENTS AND TERMINATION**

The Board may amend, alter, suspend, discontinue or terminate the Plan or any portion thereof at any time; *provided* that no such amendment, alteration, suspension, discontinuation or termination shall be made without (i) shareowner approval if such approval is necessary to qualify for or comply with any tax or regulatory requirement for which or with which the Board deems it necessary or desirable to qualify or comply or (ii) the consent of the affected Participant, if such action would impair the rights of such Participant under any outstanding Award. Notwithstanding anything to the contrary herein, the Committee may amend the Plan in such manner as may be necessary so as to have the Plan conform to local rules and regulations in any jurisdiction outside the United States.

The Committee may amend the terms of any Award theretofore granted, prospectively or retroactively, but no such amendment shall impair the rights of any Participant without his or her consent.

Notwithstanding any provision of this plan, the Committee does not have the authority to take any action that would require shareholder approval under applicable Securities and Exchange Commission or New York Stock Exchange rules including amending the terms of any Option to reduce the option price; nor may the Committee, without prior shareowner approval, cancel any outstanding Option and replace it with a new Option with a lower option price, or where the economic effect would be the same as reducing the option price of the canceled Option; nor shall the Committee, without prior shareowner approval, provide for any Option to be exchanged for any other Award under this Plan

### **SECTION 14. GENERAL PROVISIONS**

(a) Unless the Committee determines otherwise at the time the Award is granted or thereafter: (i) no Award, and no Shares subject to Awards described in Section 10 which have not been issued or as to which any

applicable restriction, performance or deferral period has not lapsed, may be sold, assigned, transferred, pledged or otherwise encumbered, except by will or by the laws of descent and distribution; *provided* that, if so determined by the Committee, a Participant may, in the manner established by the Committee, designate a beneficiary to exercise the rights of the Participant with respect to any Award upon the death of the Participant; and (ii) each Award shall be exercisable, during the Participant's lifetime, only by the Participant or, if permissible under applicable law, by the Participant's guardian or legal representative.

(b) The term of each Award shall be for such period of months or years from the date of its grant as may be determined by the Committee; *except* as provided in Section 6.

(c) No Employee or Participant shall have any claim to be granted any Award under the Plan and there is no obligation for uniformity of treatment of Employees or Participants under the Plan.

(d) The prospective recipient of any Award under the Plan shall not, with respect to such Award, be deemed to have become a Participant, or to have any rights with respect to such Award, until and unless such recipient, to the extent required by the Committee, shall have either executed an agreement or other instrument evidencing the Award and delivered a copy thereof to the Company, or otherwise evidenced acceptance of the then applicable terms and conditions.

(e) Except to the extent that such action would cause an Award subject to Section 12 not to qualify for the exemption from the limitation on deductibility imposed by Section 162(m) of the Code that is set forth in Section 162(m)(4)(C) of the Code, the Committee shall be authorized to make adjustments in performance award criteria or in the terms and conditions of other Awards in recognition of unusual or nonrecurring events affecting the Company or its financial statements or changes in applicable laws, regulations or accounting principles. The Committee may correct any defect, supply any omission or reconcile any inconsistency in the Plan or any Award in the manner and to the extent it shall deem desirable to carry it into effect. In the event the Company shall assume outstanding employee benefit awards or the right or obligation to make future such awards in connection with the acquisition of or combination with another corporation or business entity, the Committee may, in its discretion, make such adjustments in the terms of Awards under the Plan as it shall deem appropriate.

(f) Notwithstanding anything in the Plan to the contrary, the Committee shall have the authority under the Plan to determine (and may so provide in any Award Agreement) that in the event of serious misconduct by the Participant or any activity of a Participant in competition with the business of the Company or any Subsidiary or Affiliate, any outstanding Award granted to such Participant may be cancelled, in whole or in part, whether or not vested or deferred. The determination of whether a Participant has engaged in a serious breach of conduct or any activity in competition with the business of the Company or any Subsidiary or Affiliate shall be determined by the Committee in good faith and in its sole discretion. This Section 14(f) shall have no application following a Change in Control.

(g) All certificates for Shares delivered under the Plan pursuant to any Award shall be subject to such stock-transfer orders and other restrictions as the Committee may deem advisable under the rules, regulations, and other requirements of the Securities and Exchange Commission, any stock exchange upon which the Shares are then listed, and any applicable Federal or state securities law, and the Committee may cause a legend or legends to be put on any such certificates to make appropriate reference to such restrictions.

(h) No Award granted hereunder shall be construed as an offer to sell securities of the Company, and no such offer shall be outstanding, unless and until the Committee in its sole discretion has determined that any such offer, if made, would be in compliance with all applicable requirements of the U.S. federal securities laws and any other laws to which such offer, if made, would be subject.

(i) The Committee shall be authorized to establish procedures pursuant to which the payment of any Award may be deferred. Subject to the provisions of the Plan and any Award Agreement, the recipient of an Award (including, without limitation, any deferred Award) may, if so determined by the Committee, be entitled to receive,

currently or on a deferred basis, cash dividends, or cash payments in amounts equivalent to cash dividends on Shares ("dividend equivalents"), with respect to the number of Shares covered by the Award, as determined by the Committee, in its sole discretion, and the Committee may provide that such amounts (if any) shall be deemed to have been reinvested in additional Shares or otherwise reinvested.

(j) Except as otherwise required in any applicable Award Agreement or by the terms of the Plan, recipients of Awards under the Plan shall not be required to make any payment or provide consideration other than the rendering of services.

(k) The Committee may delegate to one or more Officers or a committee of Officers the right to grant Awards to Employees who are not officers or directors of the Company and to cancel or suspend Awards to Employees who are not officers or directors of the Company.

(l) The Company shall be authorized to withhold from any Award granted or payment due under the Plan the amount of withholding taxes due in respect of an Award or payment hereunder and to take such other action as may be necessary in the opinion of the Company to satisfy all obligations for the payment of such taxes not to exceed the statutory minimum withholding obligation. The Committee shall be authorized to establish procedures for election by Participants to satisfy such obligations for the payment of such taxes by delivery of or transfer of Shares to the Company, or by directing the Company to retain Shares otherwise deliverable in connection with the Award.

(m) Nothing contained in this Plan shall prevent the Board from adopting other or additional compensation arrangements, subject to shareowner approval if such approval is required; and such arrangements may be either generally applicable or applicable only in specific cases.

(n) The validity, construction, and effect of the Plan and any rules and regulations relating to the Plan shall be determined in accordance with the laws of the State of New York and applicable Federal law.

(o) If any provision of this Plan is or becomes or is deemed invalid, illegal or unenforceable in any jurisdiction, or would disqualify the Plan or any Award under any law deemed applicable by the Committee, such provision shall be construed or deemed amended to conform to applicable laws or if it cannot be construed or deemed amended without, in the determination of the Committee, materially altering the intent of the Plan, it shall be stricken and the remainder of the Plan shall remain in full force and effect.

(p) Awards may be granted to Participants who are foreign nationals or employed outside the United States, or both, on such terms and conditions different from those applicable to Awards to Employees employed in the United States as may, in the judgment of the Committee, be necessary or desirable in order to recognize differences in local law or tax policy. The Committee also may impose conditions on the exercise or vesting of Awards in order to minimize the Company's obligation with respect to tax equalization for Employees on assignments outside their home country.

#### **SECTION 15. EFFECTIVE DATE OF PLAN**

The Plan shall be effective as of the date the shareowners approve the Plan in 2004.

#### **SECTION 16. TERM OF PLAN**

No Award shall be granted pursuant to the Plan after May 31, 2009, but any Award theretofore granted may extend beyond that date.

**AT&T SENIOR MANAGEMENT INCENTIVE AWARD DEFERRAL PLAN**  
**(as amended January 21, 1998)**

**1. ELIGIBILITY**

Any Senior Manager (as defined in the AT&T 1997 Long Term Incentive Program [the "1997 Plan"]) of AT&T Corp. ("AT&T") or an Affiliate (as defined in the 1997 Plan) who is eligible for an award under the AT&T Short Term Incentive Plan (the "Short Term Incentive Plan") and/or who has been granted a Performance Award or a Stock Unit Award under the AT&T Senior Management Long Term Incentive Plan (the "Long Term Incentive Plan") the 1987 Long Term Incentive Plan (the "1987 Plan") or the 1997 Plan shall be eligible to participate in this AT&T Senior Management Incentive Award Deferral Plan (the "Plan"). For purposes of the Plan, AT&T and any Affiliate shall be referred to as a "Participating Company". Prior to January 1, 1984, the Plan was named the Bell System Senior Management Incentive Award Deferral Plan.

**2. PARTICIPATION**

(a) Prior to the beginning of any calendar year, any Senior Manager may elect to participate in the Plan by directing that (i) all or part of an award under the Short Term Incentive Plan, or a Performance Award or a Stock Unit Award under the Long Term Incentive Plan, the 1987 Plan or the 1997 Plan and/or (ii) all or part of the dividend equivalent payments under the Long Term Incentive Plan, the 1987 Plan or the 1997 Plan, that such employee's Participating Company would otherwise pay currently to such employee in such calendar year, shall be credited to a deferred account subject to the terms of the Plan. However, in no event shall the part of an award under any plan credited during any calendar year be less than \$1,000 (based on a valuation at the time the award would otherwise be paid). There shall be no such minimum limitation on amounts credited during any calendar year that are related to dividend equivalent payments.

In addition, prior to the beginning of any calendar year, any Senior Manager may elect to participate in the Plan by directing that all or part of the compensation related to the exercise (more than six months following such election and prior to the employee's retirement or other termination of employment) of an Option awarded under the 1987 Plan or the 1997 Plan shall be credited to a deferred account subject to the terms of the Plan. The exercise of an Option shall be considered as an exercise described in the preceding sentence only if the exercise would otherwise satisfy the requirements for a stock-for-stock exercise under the stock option award agreement pertaining to such Option.

In addition, prior to the beginning of any calendar year, the Chairman of the Board and any other Senior Manager designated by the Chairman of the Board may elect to participate in the Plan by directing that all or part of such Senior Manager's salary that such employee's Participating Company would otherwise pay currently to such employee in such calendar year shall be credited to a deferred account subject to the terms of the Plan.

In addition, provided such participation shall have been approved by the Compensation and Employee Benefits Committee of the AT&T Board of Directors (the "Committee"), prior to the beginning of any calendar year, any Senior Manager may elect to participate in the Plan as to other awards under the 1987 Plan or 1997 Plan, or other amounts of compensation of such Senior Manager, by directing that all or part of such awards or compensation that such Senior Manager's Participating Company would otherwise pay currently to such Senior Manager in such calendar year be credited to a deferred account subject to the terms of the Plan.

(b) Such an election to participate in the Plan shall be in the form of a document executed by the employee and filed with the employee's Participating Company. An election related to awards, dividend equivalent payments, salary and/ or other compensation otherwise payable currently in any calendar year shall become irrevocable on the last day prior to the beginning of such calendar year.

(c) Notwithstanding anything to the contrary contained in this Section 2, in the case of a Senior Manager who is newly eligible to participate in the Plan, or in the case of any Senior Manager with respect to awards or compensation newly eligible to be deferred under the Plan, a deferral election may be made with respect to compensation otherwise receivable in the same calendar year and subsequent to such election, provided such election is made within ninety (90) days of such eligibility.

**3. DEFERRED ACCOUNTS**

(a) (i) Except as provided in Section 3(b)(iii), deferred amounts related to awards, dividend equivalent payments which would otherwise have been distributed in cash by a Participating Company and deferred amounts related to salary and/or other cash compensation shall be credited to the employee's account and shall bear interest from the date the awards, dividend equivalent payments, salary and/or other cash compensation would otherwise have been paid. The interest credited to the account will be compounded at the end of each calendar quarter, and the annual rate of interest applied at the end of any calendar quarter shall be determined by the Committee from time to time, provided however, that the interest rate to be applied, for any subsequent quarter, to an employee's (or former employee's) deferred account balance as of December 31, 1998, plus any additions to such account after December 31, 1998 that result from deferral elections made by an employee prior to December 31, 1998, (reduced by any distributions attributable to such account balance) shall not be less than the applicable 10 Year U.S. Treasury Note Rate for the prior calendar

quarter, plus five (5) percent.

(ii) Furthermore, if an employee made an election described in Section 2, which election was effective on December 31, 1983, then such employee's account shall also be credited during 1984 with an amount equal to the deferred amounts which would have been credited to the employee's account during 1984 had the company which employed the employee on December 31, 1983 continued to be a Participating Company during 1984, and such amount shall bear interest in accordance with (a)(i) above from the date such amount would have been credited had such company continued to be a Participating Company during 1984.

(b)(i) Deferred amounts related to awards that would otherwise have been distributed in AT&T common shares by a Participating Company shall be credited to the employee's account as deferred AT&T shares. Furthermore, if an employee made an election described in Section 2, which election was effective on December 31, 1983, then such employee's account shall also be credited during 1984 with the deferred AT&T shares which would have been credited to the employee's account had the company which employed the employee on December 31, 1983 continued to be a Participating Company in the Plan and in the Long Term Incentive Plan during 1984.

(ii) Deferred amounts related to the compensation on the exercise of an Option also shall be credited to the employee's account as deferred AT&T shares. The number of deferred AT&T shares credited under the preceding sentence shall equal the number of additional AT&T shares the employee would have received on the actual stock-for-stock exercise of such Option.

(iii) Prior to the beginning of any calendar year, the Chairman of the Board and any other Senior Manager designated by the Chairman of the Board may elect that deferred amounts related to dividend equivalent payments, which would otherwise have been distributed in cash by a Participating Company during such calendar year, shall be credited to the employee's account as deferred AT&T shares. The number of deferred AT&T shares credited, with respect to each dividend equivalent, shall be determined in accordance with the conversion formula set forth in the following paragraph, as if such dividend equivalent were the amount to be converted to a number of additional deferred AT&T shares.

(iv) The employee's account shall also be credited on each dividend payment date for AT&T shares with an amount equivalent to the dividend payable on the number of AT&T common shares equal to the number of deferred AT&T shares in the employee's account on the record date for such dividend. Such amount shall then be converted to a number of additional deferred AT&T shares determined by dividing such amount by the price of AT&T common shares, as determined in the following sentence. The price of AT&T common shares related to any dividend payment date shall be the average of the daily high and low sale prices of AT&T common shares on the New York Stock Exchange ("NYSE") for the period of five trading days ending on such dividend payment date, or the period of five trading days immediately preceding such dividend payment date if the NYSE is closed on the dividend payment date.

(c) In the event of any change in outstanding AT&T common shares by reason of any stock dividend or split, recapitalization, merger, consolidation, combination or exchange of shares or other similar corporate change, the Committee shall make such adjustments, if any, that it deems appropriate in the number of deferred AT&T shares then credited to employees' accounts. Any and all such adjustments shall be conclusive and binding upon all parties concerned.

#### 4. DISTRIBUTION

(a) At the time an eligible employee makes an election to participate in the Plan, the employee shall also make an election with respect to the distribution (during the employee's lifetime or in the event of the employee's death) of the amounts credited to the employee's deferred account. Such an election related to the distribution during the employee's lifetime, of amounts otherwise payable currently in any calendar year, shall become irrevocable on the last day prior to the beginning of such calendar year.

The election related to the distribution in the event of the employee's death, including the designation of a beneficiary or beneficiaries, may be changed by the employee at any time by filing the appropriate document with the Secretary of the Company.

Amounts credited as cash plus accumulated interest shall be distributed in cash; amounts credited as deferred AT&T shares shall be distributed in the form of an equal number of AT&T shares.

(b)(i) With respect to amounts related to deferred cash credited to the employee's account under Section 3(a), and to deferred AT&T shares credited to the employee's account under Section 3 (b)(i) or (iii), an employee may elect to receive such amounts in one payment or in some other number of approximately equal annual installments (not exceeding 20), provided however, that the number of annual installments may not extend beyond the life expectancy of the employee, determined as of the date the first installment is paid. The employee's election shall also specify that the first installment (or the single payment if the employee has so elected) shall be paid either (1) as soon as practicable after the first day of the calendar quarter next following the end of the month in which the employee attains the age specified in such election, which age shall not be earlier than age 55 or later than age 70-1/2, or (2) as soon as practicable after the first day of the calendar quarter next following the end of the month in which the employee retires from a Participating Company or otherwise terminates employment with a Participating Company (except for a transfer to another Participating Company); provided, however, that the Committee may, in its sole discretion, direct that the first installment (or the single payment) shall be paid on the first day of the first calendar quarter in the calendar year next following the year of retirement or other termination of employment. In addition any Senior Manager eligible to defer salary may specify that the first installment (or the single payment if the employee has so elected) shall be paid as soon as practicable after the first day of the first calendar quarter in the

calendar year next following the calendar year in which the employee retires from a Participating Company or otherwise terminates employment with a Participating Company (except for a transfer to another Participating Company).

(ii) With respect to deferred AT&T shares credited to the employee's account under Section 3(b)(ii), an employee may elect to receive the deferred AT&T shares in one payment or in some other number of approximately equal annual installments (not exceeding 20), provided however, that the number of annual installments may not extend beyond the life expectancy of the employee, determined as of the date the first installment is paid. The employee's election shall also specify that the first installment (or the single payment if the employee has so elected) shall be paid as soon as practicable after the first day of the calendar quarter next following the later of (1) the end of the month that is five years following the month in which the related deferred AT&T shares were initially credited, and (2)(A) the end of the month in which the employee attains the age specified in such election, which age shall not be earlier than age 55 or later than age 70-1/2, or (B) the end of the month in which the employee retires from a Participating Company or otherwise terminates employment with a Participating Company (except for a transfer to another Participating Company); provided, however, that the Committee may, in its sole discretion, direct that the first installment (or the single payment) shall be paid on the first day of the first calendar quarter in the calendar year next following the year of retirement or other termination of employment.

(c) Notwithstanding an election pursuant to Paragraph (b) of this Section 4, the entire amount then credited to an employee's account shall be paid immediately in a single payment (1) if the employee is discharged for cause by his or her Participating Company, (2) if the such Participating Company determines that the employee engaged in misconduct in connection with the employee's employment with the Participating Company, (3) if the employee without the consent of his or her Participating Company, while employed by such Participating Company or after the termination of such employment, establishes a relationship with a competitor of the Company or engages in activity which is in conflict with or adverse to the interest of the Company as determined under the AT&T Non-Competition Guideline, or (4) the employee becomes employed by a governmental agency having jurisdiction over the activities of a Participating Company or any of its subsidiaries.

(d) An employee may elect that, in the event the employee should die before full payment of all amounts credited to the employee's account, the balance of the deferred amounts shall be distributed in one payment or in some other number of approximately equal annual installments (not exceeding 10) to the beneficiary or beneficiaries designated in writing by the employee, or if no designation has been made, to the estate of the employee. The first installment (or the single payment if the employee has so elected) shall be paid on the first day of the calendar quarter next following the month of death; provided, however, that the Committee may, in its sole discretion, direct that the first installment (or the single payment) shall be paid on the first day of the first calendar quarter in the calendar year next following the year of death.

(e) Installments subsequent to the first installment to the employee, or to a beneficiary or to the employee's estate, shall be paid on the first day of the applicable calendar quarter in each succeeding calendar year until the entire amount credited to the employee's deferred account shall have been paid. Deferred amounts held pending distribution shall continue to be credited with interest or additional deferred AT&T shares, as applicable, determined in accordance with Section 3(a) and (b).

(f) In the event an employee, or the employee's beneficiary after the employee's death, incurs a severe financial hardship, the Committee, in its sole discretion, may accelerate or otherwise revise the payment schedule from the employee's account to the extent reasonably necessary to eliminate the severe financial hardship. For the purpose of this subsection (f), a severe financial hardship must have been caused by an accident, illness, or other event beyond the control of the employee or, if applicable, the beneficiary.

(g) The obligation to make a distribution of deferred amounts credited to an employee's account during any calendar year plus the additional amounts credited on such deferred amounts pursuant to Section 3(a) and (b) shall be borne by the Participating Company which otherwise would have paid the related award or salary currently. However, the obligation to make distribution with respect to deferred amounts which are related to amounts credited to an employee's account under Section 3(a)(ii) and under the second sentence of Section 3(b)(i), and with respect to which no Participating Company would otherwise have paid the related award currently, shall be borne by the Participating Company which employed the employee on January 1, 1984.

(h) Notwithstanding any provision to the contrary, the amount credited to an employee's account shall be reduced by the amount specified in an Election to Forego Compensation Form executed by the employee under the AT&T Corp. Estate Enhancement Program, and the reduction shall be effective as of the effective date of such election.

## 5. MISCELLANEOUS

(a) The deferred amounts shall be held in the general funds of the Participating Companies. The Participating Companies shall not be required to reserve, or otherwise set aside, funds for the payment of such amounts.

(b) The rights of an employee to any deferred amounts plus the additional amounts credited pursuant to Section 3(a) and (b) shall not be subject to assignment by the employee.

(c) The Executive Vice President - Human Resources of AT&T shall have the authority to administer the Plan.

(d) The Committee may at any time amend the Plan or terminate the Plan, but such amendment or termination shall not adversely affect the rights of any employee, without his or her consent, to any benefit under the Plan to which such employee may have



previously become entitled prior to the effective date of such amendment or termination. The Executive Vice President - Human Resources of AT&T with the concurrence of the General Counsel of AT&T shall be authorized to make minor or administrative changes to the Plan, as well as amendments required by applicable federal or state law (or authorized or made desirable by such statutes).

**AT&T Inc.**  
**2006 INCENTIVE PLAN**

Plan Effective: May 1, 2006

**AT&T INC.  
2006 INCENTIVE PLAN**

Article 1        Establishment and Purpose.

- 1.1        Establishment of the Plan. AT&T Inc., a Delaware corporation (the "Company" or "AT&T"), hereby establishes an incentive compensation plan (the "Plan"), as set forth in this document.
- 1.2        Purpose of the Plan. The purpose of the Plan is to promote the success and enhance the value of the Company by linking the personal interests of Participants to those of the Company's shareowners, and by providing Participants with an incentive for outstanding performance.
- 1.3        Effective Date of the Plan. The Plan shall become effective on May 1, 2006, provided that the stockholders of the Company have approved the Plan prior to that time.

Article 2        Definitions. Whenever used in the Plan, the following terms shall have the meanings set forth below and, when the meaning is intended, the initial letter of the word is capitalized:

- (a)        "Award" means, individually or collectively, a grant or award under this Plan of Stock Options, Restricted Stock (including unrestricted Stock), Restricted Stock Units, Performance Units, or Performance Shares.
- (b)        "Award Agreement" means an agreement which may be entered into by each Participant and the Company, setting forth the terms and provisions applicable to Awards granted to Participants under this Plan.
- (c)        "Board" or "Board of Directors" means the AT&T Board of Directors.
- (d)        "Cause" shall mean willful and gross misconduct on the part of an Employee that is materially and demonstrably detrimental to the Company or any Subsidiary as determined by the Company in its sole discretion.
- (e)        "Change in Control" shall be deemed to have occurred if (i) any "person" (as such term is used in Sections 13(d) and 14(d) of the Exchange Act), other than a trustee or other fiduciary holding securities under an employee benefit plan of the Company or a corporation owned directly or indirectly by the shareowners of the Company in substantially the same proportions as their ownership of stock of the Company, is or becomes the "beneficial owner" (as defined in Rule 13d-3 under said Act), directly or indirectly, of securities of the Company representing twenty percent (20%) or more of the total voting power represented by the Company's then outstanding voting securities, or (ii)

during any period of two (2) consecutive years, individuals who at the beginning of such period constitute the Board of Directors of the Company and any new Director whose election by the Board of Directors or nomination for election by the Company's shareowners was approved by a vote of at least two-thirds (2/3) of the Directors then still in office who either were Directors at the beginning of the period or whose election or nomination for election was previously so approved, cease for any reason to constitute a majority thereof, or (iii) the consummation of a merger or consolidation of the Company with any other corporation, other than a merger or consolidation which would result in the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity) at least fifty percent (50%) of the total voting power represented by the voting securities of the Company or such surviving entity outstanding immediately after such merger or consolidation, or the shareowners of the Company approve a plan of complete liquidation of the Company or an agreement for the sale or disposition by the Company of all or substantially all the Company's assets.

- (f) "Code" means the Internal Revenue Code of 1986, as amended from time to time.
- (g) "Committee" means the committee or committees of the Board of Directors given authority to administer the Plan as provided in Article 3.
- (h) "Director" means any individual who is a member of the AT&T Board of Directors.
- (i) "Disability" shall mean absence of an Employee from work under the relevant Company or Subsidiary long term disability plan.
- (j) "Employee" means any employee of the Company or of one of the Company's Subsidiaries. "Employment" means the employment of an Employee by the Company or one of its Subsidiaries. Directors who are not otherwise employed by the Company shall not be considered Employees under this Plan.
- (k) "Exchange Act" means the Securities Exchange Act of 1934, as amended from time to time, or any successor Act thereto.
- (l) "Exercise Price" means the price at which a Share may be purchased by a Participant pursuant to an Option, as determined by the Committee.
- (m) "Fair Market Value" shall mean the closing price on the New York Stock Exchange ("NYSE") for a Share on the relevant date, or if such date was not a trading day, the next preceding trading date, all as determined by the Company. A trading day is any day that the Shares are traded on the NYSE.

In lieu of the foregoing, the Committee may, from time to time, select any other index or measurement to determine the Fair Market Value of Shares under the Plan, including but not limited to an average determined over a period of trading days.

- (n) "Insider" shall mean an Employee who is, on the relevant date, an officer, director, or ten percent (10%) beneficial owner of the Company, as those terms are defined under Section 16 of the Exchange Act.
- (o) "Option" means an option to purchase Shares from AT&T.
- (p) "Participant" means an Employee or former Employee who holds an outstanding Award granted under the Plan.
- (q) "Performance Unit" and "Performance Share" shall each mean an Award granted to an Employee pursuant to Article 8 herein.
- (r) "Plan" means this 2006 Incentive Plan. The Plan may also be referred to as the "AT&T 2006 Incentive Plan" or as the "AT&T Inc. 2006 Incentive Plan."
- (s) "Retirement" or to "Retire" shall mean the Participant's Termination of Employment for any reason other than death, Disability or for Cause, on or after the earlier of the following dates, or as otherwise provided by the Committee: (1) for Officer Level Employees (Participants deemed officer level Employees for compensation purposes as indicated on the records of AT&T), the date the Participant is at least age 55 and has five (5) years of net credited service); or (2) the date the Participant has attained one of the following combinations of age and service, except as otherwise indicated below:

<u>Net Credited Service</u>	<u>Age</u>
10 years or more	65 or older
20 years or more	55 or older
25 years or more	50 or older
30 years or more	Any age

For purposes of this Plan only, Net Credited Service shall be calculated in the same manner as "Pension Eligibility Service" under the AT&T Pension Benefit Plan – Nonbargained Program ("Pension Plan"), as that may be amended from time to time, except that service with an Employer shall be counted as though the Employer were a "Participating Company" under the Pension Plan and the Employee was a participant in the Pension Plan.

- (t) "Rotational Work Assignment Company" ("RWAC") shall mean any entity with which AT&T Inc. or any of its Subsidiaries may enter into an agreement to provide an employee for a rotational work assignment.

- (u) "Shares" or "Stock" means the shares of common stock of the Company.
- (v) "Subsidiary" shall mean any corporation, partnership, venture or other entity in which AT&T holds, directly or indirectly, a fifty percent (50%) or greater ownership interest. The Committee may, at its sole discretion, designate, on such terms and conditions as the Committee shall determine, any other corporation, partnership, limited liability company, venture other entity a Subsidiary for purposes of this Plan. Unless otherwise provided by the Committee, Cingular and its direct or indirect majority-owned subsidiaries shall each be deemed a Subsidiary so long as AT&T holds a direct or indirect twenty five percent (25%) or greater ownership interest in Cingular Wireless LLC or its successor.
- (w) "Termination of Employment" or a similar reference shall mean the event where the Employee is no longer an Employee of the Company or of any Subsidiary, including but not limited to where the employing company ceases to be a Subsidiary.

Article 3                      Administration.

3.1                      The Committee. Administration of the Plan shall be as follows:

- (a) With respect to Insiders, the Plan and Awards hereunder shall be administered by the Human Resources Committee of the Board or such other committee as may be appointed by the Board for this purpose (each of the Human Resources Committee and such other committee is the "Disinterested Committee"), where each Director on such Disinterested Committee is a "Non-Employee Director", as that term is used in Rule 16b-3 under the Exchange Act (or any successor designation for determining the committee that may administer plans, transactions or awards exempt under Section 16(b) of the Exchange Act), as that rule may be modified from time to time.
- (b) With respect to persons who are not Insiders, the Plan and Awards hereunder shall be administered by each of the Disinterested Committee and such other committee, if any, to which the Board may delegate such authority (such other Committee shall be the "Non-Insider Committee"), and each such Committee shall have full authority to administer the Plan and all Awards hereunder, except as otherwise provided herein or by the Board. The Disinterested Committee may, from time to time, limit the authority of the Non-Insider Committee in any way. Any Committee may be replaced by the Board at any time.

- (c) Except as otherwise indicated from the context, references to the "Committee" in this Plan shall be to either of the Disinterested Committee or the Non-Insider Committee.

3.2

Authority of the Committee. The Committee shall have complete control over the administration of the Plan and shall have the authority in its sole discretion to (a) exercise all of the powers granted to it under the Plan, (b) construe, interpret and implement the Plan, grant terms and grant notices, and all Award Agreements, (c) prescribe, amend and rescind rules and regulations relating to the Plan, including rules governing its own operations, (d) make all determinations necessary or advisable in administering the Plan, (e) correct any defect, supply any omission and reconcile any inconsistency in the Plan, (f) amend the Plan to reflect changes in applicable law (whether or not the rights of the holder of any Award are adversely affected, unless otherwise provided by the Committee), (g) grant Awards and determine who shall receive Awards, when such Awards shall be granted and the terms and conditions of such Awards, including, but not limited to, conditioning the exercise, vesting, payout or other term of condition of an Award on the achievement of Performance Goals (defined below), (h) unless otherwise provided by the Committee, amend any outstanding Award in any respect, not materially adverse to the Participant, including, without limitation, to (1) accelerate the time or times at which the Award becomes vested, unrestricted or may be exercised (and, in connection with such acceleration, the Committee may provide that any Shares acquired pursuant to such Award shall be Restricted Shares, which are subject to vesting, transfer, forfeiture or repayment provisions similar to those in the Participant's underlying Award), (2) accelerate the time or times at which shares of Common Stock are delivered under the Award (and, without limitation on the Committee's rights, in connection with such acceleration, the Committee may provide that any shares of Common Stock delivered pursuant to such Award shall be Restricted Shares, which are subject to vesting, transfer, forfeiture or repayment provisions similar to those in the Grantee's underlying Award), or (3) waive or amend any goals, restrictions or conditions applicable such Award, or impose new goals, restrictions and (i) determine at any time whether, to what extent and under what circumstances and method or methods (1) Awards may be (A) settled in cash, shares of Stock, other securities, other Awards or other property (in which event, the Committee may specify what other effects such settlement will have on the Participant's Award), (B) exercised or (C) canceled, forfeited or suspended, (2) Shares, other securities, cash, other Awards or other property and other amounts payable with respect to an Award may be deferred either automatically or at the election of the Participant or of the Committee, or (3) Awards may be settled by the Company or any of its Subsidiaries or any of its or their designees.

No Award may be made under the Plan more than ten years after its effective date.

References to determinations or other actions by AT&T or the Company, herein, shall mean actions authorized by the Committee, the Chairman of the Board of AT&T, the Senior Executive Vice President of AT&T in charge of Human

Resources or their respective successors or duly authorized delegates, in each case in the discretion of such person, provided, however, only the Disinterested Committee may take action with respect to Insiders with regard to granting or determining the terms of Awards or other matters that would require the Disinterested Committee to act in order to comply with Rule 16b-3 promulgated under the Exchange Act.

All determinations and decisions made by AT&T pursuant to the provisions of the Plan and all related orders or resolutions of the Board shall be final, conclusive, and binding on all persons, including but not limited to the Company, its stockholders, Employees, Participants, and their estates and beneficiaries.

Article 4                    Shares Subject to the Plan.

- 4.1                    Number of Shares. Subject to adjustment as provided in Section 4.3 herein, the number of Shares available for issuance under the Plan shall not exceed 90 million Shares. The Shares granted under this Plan may be either authorized but unissued or reacquired Shares. The Disinterested Committee shall have full discretion to determine the manner in which Shares available for grant are counted in this Plan.
- 4.2                    Share Accounting. Without limiting the discretion of the Committee under this section, unless otherwise provided by the Disinterested Committee, the following rules will apply for purposes of the determination of the number of Shares available for grant under the Plan or compliance with the foregoing limits:
- (a)                    If an outstanding Award for any reason expires or is terminated or canceled without having been exercised or settled in full, or if Shares acquired pursuant to an Award subject to forfeiture or repurchase are forfeited or repurchased by the Company for an amount not greater than the Participant's original purchase price, the Shares allocable to the terminated portion of such Award or such forfeited or repurchased Shares shall again be available for issuance under the Plan.
  - (b)                    Shares shall not be deemed to have been issued pursuant to the Plan with respect to any portion of an Award that is settled in cash, other than an Option.
  - (c)                    Shares withheld or reacquired by the Company in satisfaction of tax withholding obligations under a Restricted Stock Award shall not again be available for issuance under the Plan; however Shares withheld for tax withholding from other awards shall be available for issuance again.
  - (d)                    If the exercise price of an Option is paid by tender to the Company, or attestation to the ownership, of Shares owned by the Participant, or an Option is settled without the payment of the exercise price, the number of shares



available for issuance under the Plan shall be reduced by the gross number of shares for which the Option is exercised.

- 4.3            Adjustments in Authorized Plan Shares. In the event of any merger, reorganization, consolidation, recapitalization, separation, liquidation, Stock dividend, split-up, Share combination, or other change in the corporate structure of the Company affecting the Shares, an adjustment shall be made in the number and class of Shares which may be delivered under the Plan (including but not limited to individual limits), and in the number and class of and/or price of Shares subject to outstanding Awards granted under the Plan, and/or the number of outstanding Options, Shares of Restricted Stock, and Performance Shares (and Performance Units and other Awards whose value is based on a number of Shares) constituting outstanding Awards, as may be determined to be appropriate and equitable by the Disinterested Committee, in its sole discretion, to prevent dilution or enlargement of rights.

Article 5            Eligibility and Participation.

- 5.1            Eligibility. All management Employees are eligible to receive Awards under this Plan.
- 5.2            Actual Participation. Subject to the provisions of the Plan, the Committee may, from time to time, select from all eligible Employees, those to whom Awards shall be granted and shall determine the nature and amount of each Award. No Employee is entitled to receive an Award unless selected by the Committee.

Article 6            Stock Options.

- 6.1            Grant of Options. Subject to the terms and provisions of the Plan, Options may be granted to eligible Employees at any time and from time to time, and under such terms and conditions, as shall be determined by the Committee. In addition, the Committee may, from time to time, provide for the payment of dividend equivalents on Options, prospectively and/or retroactively, on such terms and conditions as the Committee may require. The Committee shall have discretion in determining the number of Shares subject to Options granted to each Employee; provided, however, that no single Employee may receive Options under this Plan for more than one percent (1%) of the Shares approved for issuance under this Plan during any calendar year. The Committee may not grant Incentive Stock Options, as described in Section 422 of the Code, under this Plan.
- 6.2            Form of Issuance. Each Option grant may be issued in the form of an Award Agreement and/or may be recorded on the books and records of the Company for the account of the Participant. If an Option is not issued in the form of an Award Agreement, then the Option shall be deemed granted as determined by the Committee. The terms and conditions of an Option shall be set forth in the Award

Agreement, in the notice of the issuance of the grant, or in such other documents as the Committee shall determine. Such terms and conditions shall include the Exercise Price, the duration of the Option, the number of Shares to which an Option pertains (unless otherwise provided by the Committee, each Option may be exercised to purchase one Share), and such other provisions as the Committee shall determine.

- 6.3            Exercise Price. Unless a greater Exercise Price is determined by the Committee, the Exercise Price for each Option Awarded under this Plan shall be equal to one hundred percent (100%) of the Fair Market Value of a Share on the date the Option is granted.
- 6.4            Duration of Options. Each Option shall expire at such time as the Committee shall determine at the time of grant (which duration may be extended by the Committee); provided, however, that no Option shall be exercisable later than the tenth (10th) anniversary date of its grant. In the event the Committee does not specify the expiration date of an Option, then such Option will expire on the tenth (10<sup>th</sup>) anniversary date of its grant, except as otherwise provided herein.
- 6.5            Vesting of Options. Options shall vest at such times and under such terms and conditions as determined by the Committee; provided, however, unless another vesting period is provided by the Committee at or before the grant of an Option, one-third of the Options will vest on each of the first three anniversaries of the grant; if one Option remains after equally dividing the grant by three, it will vest on the first anniversary of the grant, if two Options remain, then one will vest on each of the first two anniversaries. The Committee shall have the right to accelerate the vesting of any Option; however, the Chairman of the Board or the Senior Executive Vice President-Human Resources, or their respective successors, or such other persons designated by the Committee, shall have the authority to accelerate the vesting of Options for any Participant who is not an Insider.
- 6.6            Exercise of Options. Options granted under the Plan shall be exercisable at such times and be subject to such restrictions and conditions as the Committee shall in each instance approve, which need not be the same for each grant or for each Participant. Exercises of Options may be effect only on days and during the hours that the New York Stock Exchange is open for regular trading. The Company may change or limit the times or days Options may be exercised. If an Option expires on a day or at a time when exercises are not permitted, then the Options may be exercised no later than the immediately preceding date and time that the Options were exercisable.

Options shall be exercised by providing notice to the designated agent selected by the Company (if no such agent has been designated, then to the Company), in the manner and form determined by the Company, which notice shall be irrevocable, setting forth the exact number of Shares with respect to which the Option is being exercised and including with such notice payment of the Exercise Price. When

Options have been transferred, the Company or its designated agent may require appropriate documentation that the person or persons exercising the Option, if other than the Participant, has the right to exercise the Option. No Option may be exercised with respect to a fraction of a Share.

- 6.7            **Payment.** Unless otherwise determined by the Committee, the Exercise Price shall be paid in full at the time of exercise. No Shares shall be issued or transferred until full payment has been received.

Payment may be made:

- (a)        in cash, or
  
- (b)        unless otherwise provided by the Committee at any time, and subject to such additional terms and conditions and/or modifications as the Committee or the Company may impose from time to time, and further subject to suspension or termination of this provision by the Committee or Company at any time, by:
  - (i)        delivery of Shares owned by the Participant in partial (if in partial payment, then together with cash) or full payment; provided, however, as a condition to paying any part of the Exercise Price in Shares, at the time of exercise of the Option, the Participant must establish to the satisfaction of the Company that the Stock tendered to the Company has been held by the Participant for a minimum of six (6) months preceding the tender; or
  
  - (ii)       if the Company has designated a stockbroker to act as the Company's agent to process Option exercises, issuance of an exercise notice together with instructions to such stockbroker irrevocably instructing the stockbroker: (A) to immediately sell (which shall include an exercise notice that becomes effective upon execution of a sale order) a sufficient portion of the Shares to be received from the Option exercise to pay the Exercise Price of the Options being exercised and the required tax withholding, and (B) to deliver on the settlement date the portion of the proceeds of the sale equal to the Exercise Price and tax withholding to the Company. In the event the stockbroker sells any Shares on behalf of a Participant, the stockbroker shall be acting solely as the agent of the Participant, and the Company disclaims any responsibility for the actions of the stockbroker in making any such sales. No Shares shall be issued until the settlement date and until the proceeds (equal to the Option Price and tax withholding) are paid to the Company.

If payment is made by the delivery of Shares, the value of the Shares delivered shall be equal to the then most recent Fair Market Value of the Shares established before the exercise of the Option.

Restricted Stock may not be used to pay the Exercise Price.

6.8 Termination of Employment. Unless otherwise provided by the Committee, the following limitations on exercise of Options shall apply upon Termination of Employment:

- (a) Termination by Death or Disability. In the event of the Participant's Termination of Employment by reason of death or Disability, all outstanding Options granted to that Participant shall immediately vest as of the date of Termination of Employment and may be exercised, if at all, no more than three (3) years from the date of the Termination of Employment, unless the Options, by their terms, expire earlier. However, in the event the Participant was eligible to Retire at the time of Termination of Employment, notwithstanding the foregoing, the Options may be exercised, if at all, no more than five (5) years from the date of the Termination of Employment, unless the Options, by their terms, expire earlier.
- (b) Termination for Cause. In the event of the Participant's Termination of Employment by the Company for Cause, all outstanding Options held by the Participant shall immediately be forfeited to the Company and no additional exercise period shall be allowed, regardless of the vested status of the Options.
- (c) Retirement or Other Termination of Employment. In the event of the Participant's Termination of Employment for any reason other than the reasons set forth in (a) or (b), above:
  - (i) If upon the Participant's Termination of Employment, the Participant is eligible to Retire (and if the Participant is an officer level employee for compensation purposes as determined by AT&T, the employee must also be age 55 or older at Termination of Employment), then all outstanding unvested Options granted to that Participant shall immediately vest as of the date of the Participant's Termination of Employment;
  - (ii) All outstanding Options which are vested as of the effective date of Termination of Employment may be exercised, if at all, no more than five (5) years from the date of Termination of Employment if the Participant is eligible to Retire, or three (3) months from the date of the Termination of Employment if the Participant is not eligible to Retire, as the case may be, unless in either case the Options, by their terms, expire earlier; and
  - (iii) In the event of the death of the Participant after Termination of Employment, this paragraph (c) shall still apply and not paragraph (a), above.

- (d) Options not Vested at Termination. Except as provided in paragraphs (a) and (c)(i), above, all Options held by the Participant which are not vested on or before the effective date of Termination of Employment shall immediately be forfeited to the Company (and the Shares subject to such forfeited Options shall once again become available for issuance under the Plan).
- (e) Notwithstanding the foregoing, the Committee may, in its sole discretion, establish different, or waive, terms and conditions pertaining to the effect of Termination of Employment on Options, whether or not the Options are outstanding, but no such modification shall shorten the terms of Options issued prior to such modification or otherwise be materially adverse to the Participant.

6.9 Employee Transfers. For purposes of the Plan, transfer of employment of a Participant between the Company and any one of its Subsidiaries (or between Subsidiaries) or between the Company or a Subsidiary and a RWAC, to the extent the period of employment at a RWAC is equal to or less than five (5) years, shall not be deemed a Termination of Employment. Provided, however, for purposes of this Article 6, termination of employment with a RWAC without a concurrent transfer to the Company or any of its Subsidiaries shall be deemed a Termination of Employment as that term is used herein. Similarly, termination of an entity's status as a Subsidiary or as a RWAC shall be deemed a Termination of Employment of any Participants employed by such Subsidiary or RWAC.

6.10 Restrictions on Exercise and Transfer of Options. Unless otherwise provided by the Committee:

- (a) During the Participant's lifetime, the Participant's Options shall be exercisable only by the Participant or by the Participant's guardian or legal representative. After the death of the Participant, except as otherwise provided by AT&T's Rules for Employee Beneficiary Designations, an Option shall only be exercised by the holder thereof (including, but not limited to, an executor or administrator of a decedent's estate) or his or her guardian or legal representative.
- (b) No Option shall be transferable except: (i) in the case of the Participant, only upon the Participant's death and in accordance with the AT&T Rules for Employee Beneficiary Designations; and (ii) in the case of any holder after the Participant's death, only by will or by the laws of descent and distribution.

6.11 Competition and Solicitation. In the event a Participant directly or indirectly, engages in competitive activity, or has become associated with, employed by, controls, or renders service to any business that is engaged in competitive activity, with (i) the Company, (ii) any Subsidiary, or (iii) any business in which any of the foregoing have a substantial interest, or if the Participant attempts, directly or

indirectly, to induce any employee of the Company or a Subsidiary to be employed or perform services elsewhere without the permission of the Company, then the Company may (i) cancel any Option granted to such Participant, whether or not vested, in whole or in part; and/or (ii) rescind any exercise of the Participant's Options that occurred on or after that date six months prior to engaging in such activity, in which case the Participant shall pay the Company the gain realized or received upon such exercise of Options. "Has become associated with" shall include, among other things, beneficial ownership of 1/10 of 1% or more of a business engaged in competitive activity. The determination of whether a Participant has engaged in any such activity and whether to cancel Options and/or rescind the exercise of Options shall be made by AT&T, and in each case such determination shall be final, conclusive and binding on all persons.

Article 7            Restricted Stock.

- 7.1            Grant of Restricted Stock. Subject to the terms and provisions of the Plan, the Committee, at any time and from time to time, may grant Shares of Restricted Stock to eligible Employees in such amounts and upon such terms and conditions as the Committee shall determine. In addition to any other terms and conditions imposed by the Committee, vesting of Restricted Stock may be conditioned upon the achievement of Performance Goals in the same manner as provided in Section 8.4, herein, with respect to Performance Shares. No Employee may be awarded, in any calendar year, a number of Shares in the form of Restricted Stock (or Restricted Stock Units) exceeding one percent (1%) of the Shares approved for issuance under this Plan.
- 7.2            Restricted Stock Agreement. The Committee may require, as a condition to receiving a Restricted Stock Award, that the Participant enter into a Restricted Stock Award Agreement, setting forth the terms and conditions of the Award. In lieu of a Restricted Stock Award Agreement, the Committee may provide the terms and conditions of an Award in a notice to the Participant of the Award, on the Stock certificate representing the Restricted Stock, in the resolution approving the Award, or in such other manner as it deems appropriate.
- 7.3            Transferability. Except as otherwise provided in this Article 7, and subject to any additional terms in the grant thereof, Shares of Restricted Stock granted herein may not be sold, transferred, pledged, assigned, or otherwise alienated or hypothecated until fully vested.
- 7.4            Restrictions. The Restricted Stock shall be subject to such vesting terms, including the achievement of Performance Goals (as described in Section 8.4), as may be determined by the Committee. Unless otherwise provided by the Committee, to the extent Restricted Stock is subject to any condition to vesting, if such condition or conditions are not satisfied by the time the period for achieving such condition has expired, such Restricted Stock shall be forfeited. The Committee may impose such

other conditions and/or restrictions on any Shares of Restricted Stock granted pursuant to the Plan as it may deem advisable including but not limited to a requirement that Participants pay a stipulated purchase price for each Share of Restricted Stock and/or restrictions under applicable Federal or state securities laws; and may legend the certificates representing Restricted Stock to give appropriate notice of such restrictions. The Committee may also grant Restricted Stock without any terms or conditions in the form of vested Stock Awards.

The Company shall also have the right to retain the certificates representing Shares of Restricted Stock in the Company's possession until such time as the Shares are fully vested and all conditions and/or restrictions applicable to such Shares have been satisfied.

- 7.5            Removal of Restrictions. Except as otherwise provided in this Article 7 or otherwise provided in the grant thereof, Shares of Restricted Stock covered by each Restricted Stock grant made under the Plan shall become freely transferable by the Participant after completion of all conditions to vesting, if any. However, the Committee, in its sole discretion, shall have the right to immediately vest the shares and waive all or part of the restrictions and conditions with regard to all or part of the Shares held by any Participant at any time.
- 7.6            Voting Rights, Dividends and Other Distributions. Participants holding Shares of Restricted Stock granted hereunder may exercise full voting rights and shall receive all regular cash dividends paid with respect to such Shares. Except as provided in the following sentence, in the sole discretion of the Committee, other cash dividends and other distributions paid to Participants with respect to Shares of Restricted Stock may be subject to the same restrictions and conditions as the Shares of Restricted Stock with respect to which they were paid. If any such dividends or distributions are paid in Shares, the Shares shall be subject to the same restrictions and conditions as the Shares of Restricted Stock with respect to which they were paid.
- 7.7            Termination of Employment Due to Death or Disability. In the event of the Participant's Termination of Employment by reason of death or Disability, all restrictions imposed on outstanding Shares of Restricted Stock held by the Participant shall immediately lapse and the Restricted Stock shall immediately become fully vested as of the date of Termination of Employment.
- 7.8            Termination of Employment for Other Reasons. Unless otherwise provided by the Committee, in the event of the Participant's Termination of Employment for any reason other than those specifically set forth in Section 7.7 herein, all Shares of Restricted Stock held by the Participant which are not vested as of the effective date of Termination of Employment immediately shall be forfeited and returned to the Company.

7.9 Employee Transfers. For purposes of the Plan, transfer of employment of a Participant between the Company and any one of its Subsidiaries (or between Subsidiaries) or between the Company or a Subsidiary and a RWAC, to the extent the period of employment at a RWAC is equal to or less than five (5) years, shall not be deemed a Termination of Employment. Provided, however, for purposes of this Article, termination of employment with a RWAC without a concurrent transfer to the Company or any of its Subsidiaries shall be deemed a Termination of Employment as that term is used herein. Similarly, termination of an entity's status as a Subsidiary or as a RWAC shall be deemed a Termination of Employment of any Participants employed by such Subsidiary or RWAC.

7.10 Restricted Stock Units. In lieu of or in addition to Restricted Stock, the Committee may grant Restricted Stock Units ("Units") under such terms and conditions as shall be determined by the Committee. Units shall otherwise be subject to the same terms and conditions under this Plan as Restricted Stock (including but not limited to Change in Control provisions), except that upon vesting, the Participant holding such Units shall receive Shares (or cash equal to the Fair Market Value of the number of Shares) equal to the number of such Units. Units shall have no voting rights, and Units shall not receive dividends, but shall, unless otherwise provided by the Committee, receive dividend equivalents at the time and at the same rate per Unit as dividends are paid per Share with the same record and pay dates.

Article 8 Performance Units and Performance Shares.

8.1 Grants of Performance Units and Performance Shares. Subject to the terms of the Plan, Performance Shares and Performance Units may be granted to eligible Employees at any time and from time to time, as determined by the Committee. The Committee shall have complete discretion in determining the number of Performance Units and/or Performance Shares Awarded to each Participant and the terms and conditions of each such Award.

8.2 Value of Performance Shares and Units.

- (a) A Performance Share is equivalent in value to a Share. In any calendar year, no individual may be awarded Performance Shares having a potential payout of Shares exceeding one percent (1%) of the Shares approved for issuance under this Plan.
- (b) A Performance Unit shall be equal in value to a fixed dollar amount determined by the Committee. In any calendar year, no individual may be Awarded Performance Units having a potential payout equivalent exceeding the Fair Market Value, as of the date of granting the Award, of one percent (1%) of the Shares approved for issuance under this Plan. The number of Shares equivalent to the potential payout of a Performance Unit shall be determined by dividing the maximum cash payout of the Award by the Fair



Market Value per Share on the effective date of the grant. The Committee may denominate a Performance Unit Award in dollars instead of Performance Units. A Performance Unit Award may be referred to as a "Key Executive Officer Short Term Award."

8.3 Performance Period. The Performance Period for Performance Shares and Performance Units is the period over which the Performance Goals are measured. The Performance Period is set by the Committee for each Award; however, in no event shall an Award have a Performance Period of less than one year.

8.4 Performance Goals. For each Award of Performance Shares or Performance Units, the Committee shall establish (and may establish for other Awards) performance objectives ("Performance Goals") for the Company, its Subsidiaries, and/or divisions of any of foregoing, using the Performance Criteria and other factors set forth in (a) and (b), below. It may also use other criteria or factors in establishing Performance Goals in addition to or in lieu of the foregoing. A Performance Goal may be stated as an absolute value or as a value determined relative to an index, budget, prior period, similar measures of a peer group of other companies or other standard selected by the Committee. Performance Goals shall include payout tables, formulas or other standards to be used in determining the extent to which the Performance Goals are met, and, if met, the number of Performance Shares and/or Performance Units which would be converted into Stock and/or cash (or the rate of such conversion) and distributed to Participants in accordance with Section 8.6. Unless previously canceled or reduced, Performance Shares and Performance Units which may not be converted because of failure in whole or in part to satisfy the relevant Performance Goals or for any other reason shall be canceled at the time they would otherwise be distributable. When the Committee desires an Award of Performance Shares, Performance Units, Restricted Stock or Restricted Stock Units to qualify under Section 162(m) of the Code, as amended, the Committee shall establish the Performance Goals for the respective Award prior to or within 90 days of the beginning of the Performance Period relating to such Performance Goal, and not later than after 25% of such period has elapsed. For all other Awards, the Performance Goals must be established before the end of the respective Performance Period.

(a) The Performance Criteria which the Committee is authorized to use, in its sole discretion, are any of the following criteria or any combination thereof, including but not limited to the offset against each other of any combination of the following criteria:

(1) Financial performance of the Company (on a consolidated basis), of one or more of its Subsidiaries, and/or a division of any of the foregoing. Such financial performance may be based on net income, Value Added (after-tax cash operating profit less depreciation and less a capital charge), EBITDA (earnings before interest, taxes, depreciation and amortization), revenues, sales, expenses, costs, gross

margin, operating margin, profit margin, pre-tax profit, market share, volumes of a particular product or service or category thereof, including but not limited to the product's life cycle (for example, products introduced in the last 2 years), number of customers or subscribers, number of items in service, including but not limited to every category of access or other telecommunication or television lines, return on net assets, return on assets, return on capital, return on invested capital, cash flow, free cash flow, operating cash flow, operating revenues, operating expenses, and/or operating income.

- (2) Service performance of the Company (on a consolidated basis), of one or more of its Subsidiaries, and/or of a division of any of the foregoing. Such service performance may be based upon measured customer perceptions of service quality. Employee satisfaction, employee retention, product development, completion of a joint venture or other corporate transaction, completion of an identified special project, and effectiveness of management.
  - (3) The Company's Stock price, return on stockholders' equity, total stockholder return (Stock price appreciation plus dividends, assuming the reinvestment of dividends), and/or earnings per Share.
  - (4) Impacts of acquisitions, dispositions, or restructurings, on any of the foregoing.
- (b) Except to the extent otherwise provided by the Committee in full or in part, if any of the following events occur during a Performance Period and would directly affect the determination of whether or the extent to which Performance Goals are met, the effects of such events shall be disregarded in any such computation: changes in accounting principles; extraordinary items; changes in tax laws affecting net income and/or Value Added; natural disasters, including but not limited to floods, hurricanes, and earthquakes; and intentionally inflicted damage to property which directly or indirectly damages the property of the Company or its Subsidiaries. No such adjustment shall be made to the extent such adjustment would cause the Award to fail to satisfy the performance based exemption of Section 162(m) of the Code.
- 8.5 Dividend Equivalents on Performance Shares. Unless reduced or eliminated by the Committee, a cash payment in an amount equal to the dividend payable on one Share will be made to each Participant for each Performance Share held by a Participant on the record date for the dividend.
- 8.6 Form and Timing of Payment of Performance Units and Performance Shares. As soon as practicable after the applicable Performance Period has ended and all other conditions (other than Committee actions) to conversion and distribution of a Performance Share and/or Performance Unit Award have been satisfied (or, if

applicable, at such other time determined by the Committee at or before the establishment of the Performance Goal), the Committee shall determine whether and the extent to which the Performance Goals were met for the applicable Performance Units and Performance Shares. If Performance Goals have been met, then the number of Performance Units and Performance Shares to be converted into Stock and/or cash and distributed to the Participants shall be determined in accordance with the Performance Goals for such Awards, subject to any limits imposed by the Committee. Unless the Participant has elected to defer all or part of his Performance Units or Performance Shares as provided in Article 10, herein, payment of Performance Units and Performance Shares shall be made in a single lump sum, as soon as reasonably administratively possible following the determination of the number of Shares or amount of cash to which the Participant is entitled. Performance Units will be distributed to Participants in the form of cash. Performance Shares will be distributed to Participants in the form of 50% Stock and 50% Cash, or at the Participant's election, 100% Stock or 100% Cash. In the event the Participant is no longer an Employee at the time of the distribution, then the distribution shall be 100% in cash, provided the Participant may elect to take 50% or 100% in Stock. At any time prior to the distribution of the Performance Shares and/or Performance Units (or if distribution has been deferred, then prior to the time the Awards would have been distributed), unless otherwise provided by the Committee or prohibited by this Plan (such as in the case of a Change in Control), the Committee shall have the authority to reduce or eliminate the number of Performance Units or Performance Shares to be converted and distributed, or to cancel any part or all of a grant or award of Performance Units or Performance Shares, or to mandate the form in which the Award shall be paid (i.e., in cash, in Stock or both, in any proportions determined by the Committee).

Unless otherwise provided by the Committee, any election to take a greater amount of cash or Stock with respect to Performance Shares must be made in the calendar year prior to the calendar year in which the Performance Shares are distributed (or if distribution has been deferred, then in the year prior to the year the Performance Shares would have been distributed absent such deferral).

For the purpose of converting Performance Shares into cash and distributing the same to the holders thereof (or for determining the amount of cash to be deferred), the value of a Performance Share shall be the Fair Market Value of a Share on the date the Committee authorizes the payout of Awards. Performance Shares to be distributed in the form of Stock will be converted at the rate of one (1) Share per Performance Share.

- 8.7            Termination of Employment Due to Death or Disability. In the event of the Participant's Termination of Employment by reason of death or Disability, the Participant shall receive a lump sum payout of all outstanding Performance Units and Performance Shares calculated as if all unfinished Performance Periods had ended with 100% of the Performance Goals achieved, payable in the year following the date of Termination of Employment.

- 8.8 Termination of Employment for Other Reasons. Unless the Committee determines otherwise, in the event of the Participant's Termination of Employment for other than a reason set forth in Section 8.7 (and other than for Cause), if the Participant is not Retirement eligible at Termination of Employment, then upon Termination, the number of the Participant's Performance Units and/or Performance Shares shall be reduced at the time of the Termination of Employment so that the Participant may receive no more than a prorated payout of all Performance Units and Performance Shares granted, based on the number of months the Participant worked at least one day during the respective Performance Period divided by the number of months in the Performance Period.
- 8.9 Termination of Employment for Cause. In the event of the Termination of Employment of a Participant by the Company for Cause, all Performance Units and Performance Shares shall be forfeited by the Participant to the Company.
- 8.10 Nontransferability. Performance Units and Performance Shares may not be sold, transferred, pledged, assigned, or otherwise alienated or hypothecated, other than in accordance with the AT&T Rules for Employee Beneficiary Designations.
- Article 9 Beneficiary Designation. In the event of the death of a Participant, distributions or Awards under this Plan, other than Restricted Stock, shall pass in accordance with the AT&T Rules for Employee Beneficiary Designations, as the same may be amended from time to time. Beneficiary Designations of a Participant received by AT&T prior to November 16, 2001, that were applicable to awards under the 1996 Stock and Incentive Plan will also apply to awards under this Plan unless and until the Participant provides to the contrary in accordance with the procedures set forth in such Rules.
- Article 10 Deferrals. Unless otherwise provided by the Committee, a Participant may, as permitted by the Company, defer all or part of Awards made under this Plan in accordance with and subject to the terms of such plans so long as such deferral is determined by the Company to be consistent in all respects with Section 409A of the Code.
- Article 11 Employee Matters.
- 11.1 Employment Not Guaranteed. Nothing in the Plan shall interfere with or limit in any way the right of the Company or any Subsidiary to terminate any Participant's Employment at any time, nor confer upon any Participant any right to continue in the employ of the Company or one of its Subsidiaries.

- 11.2 Participation. No Employee shall have the right to be selected to receive an Award under this Plan, or, having been so selected, to be selected to receive a future Award.

Article 12 Change in Control.

Unless the Committee provides otherwise prior to the grant of an Award, upon the occurrence of a Change in Control, the following shall apply to such Award:

- (a) Any and all Options granted hereunder to a Participant immediately shall become vested and exercisable upon the Termination of Employment of the Participant by the Company or by the Participant for “Good Reason”;
- (b) Any Restriction Periods and all restrictions imposed on Restricted Stock shall lapse and they shall immediately become fully vested upon the Termination of Employment of the Participant by the Company or by the Participant for “Good Reason”;
- (c) Unless otherwise determined by the Committee, the payout of Performance Units and Performance Shares shall be determined exclusively by the attainment of the Performance Goals established by the Committee, which may not be modified after the Change in Control, and AT&T shall not have the right to reduce the Awards for any other reason;
- (d) For purposes of this Plan, “Good Reason” means in connection with a termination of employment by a Participant within two (2) years following a Change in Control, (a) an adverse alteration in the Participant’s position or in the nature or status of the Participant’s responsibilities from those in effect immediately prior to the Change in Control, or (b) any reduction in the Participant’s base salary rate or target annual bonus, in each case as in effect immediately prior to the Change in Control, or (c) the relocation of the Participant’s principal place of employment to a location that is more than fifty (50) miles from the location where the Participant was principally employed at the time of the Change in Control (except for required travel on the Company’s business to an extent substantially consistent with the Participant’s customary business travel obligations in the ordinary course of business prior to the Change in Control).

Article 13 Amendment, Modification, and Termination.

- 13.1 Amendment, Modification, and Termination. The Board or the Disinterested Committee may at any time and from time to time, alter or amend the Plan or any Award in whole or in part or suspend or terminate the Plan in whole or in part.

13.2        Awards Previously Granted. No termination, amendment, or modification of the Plan or any Award shall adversely affect in any material way any Award previously granted under the Plan, without the written consent of the Participant holding such Award; provided, however, that any such modification made for the purpose of complying with Section 409A of the Code may be made by the Company without the consent of any Participant.

13.3        Delay in Payment. To the extent required in order to avoid the imposition of any interest and/or additional tax under Section 409A(a)(1)(B) of the Code, any payments or deliveries due as a result of a Termination of Employment may be delayed for six months if a Participant is deemed to be a "specified employee" as defined in Section 409A(a)(2)(i)(B) of the Code.

Article 14        Withholding.

14.1        Tax Withholding. Unless otherwise provided by the Committee, the Company shall deduct or withhold an amount sufficient to satisfy Federal, state, and local taxes (including but not limited to the Participant's employment tax obligations) required by law to be withheld with respect to any taxable event arising or as a result of this Plan ("Withholding Taxes").

14.2        Share Withholding. Unless otherwise provided by the Committee, upon the exercise of Options, the lapse of restrictions on Restricted Stock, the distribution of Performance Shares in the form of Stock, or any other taxable event hereunder involving the transfer of Stock to a Participant, the Company shall withhold Stock equal in value, using the Fair Market Value on the date determined by the Company to be used to value the Stock for tax purposes, to the Withholding Taxes applicable to such transaction.

Any fractional Share of Stock payable to a Participant shall be withheld as additional Federal withholding, or, at the option of the Company, paid in cash to the Participant.

Unless otherwise determined by the Committee, when the method of payment for the Exercise Price is from the sale by a stockbroker pursuant to Section 6.7(b)(ii), herein, of the Stock acquired through the Option exercise, then the tax withholding shall be satisfied out of the proceeds. For administrative purposes in determining the amount of taxes due, the sale price of such Stock shall be deemed to be the Fair Market Value of the Stock.

If permitted by the Committee, prior to the end of any Performance Period a Participant may elect to have a greater amount of Stock withheld from the distribution of Performance Shares to pay withholding taxes; provided, however, the Committee may prohibit or limit any individual election or all such elections at any time.

Article 15            Successors.

All obligations of the Company under the Plan, with respect to Awards granted hereunder, shall be binding on any successor to the Company, whether the existence of such successor is the result of a direct or indirect purchase, merger, consolidation, or otherwise, of all or substantially all of the business and/or assets of the Company.

Article 16            Legal Construction.

- 16.1            Gender and Number. Except where otherwise indicated by the context, any masculine term used herein also shall include the feminine; the plural shall include the singular and the singular shall include the plural.
- 16.2            Severability. In the event any provision of the Plan shall be held illegal or invalid for any reason, the illegality or invalidity shall not affect the remaining parts of the Plan, and the Plan shall be construed and enforced as if the illegal or invalid provision had not been included.
- 16.3            Requirements of Law. The granting of Awards and the issuance of Shares under the Plan shall be subject to all applicable laws, rules, and regulations, and to such approvals by any governmental agencies or national securities exchanges as may be required.
- 16.4            Errors. At any time AT&T may correct any error made under the Plan without prejudice to AT&T. Such corrections may include, among other things, changing or revoking an issuance of an Award.
- 16.5            Elections and Notices. Notwithstanding anything to the contrary contained in this Plan, all elections and notices of every kind shall be made on forms prepared by AT&T or the General Counsel, Secretary or Assistant Secretary, or their respective delegates or shall be made in such other manner as permitted or required by AT&T or the General Counsel, Secretary or Assistant Secretary, or their respective delegates, including but not limited to elections or notices through electronic means, over the Internet or otherwise. An election shall be deemed made when received by AT&T (or its designated agent, but only in cases where the designated agent has been appointed for the purpose of receiving such election), which may waive any defects in form. AT&T may limit the time an election may be made in advance of any deadline.

Where any notice or filing required or permitted to be given to AT&T under the Plan, it shall be delivered to the principal office of AT&T, directed to the attention

of the Senior Executive Vice President-Human Resources of AT&T or his or her successor. Such notice shall be deemed given on the date of delivery.

Notice to the Participant shall be deemed given when mailed (or sent by telecopy) to the Participant's work or home address as shown on the records of AT&T or, at the option of AT&T, to the Participant's e-mail address as shown on the records of AT&T. It is the Participant's responsibility to ensure that the Participant's addresses are kept up to date on the records of AT&T. In the case of notices affecting multiple Participants, the notices may be given by general distribution at the Participants' work locations.

16.6            Governing Law. To the extent not preempted by Federal law, the Plan, and all awards and agreements hereunder, and any and all disputes in connection therewith, shall be governed by and construed in accordance with the substantive laws of the State of Texas, without regard to conflict or choice of law principles which might otherwise refer the construction, interpretation or enforceability of this Plan to the substantive law of another jurisdiction.

16.7            Venue. Because awards under the Plan are granted in Texas, records relating to the Plan and awards thereunder are located in Texas, and the Plan and awards thereunder are administered in Texas, the Company and the Participant to whom an award under this Plan is granted, for themselves and their successors and assigns, irrevocably submit to the exclusive and sole jurisdiction and venue of the state or federal courts of Texas with respect to any and all disputes arising out of or relating to this Plan, the subject matter of this Plan or any awards under this Plan, including but not limited to any disputes arising out of or relating to the interpretation and enforceability of any awards or the terms and conditions of this Plan. To achieve certainty regarding the appropriate forum in which to prosecute and defend actions arising out of or relating to this Plan, and to ensure consistency in application and interpretation of the Governing Law to the Plan, the parties agree that (a) sole and exclusive appropriate venue for any such action shall be an appropriate federal or state court in Bexar County, Texas, and no other, (b) all claims with respect to any such action shall be heard and determined exclusively in such Texas court, and no other, (c) such Texas court shall have sole and exclusive jurisdiction over the person of such parties and over the subject matter of any dispute relating hereto and (d) that the parties waive any and all objections and defenses to bringing any such action before such Texas court, including but not limited to those relating to lack of personal jurisdiction, improper venue or *forum non conveniens*.



**AT&T Inc.**  
**COMPUTATION OF RATIOS OF EARNINGS TO FIXED CHARGES**  
Dollars in Millions

	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Income Before Income Taxes, Extraordinary Items and Cumulative Effect of Accounting Changes*	\$ 5,267	\$ 6,623	\$ 7,751	\$ 8,685	\$ 9,984
Add: Interest Expense	1,456	1,023	1,191	1,382	1,599
Dividends on Preferred Securities	31	24	22	24	57
1/3 Rental Expense	157	160	140	195	266
Adjusted Earnings	<u>\$ 6,911</u>	<u>\$ 7,830</u>	<u>\$ 9,104</u>	<u>\$ 10,286</u>	<u>\$ 11,906</u>
Total Interest Charges	\$ 1,492	\$ 1,054	\$ 1,228	\$ 1,440	\$ 1,718
Dividends on Preferred Securities	31	24	22	24	57
1/3 Rental Expense	157	160	140	195	266
Adjusted Fixed Charges	<u>\$ 1,680</u>	<u>\$ 1,238</u>	<u>\$ 1,390</u>	<u>\$ 1,659</u>	<u>\$ 2,041</u>
Ratio of Earnings to Fixed Charges	4.11	6.32	6.55	6.20	5.83

\* All periods presented exclude undistributed earnings on investments accounted for under the equity method as well as "Income From Discontinued Operations, net of tax" in our Consolidated Statements of Income, which was from the sale of our interest in the directory advertising business in Illinois and northwest Indiana.

## Selected Financial and Operating Data

Dollars in millions except per share amounts

At December 31 or for the year ended:	2005	2004	2003	2002	2001
<b>Financial Data<sup>1,2</sup></b>					
Operating revenues	\$43,862	\$40,787	\$40,498	\$42,821	\$45,381
Operating expenses	\$37,694	\$34,886	\$34,214	\$34,383	\$35,085
Operating income	\$6,168	\$5,901	\$6,284	\$8,438	\$10,296
Interest expense	\$1,456	\$1,023	\$1,191	\$1,382	\$1,599
Equity in net income of affiliates	\$609	\$873	\$1,253	\$1,921	\$1,595
Other income (expense) – net	\$14	\$922	\$1,767	\$733	\$(236)
Income taxes	\$932	\$2,186	\$2,857	\$2,910	\$3,858
<b>Income from continuing operations</b>	<b>\$4,786</b>	<b>\$4,979</b>	<b>\$5,859</b>	<b>\$7,361</b>	<b>\$6,881</b>
<b>Income from discontinued operations, net of tax<sup>3</sup></b>	<b>\$-</b>	<b>\$908</b>	<b>\$112</b>	<b>\$112</b>	<b>\$127</b>
<b>Income before extraordinary item and cumulative effect of accounting changes</b>	<b>\$4,786</b>	<b>\$5,887</b>	<b>\$5,971</b>	<b>\$7,473</b>	<b>\$7,008</b>
<b>Net income<sup>4</sup></b>	<b>\$4,786</b>	<b>\$5,887</b>	<b>\$8,505</b>	<b>\$5,653</b>	<b>\$7,008</b>
<b>Earnings per common share:</b>					
<b>Income from continuing operations</b>	<b>\$1.42</b>	<b>\$1.50</b>	<b>\$1.77</b>	<b>\$2.21</b>	<b>\$2.04</b>
<b>Income before extraordinary item and cumulative effect of accounting changes</b>	<b>\$1.42</b>	<b>\$1.78</b>	<b>\$1.80</b>	<b>\$2.24</b>	<b>\$2.08</b>
<b>Net income<sup>4</sup></b>	<b>\$1.42</b>	<b>\$1.78</b>	<b>\$2.56</b>	<b>\$1.70</b>	<b>\$2.08</b>
<b>Earnings per common share—assuming dilution:</b>					
<b>Income from continuing operations</b>	<b>\$1.42</b>	<b>\$1.50</b>	<b>\$1.76</b>	<b>\$2.20</b>	<b>\$2.03</b>
<b>Income before extraordinary item and cumulative effect of accounting changes</b>	<b>\$1.42</b>	<b>\$1.77</b>	<b>\$1.80</b>	<b>\$2.23</b>	<b>\$2.07</b>
<b>Net income<sup>4</sup></b>	<b>\$1.42</b>	<b>\$1.77</b>	<b>\$2.56</b>	<b>\$1.69</b>	<b>\$2.07</b>
Total assets	\$145,632	\$110,265	\$102,016	\$95,170	\$96,416
Long-term debt	\$26,115	\$21,231	\$16,097	\$18,578	\$17,153
Construction and capital expenditures	\$5,576	\$5,099	\$5,219	\$6,808	\$11,189
Dividends declared per common share <sup>5</sup>	\$1.30	\$1.26	\$1.41	\$1.08	\$1.025
Book value per common share	\$14.11	\$12.27	\$11.57	\$10.01	\$9.82
Ratio of earnings to fixed charges	4.11	6.32	6.55	6.20	5.83
Debt ratio	35.9%	40.0%	32.0%	39.9%	44.3%
Weighted-average common shares outstanding (000,000)	3,368	3,310	3,318	3,330	3,366
Weighted-average common shares outstanding with dilution (000,000)	3,379	3,322	3,329	3,348	3,396
End of period common shares outstanding (000,000)	3,877	3,301	3,305	3,318	3,354
<b>Operating Data</b>					
Network access lines in service (000) <sup>6</sup>	49,413	52,356	54,683	57,083	59,532
DSL lines in service (000) <sup>6</sup>	6,921	5,104	3,515	2,199	1,333
Wireless customers (000) – Cingular <sup>7</sup>	54,144	49,132	24,027	21,925	21,596
Number of employees <sup>2</sup>	189,950	162,700	168,950	175,980	193,420

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

<sup>2</sup> Amounts in 2005 reflect results from AT&T Corp. for the 43 days following the November 18, 2005 acquisition.

<sup>3</sup> Our 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."

<sup>4</sup> Amounts 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" 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" 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."

<sup>5</sup> Dividends declared by AT&T's Board of Directors reflect the following: 2003, includes three additional dividends totaling \$0.25 per share above our regular quarterly dividend payout.

<sup>6</sup> The number presented reflects wireline segment lines in service.

<sup>7</sup> The 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. 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

For ease of reading, AT&T Inc. is referred to as "we," "AT&T," or the "Company" throughout this document and the names of the particular subsidiaries and affiliates providing the services have been omitted. Prior to the November 18, 2005 acquisition of AT&T Corp. (ATTC), we were known as SBC Communications Inc. (SBC). AT&T is a holding company; AT&T does not provide communications services, rather, its subsidiaries and affiliates operate in the communications services industry both domestically and internationally 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 2006 in the "Operating Environment and Trends of the Business" section.

We completed our acquisition of ATTC on November 18, 2005. In accordance with U.S. generally accepted accounting principles (GAAP), we included results from ATTC in our consolidated results for the remaining 43 days of 2005 (see Note 2). Operating results for ATTC prior to our acquisition are not discussed. Also in accordance with GAAP, our financial statements 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.

	Percent Change				
	2005	2004	2003	2005 vs.	2004 vs.
				2004	2003
Operating revenues	<b>\$43,862</b>	\$40,787	\$40,498	<b>7.5%</b>	0.7%
Operating expenses	<b>37,694</b>	34,886	34,214	<b>8.0</b>	2.0
Operating income	<b>6,168</b>	5,901	6,284	<b>4.5</b>	(6.1)
Income before income taxes	<b>5,718</b>	7,165	8,716	<b>(20.2)</b>	(17.8)
Income from continuing operations	<b>4,786</b>	4,979	5,859	<b>(3.9)</b>	(15.0)
Income from discontinued operations, net of tax	-	908	112	-	-
Income before extraordinary item and cumulative effect of accounting changes	<b>4,786</b>	5,887	5,971	<b>(18.7)</b>	(1.4)
Extraordinary item <sup>1</sup>	-	-	(7)	-	-
Cumulative effect of accounting changes <sup>2</sup>	-	-	2,541	-	-
Net income	<b>4,786</b>	5,887	8,505	<b>(18.7)</b>	(30.8)
Diluted earnings per share	<b>1.42</b>	1.77	2.56	<b>(19.8)</b>	(30.9)

<sup>1</sup> 2003 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).

<sup>2</sup> 2003 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.

## Management's Discussion and Analysis of Financial Condition and Results of Operations, continued

Dollars in millions except per share amounts

### Overview

**Operating income** Our operating income increased \$267, or 4.5%, in 2005 and decreased \$383, or 6.1% in 2004. Our operating income margin decreased from 15.5% in 2003 to 14.5% in 2004 and 14.1% in 2005. Approximately \$118 of the \$267 increase in operating income during 2005 was due to our AT&T Corp. segment results. Our increased operating income in 2005 was driven by further growth in Data and Long-distance voice revenues, reflecting increased volumes, our continued emphasis on our bundling strategy and the addition of new business customers, partially offset by a decline in our Voice revenue as we continue to experience increasing competition. The operating margin decrease in 2005 reflects additional operating expenses associated with a charge to terminate an agreement with WiTel Communications (WiTel) and merger-related charges. The operating income and associated margin decrease in 2004 was primarily due to increased cost of sales and expenses from strike preparation and labor settlements. These expense increases were larger than the increase in revenue, which was attributable to growth in Long-distance voice and Data revenues partially offset by the decline in Voice revenue caused by a decline in retail access lines.

Retail access lines continued to decline due to increased competition, as customers disconnected both primary and additional lines and began using wireless and, to a lesser extent, Voice over Internet Protocol (VoIP) technology and cable instead of phone lines for voice and data. This was also a contributing factor in the year-ago period. Retail access lines also declined for both periods due to 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 primary lines to a competitor that relies on a resale or commercial UNE-P replacements (commercial agreements with various Unbundled Network Element-Platform or "UNE-P" providers) (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 or a facilities-based competitor. 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 and facilities-based competition will continue to pressure our operating margins. Although retail access line losses have continued, the trend has slowed, reflecting in part our ability to offer retail nationwide long-distance service as well as offerings combining multiple services for one fixed price (bundles).

The decline in Voice revenue for both 2005 and 2004 also reflects decreasing wholesale revenues from lines provided under UNE-P rules (which include commercial UNE-P replacements), reflecting changes in UNE-P rules over the past two years. During the 12-month transition period for the elimination of the UNE-P requirements (which ends in March 2006), we have been experiencing a decrease in the number of UNE-P lines as competitors move to alternate arrangements to serve their customers or their customers choose an alternative technology. Since this transition period started, our wholesale customers representing a majority of our UNE-P lines have signed commercial agreements with us. For the remaining UNE-P lines, we believe, based on marketing research, that customers are primarily switching from their UNE-P provider to alternative technology or facilities-based competitors (competitors with their own networks) as opposed to returning as our retail customers. For additional details on UNE-P, see "Triennial Review Remand Order" discussed in "Regulatory Developments."

**Operating revenues** Our operating revenues increased \$3,075, or 7.5%, in 2005 and \$289, or 0.7%, in 2004. Operating revenues from our AT&T Corp. segment were \$2,887. Our significant revenue impacts are listed below and discussed in greater detail in our "Segment Results" section.

- Data revenues increased \$1,980 in 2005 and \$834 in 2004, primarily driven by additional revenues of \$1,129 from ATTC in 2005 and continued growth in DSL for both periods.
- Long-distance voice revenues increased \$1,667 in 2005 and \$736 in 2004, mostly attributable to ATTC revenues of \$1,208 in 2005 and increased bundled sales of combined long-distance and local calling fixed-fee offerings in both periods.

These increases in Data and Long-distance voice revenues were partially offset by declines of \$759 in 2005 and \$1,190 in 2004 in Voice revenues, primarily resulting from the loss of retail and wholesale access lines

## Management's Discussion and Analysis of Financial Condition and Results of Operations, continued

Dollars in millions except per share amounts

and lower prices due to increased competition. The decline in our 2005 Voice revenues was slightly offset by the inclusion of ATTC Voice revenues for 43 days. Our 2005 Voice revenue decline also reflects an increase of \$60 in 2004 related to regulatory and other matters, including the California Public Utilities Commission's (CPUC) September 2004 decision on UNE-P rates (see "State UNE Pricing Proceedings" discussed in "Regulatory Developments").

**Operating expenses** Our operating expenses increased \$2,808, or 8.0%, in 2005 and \$672, or 2.0%, in 2004. Our significant expense changes are listed below and discussed in greater detail in our "Segment Results" sections.

### 2005

- Following our acquisition of ATTC, we included approximately \$2,769 of its operating expenses for the 43-day period ended December 31, 2005. This included depreciation and amortization expense of \$414, of which \$191 was associated with acquired intangible assets.
- Merger-related asset impairments and severance accruals increased operating expense approximately \$349 and \$283, respectively.
- Costs primarily associated with wage increases increased operating expense approximately \$338.
- A charge to terminate existing agreements with WiTel increased operating expenses approximately \$236.
- Traffic compensation in our wireline segment (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 \$330. Included in ATTC's operating expenses was traffic compensation expense, a significant expense for our AT&T Corp. segment, of approximately \$1,102 for the 43 days.
- Costs associated with equipment sales and related network integration services reflecting sales in the large-business market, and prior to the amendment discussed in "Other Business Matters," our co-branded AT&T | DISH Network satellite TV service, which had more total customers than in the prior year, increased operating expenses approximately \$195.

Partially offsetting the 2005 increase were reduced expenses of approximately \$590 associated with reduced workforce levels and lower depreciation expenses of approximately \$333 in the wireline segment as well as the 2004 charges of approximately \$263 associated with strike preparation and labor contract settlements. Expenses also reflect an increase of approximately \$49 for net pension and postretirement cost, a decrease of approximately \$96 associated with changes in retiree out-of-region phone concessions in 2005 and \$90 due to a charge resulting from an amendment to our management pension plan in 2004 (see Note 10).

### 2004

- 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.
- Net impacts from strike preparation and labor settlements increased operating expenses approximately \$263.
- Costs associated with traffic compensation primarily due to higher call volumes generated by growth in our long-distance business, increased operating expenses approximately \$122.
- A fourth-quarter 2004 amendment to our management pension plan resulted in a charge which increased operating expenses approximately \$90.

The 2004 increases were partially offset by decreased combined pension and postretirement cost of approximately \$548. 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. Also contributing to the decreased

## Management's Discussion and Analysis of Financial Condition and Results of Operations, continued

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combined pension and postretirement costs were 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 those expense decreases were (1) higher-than-expected medical and prescription drug claims, increasing expense approximately \$156; (2) 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, increasing expense \$141; and (3) our 2004 medical cost trend rate increase, increasing expense \$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.

**Interest expense** increased \$433, or 42.3%, in 2005 and decreased \$168, or 14.1%, in 2004. The increase in 2005 was primarily due to issuing additional debt in the fourth quarter of 2004, thus accruing interest expense for a full 12 months of 2005 in comparison to less than three months of 2004. In 2004 we issued debt totaling approximately \$8,750 to finance our portion of Cingular's purchase price for AT&T Wireless Services Inc. (AT&T Wireless). In addition, we recorded approximately \$63 of interest expense related to ATTC's outstanding debt. We expect our future interest expense to increase as a result of including ATTC's outstanding debt in our consolidated financial statements. However, this increase will be partially offset due to our redemption, prior to maturity, of approximately \$1,559 of debt in 2005.

The decrease in 2004 was primarily due to lower debt levels caused by the early redemption of approximately \$1,743 of our bonds in 2003.

**Interest income** decreased \$109, or 22.2%, in 2005 and \$111, or 18.4%, in 2004. The decrease in 2005 was primarily due to lower investment balances during 2005 as investments held for the majority of 2004 were liquidated and used to fund our portion of Cingular's purchase price for AT&T Wireless, and less income earned on our advances to Cingular resulting from payments during 2005 on a portion of outstanding advances due to us. The decrease in 2004 was 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. 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.

**Equity in net income of affiliates** decreased \$264, or 30.2%, in 2005 and \$380, or 30.3%, in 2004. The 2005 decrease was due to lower results from our international holdings of approximately \$417 (largely attributable to gains that occurred in 2004, and foregone equity income from the disposition of investments), partially offset by an increase of approximately \$170 in our proportionate share of Cingular's results (including a charge of \$105 that Cingular recorded in 2004 resulting from the correction of an error related to its lease accounting practices).

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.

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 \$14 in 2005, \$922 in 2004 and \$1,767 in 2003. Results for 2005 primarily included a gain of approximately \$108 on the sales of shares of Amdocs Limited (Amdocs), SpectraSite, Inc. (SpectraSite) and Yahoo! Inc. (Yahoo), a gain of \$24 from the sale of a lease partnership and gains of approximately \$24 related to the transfer of wireless properties to Cingular. These

## Management's Discussion and Analysis of Financial Condition and Results of Operations, continued

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gains were partially offset by other expenses of \$126 to reflect an increase in value of a third-party minority holder's interest in an AT&T subsidiary's preferred stock and expenses of \$26 due to call premiums on early debt retirement.

Results for 2004 primarily included a gain of approximately \$832 on the sale of our investment in Belgacom, gains of \$270 on the sales of shares of Amdocs and Yahoo and a gain of \$57 on the sales 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. and gains of \$201 on the sales of Yahoo and BCE shares, partially offset by a loss of \$50 due to call premiums on early debt retirement.

**Income taxes** decreased \$1,254, or 57.4%, in 2005 and \$671, or 23.5%, in 2004. Our effective tax rate in 2005 was 16.3% compared to 30.5% in 2004. The decrease in income taxes and our effective tax rate in 2005 compared to 2004 was due primarily to our agreement in December 2005 with the Internal Revenue Service (IRS) to settle certain claims principally related to the utilization of capital losses and tax credits for tax years 1997-1999, by certain SBC entities. The settlement resulted in our recognition of \$902 of reduced income tax expense in 2005. The decrease in income tax expense in 2004 compared to 2003 was primarily due to lower income before income tax in 2004 than in 2003. Our effective tax rate in 2003 was 32.8%. The decrease in effective tax rate in 2004 compared to 2003 is primarily a result of the accrual related to the nontaxable Medicare Act reimbursement accruals, tax settlements and impacts from our foreign operations. (See Note 9)

**Income from discontinued operations** was \$908 in 2004 and \$112 in 2003 and represents results from the directory advertising business in Illinois and northwest Indiana that we sold in 2004. The increase of \$796 in 2004 consisted of the portion of our sold directory operations and includes the gain on the sale of these operations of \$827, net of tax (see Note 17). Operating results for 2004 include only eight months of activity prior to the sale, resulting in lower revenues and expenses than in 2003. Revenues from discontinued operations decreased \$170, or 35.3%, and expenses decreased \$116, or 39.3%, in 2004.

**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)

### Segment Results

Our segments represent strategic business units that offer different products and services and are managed accordingly. Due to the proximity of our acquisition of ATTC to year end, we have reported those results in the AT&T Corp. segment even though there may be some overlap in the products and service provided by that segment and our wireline segment. Our operating segment results presented in Note 4 and discussed

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below for each segment follow our internal management reporting. 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 six reportable segments that reflect the current management of our business: (1) wireline, (2) AT&T Corp., (3) Cingular, (4) directory, (5) international, and (6) other.

The **wireline segment** accounted for approximately 47% of our 2005 total segment operating revenues as compared to 61% in 2004 and 55% of our 2005 total segment income as compared to 52% in 2004. This segment consists of our traditional SBC wireline subsidiaries and operates 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 **AT&T Corp. segment** accounted for approximately 4% of our 2005 total segment operating revenues and 2% of our 2005 total segment income. This segment reflects 100% of the results of ATTC for the 43 days following the November 18, 2005 acquisition. ATTC operates as both a retail and wholesale seller of communications services, primarily providing long-distance and local voice, data services and managed networking to business customers. ATTC also provides local and long-distance voice and data services to consumers.

The **Cingular segment** accounted for approximately 44% of our 2005 total segment operating revenues as compared to 32% in 2004 and 7% of our 2005 total segment income as compared to 2% in 2004. This segment reflects 100% of the results reported by Cingular, our wireless joint venture with BellSouth Corporation (BellSouth). Cingular offers both wireless voice and data communications services across the United States, providing cellular and PCS services. 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 5% of our 2005 total segment operating revenues as compared to 6% in 2004 and 27% of our 2005 total segment income as compared to 30% in 2004. This segment includes all 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. In November 2004, a subsidiary in our directory segment entered into a joint venture agreement with BellSouth and acquired the internet directory publisher YELLOWPAGES.COM (YPC) (see Note 6).

Other than those international investments acquired in our acquisition of ATTC, all investments with primarily international operations are included in the **international segment**, which accounted for less than 1% of our 2005 and 2004 total segment operating revenues and approximately 5% of our 2005 total segment income as compared to 12% in 2004. Most of our international investments reflected in the international segment 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 interests in TDC, Belgacom and Telkom.

The **other segment** includes results from all corporate and other operations as well as the equity income from our investment in Cingular. In November 2005 we sold our paging operations. Although we analyze Cingular's revenues and expenses under the Cingular segment, we record its equity in net income of affiliates in this segment.



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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." Due to the fourth-quarter 2005 acquisition of ATTC and the application of purchase accounting rules required by GAAP, there are no period comparisons available and thus percentage increases and decreases are not shown for the AT&T Corp. segment. In addition, Cingular's 2005 operating revenue and expense percentage increases and decreases are not considered meaningful, due to Cingular's fourth-quarter 2004 acquisition of AT&T Wireless, and are denoted with a dash.

## Wireline

### Segment Results

	2005	2004	2003	Percent Change	
				2005 vs. 2004	2004 vs. 2003
Segment operating revenues					
Voice	\$19,904	\$20,796	\$21,986	(4.3)%	(5.4)%
Data	11,930	10,984	10,150	8.6	8.2
Long-distance voice	3,756	3,297	2,561	13.9	28.7
Other	1,855	1,810	1,843	2.5	(1.8)
Total Segment Operating Revenues	37,445	36,887	36,540	1.5	0.9
Segment operating expenses					
Cost of sales	16,814	16,603	15,941	1.3	4.2
Selling, general and administrative	9,505	9,206	8,794	3.2	4.7
Depreciation and amortization	7,121	7,454	7,763	(4.5)	(4.0)
Total Segment Operating Expenses	33,440	33,263	32,498	0.5	2.4
Segment Income	\$4,005	\$3,624	\$4,042	10.5%	(10.3)%

Our wireline segment operating income margin was 10.7% in 2005, compared to 9.8% in 2004 and 11.1% in 2003. The improvement in our wireline segment operating income margin in 2005 was due primarily to the continued growth in our Data and Long-distance voice revenues, which more than offset the loss of Voice revenue from the decline in total access lines (as shown in the following table) from 2004 to 2005 of approximately 2.9 million lines, or 5.6%, due to increasing competition.

Voice revenue declined due to customers continuing to disconnect primary and additional lines and using alternative technologies, such as wireless, and to a lesser extent VoIP 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. Voice 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 UNE-P lines. However, that trend started to change in the third quarter of 2004 and for 2005, UNE-P lines (which include lines under commercial UNE-P replacement agreements) declined by 2.2 million, or 33.8%, from 2004 levels. The decline in UNE-P lines during 2005 is also attributable to UNE-P customers switching to alternative technologies as the UNE-P rules have changed; this decline has decreased our wholesale revenues. The impact of the UNE-P rules on our operating revenue is discussed below. (The UNE-P rules are discussed in "Overview" and in "Operating Environment and Trends of the Business.") During 2005, our operating income margin was pressured on the cost side due to a charge to terminate existing agreements with WiTel and by higher costs caused by our growth initiatives in long-distance and DSL as well as, prior to the amendment of our agreement, our co-branded AT&T | DISH Network satellite TV service, sales in the large-business market and by higher repair costs caused by severe weather in our traditional SBC regions.

The decline in our wireline segment operating income margin in 2004 compared to 2003 was due primarily to the continued loss of voice revenue from the decline in total access lines from 2003 to 2004 of 2.3 million

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lines, or 4.3%. This revenue decline was caused by both an increase in customers disconnecting additional lines and using alternative technologies, our bundling strategy and other pricing responses to competitors' offerings as well as lower demand for services due to the uncertain U.S. economy (primarily in the first half of 2004). Revenue also has declined over the past several years as our retail customers disconnected their lines in order to obtain service from competitors who leased our UNE-P lines. Our operating income margin was also pressured by costs due to our growth initiatives in long-distance, DSL and the large-business market.

**Access Line Trends**

Following is a summary of our switched access lines at December 31, 2005, 2004 and 2003:

**Switched Access Lines**

(In 000s)	2005	2004	2003	Increase (Decrease)	
				2005 vs. 2004	2004 vs. 2003
Retail Consumer					
Primary	22,793	23,206	23,948	(413)	(742)
Additional	3,890	4,322	4,894	(432)	(572)
<b>Retail Consumer Subtotal</b>	<b>26,683</b>	<b>27,528</b>	<b>28,842</b>	<b>(845)</b>	<b>(1,314)</b>
Retail Business	17,457	17,552	18,264	(95)	(712)
<b>Retail Subtotal</b>	<b>44,140</b>	<b>45,080</b>	<b>47,106</b>	<b>(940)</b>	<b>(2,026)</b>
Percent of total switched access lines	89.3%	86.1%	86.1%		
UNE-P	4,300	6,497	6,664	(2,197)	(167)
Resale	638	349	445	289	(96)
<b>Wholesale Subtotal<sup>1</sup></b>	<b>4,938</b>	<b>6,846</b>	<b>7,109</b>	<b>(1,908)</b>	<b>(263)</b>
Percent of total switched access lines	10.0%	13.1%	13.0%		
<b>Payphone (retail and wholesale)</b>	<b>335</b>	<b>430</b>	<b>468</b>	<b>(95)</b>	<b>(38)</b>
Percent of total switched access lines	0.7%	0.8%	0.9%		
<b>Total Switched Access Lines</b>	<b>49,413</b>	<b>52,356</b>	<b>54,683</b>	<b>(2,943)</b>	<b>(2,327)</b>
<b>DSL Lines in Service</b>	<b>6,921</b>	<b>5,104</b>	<b>3,515</b>	<b>1,817</b>	<b>1,589</b>

<sup>1</sup> Wireline segment wholesale lines at December 31, 2005 include approximately 1.64 million lines purchased by ATTC.

Total switched access lines in service at December 31, 2005 declined 5.6% from December 31, 2004 levels. Retail access lines, while declining 2.1% from 2004 levels, represent 89.3% of total switched access lines at December 31, 2005, compared to 86.1% a year earlier. During this same period, wholesale lines (which include UNE-P, commercially negotiated UNE-P replacements and resale) decreased 27.9% and at December 31, 2005 represented 10.0% of total access lines, down from 13.1% a year earlier.

The decline in total access lines in 2005 reflects many factors, including the disconnection of additional lines as our existing customers purchase our DSL broadband services and for other reasons, and the continued growth in alternative communication technologies such as wireless, cable and other internet-based systems. While we lose some revenue when a wireline customer shifts from one of our retail lines to a competitor that relies on commercial UNE-P replacement agreements, the UNE-P rules or a resale agreement to offer service (i.e., one of our wholesale customers), we lose all customer revenue when a retail wireline customer shifts to

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an alternative technology such as cable, wireless or the Internet using VoIP or a competitor using its own traditional network. However, recently, declines in our retail business access lines have been partially offset by sales of our business internet-based systems (which are reported as Data revenues). We do not currently offer a residential internet-based service. The UNE-P rules are scheduled to end after a 12-month transition period that began March 11, 2005. Approximately 10% of our wholesale lines are still subject to the UNE-P transition rules. Based on marketing research, we believe that the majority of remaining customers that had used UNE-P service are shifting to an alternative technology or to a competitor using its own network, as opposed to returning as our retail customers. Our wireline segment's operating margins will continue to be pressured by increasing customer shifts from our traditional retail base to either alternative technologies or competitors using commercial UNE-P replacement or resale agreements or their own facilities, as well as our pricing responses to retain or regain retail customers.

Total switched access lines in service at December 31, 2004 were 52.4 million, a decline of 2.3 million, or 4.3%, from December 31, 2003 levels. Of this total, retail access lines of 45.1 million represent 86.1% of total access lines. Wholesale lines represented 13.1% of total access lines at December 31, 2004.

**Voice** revenues decreased \$892, or 4.3%, in 2005 and \$1,190, or 5.4%, in 2004 primarily due to the loss of retail and wholesale access lines. The decline in retail lines primarily reflects increased competition, including customers using wireless, VoIP technology and cable instead of phone lines for voice and data, and the disconnection of additional lines for DSL service and other reasons. The decline in wholesale lines is related to the unwinding of the UNE-P rules which are scheduled to end in March 2006.

Retail access line declines decreased revenues approximately \$328 in 2005 and \$841 in 2004. Lower demand for wholesale services, primarily due to the decline in UNE-P lines provided to competitors, decreased revenue approximately \$145 in 2005. A decline in demand for calling features (e.g., Caller ID and voice mail), due primarily to the access line declines, decreased revenues approximately \$97 in 2005 and \$180 in 2004. Continued declines in demand for voice equipment located on customer premises decreased revenues approximately \$69 in 2005 and \$87 in 2004. Lower demand for retail payphone services decreased revenues approximately \$52 in 2005 and \$57 in 2004. We expect payphone access lines and revenue to continue to decline in future periods. Reduced demand for inside wire service agreements decreased revenues approximately \$36 in 2005 and \$61 in 2004. Revenue from "local plus" plans (expanded local calling area) declined approximately \$22 in 2005 and \$76 in 2004, as more customers chose broader long-distance and other bundled offerings.

Pricing responses to competitors' offerings and regulatory changes were essentially flat in 2005 and reduced revenues approximately \$390 in 2004. Revenue was lower by \$71 in 2005 from additional revenues we recorded in 2004 related to a September 2004 ruling by the CPUC that retroactively increased UNE-P rates we could charge in California. Revenue also was lower by \$37 in 2005 from additional revenue we recorded in 2004 related to Federal Communications Commission (FCC) proceedings on the inclusion of other postretirement benefit costs in previous tariff filings.

Partially offsetting these revenue declines were net settlements and billing adjustments with our wholesale customers which increased revenues approximately \$34 in 2005 and \$204 in 2004. Also in 2004, increased demand for wholesale services, primarily UNE-P lines provided to competitors, increased revenues approximately \$94.

**Data** revenues increased \$946, or 8.6%, in 2005 and \$834, or 8.2%, in 2004 primarily due to continued growth in DSL, our broadband internet-access service, high-capacity transport and sales of data equipment and services. DSL and dial-up internet service increased Data revenues approximately \$444 in 2005 and \$538 in 2004, reflecting an increase in DSL lines in service and, in 2005, was partially driven by lower-priced promotional offerings and pricing responses to competitors. The number of DSL lines in service grew to approximately 6.9 million, a 35.6% increase from 2004. At December 31, 2004 we served 5.1 million DSL lines, a 45.2% increase from December 31, 2003.

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Revenue from our high-capacity transport services increased approximately \$273 in 2005 and declined \$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 multi-site businesses), represented about 58% of total data revenues in 2005 and 61% in 2004. Our 2004 high-capacity results include revenue declines of approximately \$65 related to the 2000 federal Coalition for Affordable Local and Long Distance Services (CALLS) order and the September 2004 California order. Included in the 2004 decrease in high-capacity transport revenues was the favorable impact of a one-time MCI, Inc. (MCI) (formerly known as WorldCom) 2003 settlement of approximately \$45 which affected year-over-year comparisons.

Revenue from data equipment sales and network integration services increased approximately \$132 in 2005 and \$402 in 2004. Revenues from large-business customers typically consist of revenue from the initial installation of equipment followed by services provided over multiple years. The significant increase in 2004 reflected our initial expansion into the large-business market following our late 2003 entry into nationwide long-distance.

**Long-distance voice** revenues increased \$459, or 13.9%, in 2005 and \$736, or 28.7%, in 2004. These increases were primarily driven by the increase in long-distance lines in service in 2005 and 2004. The number of long-distance lines in service in the wireline segment at December 31, 2005 grew to approximately 23.5 million, a 12.6% increase from 2004. At December 31, 2004, we served 20.9 million lines, a 44.8% increase from December 31, 2003. Sales of combined long-distance and local calling fixed-fee offerings (referred to as "bundling") also contributed to the increased long-distance revenues and lines. Long-distance revenues continued to increase in our traditional SBC Midwest, West and Southwest regions with the most significant improvements in results occurring in our Midwest region (Michigan, Illinois, Indiana, Ohio and Wisconsin). Our long-distance revenue growth slowed in 2005, reflecting continuing market maturity since we began providing service throughout our regions in late 2003.

Retail long-distance revenues increased approximately \$467 in 2005 and \$825 in 2004, reflecting our higher long-distance penetration levels. Continued growth in wholesale long-distance services sold to Cingular and our international and other long-distance services increased revenues approximately \$155 in 2005 and \$282 in 2004. Partially offsetting these increases was a decline of approximately \$139 in 2005 and \$340 in 2004 due to pricing responses to increased competition and a reduction in our billed minutes of use mainly related to the increased sales of our fixed-fee bundles, which do not separately bill for minutes of use.

**Other** operating revenues increased \$45, or 2.5%, in 2005 and decreased \$33, or 1.8%, in 2004. Our co-branded AT&T | DISH Network satellite TV service increased revenue approximately \$196 in 2005 and \$94 in 2004. We expect future growth in revenues from this service to moderate as we restructured our agreement with EchoStar in September 2005 (see "Other Business Matters") to record only commission revenue when signing up future customers. Price increases, primarily in directory assistance, increased revenues approximately \$23 in 2005 and \$48 in 2004. Partially offsetting these revenue increases was lower demand for directory and operator assistance, billing and collection services provided to other carriers, wholesale and other miscellaneous products and services, various one-time billing adjustments and other pricing changes decreased revenue approximately \$190 in 2005 and \$148 in 2004. Commission revenue received from Cingular related to Cingular customers added through our sales sources increased approximately \$8 in 2005 after decreasing \$27 in 2004, reflecting more stringent credit policies put in place in 2004.

**Cost of sales** expenses increased \$211, or 1.3%, in 2005 and \$662, or 4.2%, in 2004. 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 our repair technicians and repair services, certain network planning and engineering expenses, operator services, information technology, property

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taxes related to elements of our network, and payphone operations. Pension and postretirement costs, net of amounts capitalized as part of construction labor, 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.

Traffic compensation expense (for access to another carrier's network) increased approximately \$330 in 2005 and \$122 in 2004. Growth in our long-distance service generated approximately \$192 of the increase in 2005 and \$286 in 2004, partially offset by lower rates paid for local traffic (telephone calls) terminating on competitor networks and wireless customers. Expense also increased approximately \$164 in 2005 resulting from reduced expense in 2004 from non-recurring traffic compensation settlements. Offsetting these increases, traffic compensation expense decreased approximately \$26 in 2005 related to a carrier settlement.

Costs associated with equipment sales and related network integration services and, prior to the amendment of our agreement, our co-branded AT&T | DISH Network satellite TV service increased approximately \$195 in 2005 and \$603 in 2004, reflecting our emphasis on growth in DSL and sales in the large-business market and video. Prior to restructuring our relationship with EchoStar in September 2005, our co-branded AT&T | DISH Network satellite TV service had relatively high initial acquisition costs. Costs associated with equipment for large-business customers (as well as DSL and, previously, video) typically are greater than costs associated with services that are provided over multiple years. Costs in 2004 reflect our initial expansion into the large-business market.

Salary and wage merit increases and other bonus accrual adjustments increased expense approximately \$170 in 2005 and \$356 in 2004. Merger severance accruals increased expenses approximately \$176 in 2005. We also incurred repair costs of approximately \$100 in 2005 primarily related to severe weather in our regions, including California.

Partially offsetting these increases were lower employee levels which decreased expenses, primarily salary and wages, approximately \$322 in 2005 and \$208 in 2004. Nonemployee-related expenses such as contract services, agent commissions and materials and supplies costs decreased approximately \$100 in 2005 and \$148 in 2004.

Additionally, expenses decreased \$154 in 2005 due to the one-time accrual in 2004 for a retiree bonus as a result of the settlement of our labor contract negotiations in the second quarter of 2004. Benefit expenses, consisting primarily of our combined net pension and postretirement cost, decreased approximately \$12 in 2005, primarily resulting from changes made to management medical coverage in 2005. In addition, changes in 2005 to phone concessions for out-of-region retirees reduced expenses by approximately \$20 in 2005. Benefit expenses decreased by \$306 in 2004 compared to 2003 reflecting changes in nonmanagement retirees' medical coverage and our accounting for the Medicare Act.

As part of an internal business unit realignment during the second quarter of 2005, expenses incurred by the affected unit in 2004 were reported in cost of sales, while in 2005 costs incurred by this group have been reported as selling expenses. This resulted in reduced cost of sales expenses of \$148 in 2005, and a corresponding increase in selling, general and administrative expenses in 2005.

**Selling, general and administrative** expenses increased \$299, or 3.2%, in 2005 and \$412, or 4.7%, in 2004. 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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Salary and wage merit increases and other bonus accrual adjustments increased expenses approximately \$108 in 2005 and \$127 in 2004. Expenses increased during 2005 due to a charge of \$236 to terminate existing agreements with WiTel, which will continue to provide transitional and out-of-market long-distance services under a new agreement that commenced in November 2005 as a result of our acquisition of ATTC. ATTC merger-related asset impairment charges of approximately \$349 and merger-related severance cost accruals of \$107 increased expenses in 2005. Expenses increased approximately \$111 in 2004 due to higher severance accruals.

Partially offsetting these increases were lower employee levels, which decreased expenses, primarily salary and wages, approximately \$264 in 2005 and \$36 in 2004. Our provision for uncollectible accounts decreased approximately \$55 in 2005 and \$21 in 2004 as we experienced fewer losses from our retail customers and a decrease in bankruptcy filings by our wholesale customers. Advertising expense decreased approximately \$20 in 2005 and \$43 in 2004 primarily driven by higher costs in 2003 from our launch of long-distance service in new markets and bundling initiatives, which declined slightly in 2004 and 2005. Nonemployee-related expenses, such as contract services, agent commissions and materials and supplies costs, decreased approximately \$59 in 2005 and increased \$188 in 2004. Other employee-related expenses, including travel, training and conferences, decreased approximately \$21 in 2005 and increased \$29 in 2004.

Expenses decreased \$79 in 2005 due to the one-time accrual in 2004 for a retiree bonus resulting from the settlement of our labor contract negotiations in 2004. Benefit expenses, consisting primarily of our combined net pension and postretirement cost, decreased approximately \$66 in 2005 primarily due to changes made to management medical coverage in 2005. In addition, changes in 2005 to phone concessions for out-of-region retirees reduced expenses by approximately \$73 in 2005. Benefit expenses decreased by \$22 in 2004 compared to 2003 reflecting changes in nonmanagement retirees' medical coverage and our accounting for the Medicare Act.

As part of an internal business unit realignment during the second quarter of 2005, expenses incurred by the affected unit in 2004 were reported in cost of sales, while in 2005 costs incurred by this group have been reported as selling expenses. This resulted in increased selling, general and administrative expenses of \$148 in 2005 and a corresponding reduction in cost of sales in 2005.

**Depreciation and amortization** expenses decreased \$333, or 4.5%, in 2005 and \$309, or 4.0%, in 2004. Lower expenses in 2005 and 2004 were due primarily to significantly lower capital expenditure levels since 2001.

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**AT&T Corp.**  
**Segment Results**

	2005	2004	2003
Segment operating revenues			
Voice	\$361	\$-	\$-
Data	1,129	-	-
Long-distance voice	1,208	-	-
Other	189	-	-
Total Segment Operating Revenues	2,887	-	-
Segment operating expenses			
Cost of sales	1,686	-	-
Selling, general and administrative	669	-	-
Depreciation and amortization	414	-	-
Total Segment Operating Expenses	2,769	-	-
Segment Operating Income	118	-	-
Equity in Net Income of Affiliates	2	-	-
Segment Income	\$120	\$-	\$-

The AT&T Corp. segment consists of the results of ATTC after we completed our acquisition on November 18, 2005. Our AT&T Corp. segment operating income margin was 4.1% for the 43-day period ended December 31, 2005. The results included the effects of the purchase accounting rules required under GAAP. The discussion below includes our understanding of the trends of the business prior to and following the November acquisition.

**Voice** revenues of \$361 for the period have been negatively impacted by ATTC's 2004 decision to shift emphasis away from residential customer acquisitions as a result of changes in the federal regulatory environment over the past two years. For these changes, see the "Regulatory Developments" section.

**Data** revenues of \$1,129 have been negatively impacted by competitive pricing pressure. Positively impacting data revenue were advanced services, such as Enhanced Virtual Private Network and IP-enabled frame relay services.

**Long-distance voice** revenues of \$1,208 have been negatively impacted by competition, which has led to lower prices in business markets and loss of consumer and small- and medium-sized business market share, and substitution which has led to lower volumes.

**Other** operating revenues of \$189 have been negatively impacted by contract terminations and renegotiations.

**Cost of sales** of \$1,686 includes the costs of operating and maintaining the network, as well as traffic compensation expense. Traffic compensation expense was approximately \$1,102, or 65%, of total costs of sales.

**Selling, general and administrative** expenses of \$669 include our provision for uncollectible accounts and sales and marketing functions.

**Depreciation and amortization** expenses of \$414 included amortization expense of \$192 associated with acquired intangible assets, of which \$184 was from customer-related intangibles.

**Supplemental Information**

To provide improved comparability versus previous quarters, below is a supplemental table providing quarterly pro forma operating revenues of the AT&T Corp. segment. On a pro forma operating revenue basis, this segment would have represented 26% of total segment operating revenues for 2005 (segment operating revenues include 100% of our Cingular segment operating revenues).

**AT&T Corp.**

**Pro Forma Segment Operating Revenues**

	Three-Month Period Ended			
	Dec 31, 2005	Sep 30, 2005	Jun 30, 2005	Mar 31, 2005
AT&T Corp. Operating Revenues	\$ 3,481 <sup>1</sup>	\$ 6,620	\$ 6,760	\$ 7,015
AT&T Corp. Segment Operating Revenues	2,887 <sup>2</sup>	-	-	-
<b>Pro Forma AT&amp;T Corp. Segment Operating Revenues</b>	<b>\$ 6,368</b>	<b>\$ 6,620</b>	<b>\$ 6,760</b>	<b>\$ 7,015</b>

<sup>1</sup> AT&T Corp. results from October 1, 2005 – November 18, 2005.

<sup>2</sup> AT&T Corp. segment results from November 19, 2005 – December 31, 2005.

Revenues from business customers declined during 2005 reflecting continued pricing pressures in traditional voice and data products, offset in part by growth in IP-based products and E-services. Revenues from consumer (residential and small- and medium-sized businesses) customers declined during 2005 reflecting industry trends and ATTC's decision (prior to the acquisition) to shift its emphasis to other segments of the business.



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**Cingular  
Segment Results**

	2005	2004	2003	Percent Change <sup>1</sup>	
				2005 vs. 2004	2004 vs. 2003
Segment operating revenues					
Service	\$30,638	\$17,602	\$14,317	-	22.9%
Equipment	3,795	1,963	1,260	-	55.8
Total Segment Operating Revenues	34,433	19,565	15,577	-	25.6
Segment operating expenses					
Cost of services and equipment sales	14,387	7,611	5,806	-	31.1
Selling, general and administrative	11,647	7,349	5,428	-	35.4
Depreciation and amortization	6,575	3,077	2,089	-	47.3
Total Segment Operating Expenses	32,609	18,037	13,323	-	35.4
Segment Operating Income	1,824	1,528	2,254	19.4	(32.2)
Interest Expense	1,260	900	856	40.0	5.1
Equity in Net Income (Loss) of Affiliates	5	(415)	(333)	-	(24.6)
Other— net	(38)	(70)	(60)	45.7	(16.7)
Segment Income	\$531	\$143	\$1,005	-	(85.8)%

<sup>1</sup> Cingular's 2005 operating revenue and expense percentage increases and decreases are not considered meaningful due to Cingular's fourth-quarter 2004 acquisition of AT&T Wireless and are denoted with a dash.

**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. Accordingly, in our segment presentation, we present 100% of Cingular's revenues and expenses 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. We discuss Cingular's liquidity and capital expenditures under the heading "Cingular" within the "Liquidity and Capital Resources."

In the first quarter of 2005, to be consistent with industry practices, Cingular changed its income statement presentation for the current and prior-year periods to record billings to customers for various state gross receipts taxes and other fees as "Service" revenues and the taxes assessed by the various state jurisdictions and other fees as "Cost of services and equipment sales." This amount totaled approximately \$129 in 2004 and \$94 in 2003. Operating income and net income for all restated periods were not affected.

**Acquisition of AT&T Wireless**

On October 26, 2004, Cingular acquired AT&T Wireless for approximately \$41,000 in cash. 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 approximately \$21,600 to fund the purchase price. Equity ownership and management control of Cingular remains unchanged after the acquisition.

In the first half of 2005, Cingular completed all required divestitures of assets and spectrum in certain markets in response to the agreement made with the U.S. Department of Justice (DOJ) and the FCC as a

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condition to receiving regulatory approval to acquire AT&T Wireless. These required divestitures included Cingular's sale of certain former AT&T Wireless assets and properties, including licenses, network assets and subscribers that Cingular operated in several markets.

In October 2005, Cingular approved the final phase of its network integration plan. This phase will involve integrating its Global System for Mobile Communication (GSM) networks, decommissioning redundant cell sites and core network elements, and swapping vendor equipment in various markets in order to have similar equipment in each market. Cingular expects to complete its network integration plan by the end of 2006 and to incur costs of approximately \$580 related to this phase of its plan, which includes integration exit cost liabilities of \$350 that were recorded as an adjustment to the AT&T Wireless purchase price allocation. In connection with the approval of this final phase, Cingular reduced its network equipment balance by approximately \$60 for equipment removed from service during 2005. Although Cingular will be decommissioning much of its Time Division Multiple Access (TDMA) network it will continue providing analog services to some customers through February 2008.

**Cingular's Customer and Operating Trends**

As of December 31, 2005, Cingular served approximately 54.1 million cellular/PCS (wireless) customers, compared to 49.1 million at December 31, 2004 and 24.0 million at December 31, 2003. Cingular's increase in customer gross additions was primarily due to the acquisition of AT&T Wireless in late October 2004. The increase was also due to Cingular's larger distribution network, its broad range of service offerings and increased advertising. Cingular's recent customer activity is listed below:

**Wireless Customer Activity**

	Three-Month Period Ended				
	Dec 31, 2005	Sep 30, 2005	Jun 30, 2005	Mar 31, 2005	Dec 31, 2004
(in 000s)					
Gross additions	5,136	4,386	4,292	4,672	4,914
Net additions	1,820	867	952	1,367	1,699
Other adjustments <sup>1</sup>	32	(17)	140	(149)	21,761
Net additions including other adjustments <sup>1</sup>	1,852	850	1,092	1,218	23,460

<sup>1</sup> Other adjustments include customers gained or lost through property divestitures related to the AT&T Wireless acquisition and other adjustments. In the fourth quarter of 2004, other adjustments included approximately 21.9 million subscribers related to Cingular's acquisition of AT&T Wireless.

Competition and the slowing rate of new wireless users as the wireless market matures will continue to adversely impact Cingular's gross additions and revenue growth, increase expenses and put pressure on margins. Cingular expects that future revenue growth will become increasingly dependent on minimizing customer turnover (customer churn) and increasing average revenue per user/customer (ARPU). Cingular's ARPU has weakened over the past several years as it has offered a broader array of plans to expand its customer base and responded to increasing competition, resulting in pricing reductions. While Cingular's ARPU has somewhat stabilized recently, Cingular nevertheless expects continued pressure on ARPU notwithstanding increasing revenue from data services. Cingular expects its cost of services to continue increasing due to higher network system usage, including the costs Cingular is now paying T-Mobile USA (T-Mobile) for the use of its network in California and Nevada, higher costs as Cingular continues to integrate AT&T Wireless' network and operations, and, to a lesser extent, increased expenses related to operating, maintaining and decommissioning TDMA networks that duplicated GSM networks while integrating the networks acquired from AT&T Wireless. Cingular's remaining purchase commitment to T-Mobile was approximately \$520 at December 31, 2005. Operating costs will substantially increase in the event that Cingular's network expansion in California and Nevada is not completed prior to fulfilling the purchase commitment with T-Mobile.

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ARPU declined 0.1% in 2005 and 3.9% in 2004. The decline in ARPU was due to a decrease in local service and net roaming revenue per customer partially offset by an increase in average data revenue per customer and increased long-distance revenue per customer. Local service revenue per customer declined primarily due to customer shifts to all-inclusive rate plans that offer lower monthly charges and "rollover" minutes (which allow customers to carry over unused minutes from month to month for up to one year) as well as Cingular's free mobile-to-mobile plans, which allow Cingular customers to call other Cingular customers at no charge. An increase in customers on rollover plans tends to lower average monthly revenue per customer since unused minutes (and associated revenue) are deferred until subsequent months for up to one year.

The effective management of wireless customer churn is critical to Cingular's ability to maximize revenue growth and maintain and improve margins. Cingular's wireless customer churn rate is calculated by dividing the aggregate number of wireless customers (prepaid and postpaid) who cancel service during each month in a period by the total number of wireless customers at the beginning of each month in that period. Cingular's churn rate was 2.2% in 2005, down from 2.7% in 2004 and 2003.

The churn rate for Cingular's postpaid customers was 1.9% in 2005, down from 2.3% in 2004 and 2003. The decline in postpaid churn reflects benefits from the acquisition of AT&T Wireless, including more affordable rate plans, broader network coverage, higher network quality, exclusive devices and free mobile-to-mobile calling among Cingular's 54.1 million customers.

The decline in Cingular's churn rate compared to 2004 resulted primarily from a change in methodology of calculating churn related to reseller customers. Beginning in the first quarter of 2005, Cingular adopted a new reseller churn calculation methodology that resulted in an aggregate churn calculation that is more comparable with its major competitors. Prior to 2005, Cingular included gross reseller disconnects in its churn calculation. Effective with the first quarter of 2005, Cingular's churn calculation is based on total net reseller disconnects. This change resulted in an improvement to 2005 reported churn of approximately 32 basis points. Partially offsetting Cingular's churn decline was an increase in prepaid customer churn.

### Cingular's Operating Results

Our Cingular segment operating income margin was 5.3% in 2005, 7.8% in 2004 and 14.5% in 2003. The lower margins in 2005 and 2004 compared to 2003 were caused by expenses increasing at a higher rate than revenues, which was primarily attributable to the acquisition of AT&T Wireless in late October 2004. However, our Cingular segment operating income margin improved every quarter during 2005 compared to the fourth quarter of 2004. Cingular's operating income margin was 6.2% in the fourth quarter of 2005, 7.5% in the third quarter, 5.9% in the second quarter and 1.4% in the first quarter of 2005 compared to an operating loss margin of 2.1% in the fourth quarter of 2004.

Cingular's operating expenses increased \$14,572 in 2005 and \$4,714 in 2004. More than offsetting these operating expenses was revenue growth of \$14,868 in 2005. In 2004, revenue growth of \$3,988 partially offset the increased operating expenses.

**Service** revenues are comprised of local voice and data services, roaming, long-distance and other revenue. Offsetting 2005 Service revenues was approximately \$31 in customer bill credits issued to customers affected by hurricanes. Service revenues increased \$13,036 in 2005 and \$3,285 in 2004 and consisted of:

- Local voice revenues, which increased approximately \$10,219 in 2005 and \$2,741 in 2004 primarily due to the acquisition of AT&T Wireless (due to Cingular's significant increase in average number of wireless customers). Increased Universal Service Fund (USF) and regulatory compliance fees also contributed to the local voice revenues increase in 2005 and 2004.
- Data service revenues, which increased \$1,785 in 2005 and \$438 in 2004 primarily due to the inclusion of former AT&T Wireless customers (who on average were heavier data users than Cingular customers), increased average data revenue per customer and increased use of text

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messaging services. Data service revenues represented approximately 7.8% of Cingular's total revenues in 2005 and 4.6% in 2004.

- Roaming revenues from Cingular customers and other wireless carriers for use of Cingular's network, which increased \$655 in 2005 and \$6 in 2004. The 2005 increase was primarily due to roaming revenues from the acquired AT&T Wireless customer base.
- Long-distance and other revenue, which increased \$377 in 2005 and \$100 in 2004 primarily due to increased long-distance revenues from the acquired AT&T Wireless customer base as well as increased domestic and international long-distance calling.

**Equipment** revenues increased \$1,832 in 2005 and \$703 in 2004 due to 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 migrate former AT&T Wireless customers to Cingular service offerings.

**Cost of services and equipment sales** expenses increased \$6,776 in 2005 and \$1,805 in 2004 primarily due to increased cost of services resulting from incremental costs related to the acquired AT&T Wireless network. Included in the 2005 increase were integration costs of approximately \$195 related to the acquired AT&T Wireless network and hurricane-related costs of \$97.

Cost of services increased \$4,581 in 2005 and \$962 in 2004. Cost of services increased due to the following:

- Increases in network usage with a minutes of use increase of more than 110% in 2005 and more than 50% in 2004 primarily due to the increase in subscribers related to Cingular's acquisition of AT&T Wireless.
- Increased costs Cingular is now paying T-Mobile for the use of its network in California and Nevada.
- Increased expenses related to operating, maintaining and decommissioning TDMA networks that duplicated GSM networks while integrating the networks acquired from AT&T Wireless.
- Higher roaming and long-distance cost and increased USF and regulatory fees related to the increase in the customer base.

Equipment sales expense increased \$2,195 in 2005 and \$843 in 2004 primarily due to higher handset unit sales associated with the 46.1% increase in gross customer additions in 2005 and more than 30.0% in 2004, existing customers upgrading their units and the continued migration of former AT&T Wireless customers to Cingular service offerings. 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.

**Selling, general and administrative** expenses increased \$4,298 in 2005 and \$1,921 in 2004 primarily due to incremental expenses associated with the acquisition of AT&T Wireless. These increases include integration costs of approximately \$264 in 2005 and \$277 in 2004, including employee termination costs, re-branding and advertising of the Cingular and AT&T Wireless combination and customer service and systems integration costs. Also included in this increase were hurricane-related costs of \$19 in 2005.

Total selling expenses increased \$1,385 in 2005 and \$873 in 2004 primarily due to the increase in gross customer additions previously mentioned. Total selling expenses include sales, marketing, advertising and commissions expense. Cingular's sales expense increased approximately \$462 in 2005 and \$232 in 2004 primarily due to increased sales personnel costs associated with the acquired AT&T Wireless sales force. Commissions expense increased approximately \$494 in 2005 and \$289 in 2004 and advertising and marketing expenses increased \$429 in 2005 and \$352 in 2004.

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General and administrative expenses increased \$2,913 in 2005 and \$1,048 in 2004 primarily due to the previously mentioned incremental expenses from AT&T Wireless and integration costs. General and administrative expenses include customer service, upgrade commissions, billing, bad debt, other maintenance and other administrative expense. Customer service expenses increased approximately \$960 in 2005 and \$395 in 2004 due to a higher number of employees and employee-related expenses related to the significant increase in customers, as well as customer retention and customer service improvement initiatives. Other administrative expenses increased approximately \$926 in 2005 and \$307 in 2004 primarily due to incremental expenses associated with the acquired AT&T Wireless administrative functions. Billing, bad debt and other customer maintenance expense increased approximately \$766 in 2005 and \$305 in 2004 primarily due to the significant increase in Cingular's customer base. Upgrade commissions increased approximately \$261 in 2005 and \$41 in 2004 due to the previously mentioned increased customer migration and handset upgrade activity.

**Depreciation and amortization** expenses increased \$3,498 in 2005 and \$988 in 2004. These increases include approximately \$417 of integration costs in 2005. Depreciation expense increased approximately \$2,249 in 2005 and \$635 in 2004 primarily due to incremental depreciation associated with the property, plant and equipment acquired in the AT&T Wireless acquisition and depreciation related to Cingular's ongoing capital spending associated with its GSM network. Additionally, depreciation expense increased due to accelerated depreciation on certain TDMA network assets based on Cingular's projected transition of network traffic to GSM technology and accelerated depreciation on certain other network assets. Substantially all of Cingular's TDMA assets are anticipated to be fully depreciated by the end of 2007.

Amortization expense increased approximately \$1,249 in 2005 and \$353 in 2004 primarily due to the amortization of the AT&T Wireless customer contracts and other intangible assets acquired.

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**Supplemental Information**

Because Cingular's acquisition of AT&T Wireless has a significant effect on comparative financial information, we have included the following sequential quarterly results for comparative purposes.

Cingular's operating margins have increased since the acquisition reflecting the continued increase in the number of wireless customers, continued progress in its merger-integration initiatives, as well as continued improvement in customer churn compared with 2004.

**Cingular**  
**Sequential Segment Results**

	Three-Month Period Ended				
	Dec 31, 2005	Sep 30, 2005	Jun 30, 2005	Mar 31, 2005	Dec 31, 2004
Segment operating revenues					
Service revenues	\$7,779	\$7,721	\$7,719	\$7,419	\$6,313
Equipment revenues	1,070	1,025	890	810	806
Total Segment Operating Revenues	8,849	8,746	8,609	8,229	7,119
Segment operating expenses					
Cost of services and equipment sales	3,758	3,667	3,523	3,439	2,939
Selling, general and administrative	2,812	2,881	2,953	3,001	2,947
Depreciation and amortization	1,730	1,541	1,629	1,675	1,386
Total Segment Operating Expenses	8,300	8,089	8,105	8,115	7,272
Segment Operating Income (Loss)	549	657	504	114	(153)
Interest Expense	292	304	326	338	303
Equity in Net Income (Loss) of					
Affiliates	1	1	1	2	(114)
Other – net	(6)	(28)	(8)	4	13
Segment Income (Loss)	\$252	\$326	\$171	\$(218)	\$(557)

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**Directory  
Segment Results**

				Percent Change	
	2005	2004	2003	2005 vs. 2004	2004 vs. 2003
Total Segment Operating Revenues	\$3,714	\$3,759	\$3,773	(1.2)%	(0.4)%
Segment operating expenses					
Cost of sales	1,103	1,022	964	7.9	6.0
Selling, general and administrative	612	622	673	(1.6)	(7.6)
Depreciation and amortization	5	9	21	(44.4)	(57.1)
Total Segment Operating Expenses	1,720	1,653	1,658	4.1	(0.3)
Segment Operating Income	1,994	2,106	2,115	(5.3)	(0.4)
Equity in Net Income (Loss) of Affiliates	(5)	-	-	-	-
Segment Income	\$1,989	\$2,106	\$2,115	(5.6)%	(0.4)%

In September 2004, we sold our interest in the directory advertising business in Illinois and northwest Indiana. Our directory segment results exclude the results of those operations (see Note 17). In November 2004, our directory segment entered into a joint venture agreement with BellSouth and acquired the internet directory publisher, YPC. We account for YPC under the equity method of accounting.

Our directory segment operating income margin was 53.6% in 2005, 56.0% in 2004 and 56.1% in 2003. The segment operating income margin decrease in 2005 is a result of both higher expenses and lower revenues. The segment operating income margin stability in 2004 is due to our revenues and expenses for both periods being relatively flat.

**Operating revenues** decreased \$45, or 1.2%, in 2005 and \$14, or 0.4%, in 2004. The decrease in revenues in 2005 was primarily due to a decrease of approximately \$74 in our local Yellow Pages advertising, which was partially offset by an increase of \$39 in internet advertising revenue. Revenues in 2004 decreased primarily in our local Yellow Pages advertising, which decreased approximately \$95 in 2004, and was partially offset by an increase of \$30 in internet advertising revenue and an improvement of \$27 in revenue adjustments related to customer satisfaction. These results reflect the impact of competition from other publishers, other advertising media and continuing economic pressures on advertising customers.

**Cost of sales** increased \$81, or 7.9%, in 2005 and \$58, or 6.0%, in 2004. The increase in 2005 was primarily driven by higher costs for internet traffic of approximately \$22, publishing of \$17 and distribution of \$9. In 2004, cost of sales increased due to higher costs for commissions, publishing and distribution which were partially offset by decreased costs for paper and printing.

**Selling, general and administrative** expenses decreased \$10, or 1.6%, in 2005 and \$51, or 7.6%, in 2004. The expense reduction in 2005 was primarily due to lower advertising expense. Decreased expenses in 2004 were primarily due to lower uncollectible expense of approximately \$68, partially offset by increases in advertising expense of \$25 and increased employee benefit-related costs of \$14.

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**International  
Segment Results**

	2005	2004	2003	Percent Change	
				2005 vs. 2004	2004 vs. 2003
Total Segment Operating Revenues	\$10	\$22	\$30	(54.5)%	(26.7)%
Total Segment Operating Expenses	28	31	47	(9.7)	(34.0)
Segment Operating Income (Loss)	(18)	(9)	(17)	-	47.1
Equity in Net Income of Affiliates	395	812	606	(51.4)	34.0
Segment Income	\$377	\$803	\$589	(53.1)%	36.3%

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 the segment's 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. The following table summarizes the individual results for our significant equity holdings in the international segment. A discussion of these results follows. See "Other income (expense) – net" and Note 2 for information on the sale of several investments during 2004.

**Segment operating revenues** decreased \$12, or 54.5%, in 2005 and \$8, or 26.7%, in 2004. Revenues declined primarily due to forgone management-fee revenues from the disposition of investments.

**Segment operating expenses** decreased \$3, or 9.7%, in 2005 and \$16, or 34.0%, in 2004. Expenses in 2005 declined primarily due to lower employee costs resulting from fewer foreign-based employees. Expenses in 2004 declined primarily due to lower corporate-allocated charges.

Our equity in net income of affiliates by major investment at December 31, are listed below:

	2005	2004	2003
América Móvil	\$ 198	\$ 132	\$ 76
Belgacom <sup>1</sup>	-	49	28
TDC <sup>1</sup>	-	328	182
Telkom South Africa <sup>1</sup>	-	115	121
Telmex	212	180	196
Other	(15)	8	3
<b>Equity in Net Income of Affiliates</b>	<b>\$ 395</b>	<b>\$ 812</b>	<b>\$ 606</b>

<sup>1</sup> Investment sold in 2004.

**Equity in net income of affiliates** decreased \$417, or 51.4%, in 2005 and increased \$206, or 34.0%, in 2004. The decrease in 2005 was primarily due to gains that occurred in 2004, and foregone equity income from the disposition of investments. Increases at América Móvil and Telmex reflect better operating results at both companies and reduced income taxes at América Móvil.

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



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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. Equity in net income of affiliates in 2004 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.

**Other  
Segment Results**

	2005	2004	2003	Percent Change	
				2005 vs. 2004	2004 vs. 2003
Total Segment Operating Revenues	\$253	\$244	\$263	3.7%	(7.2)%
Total Segment Operating Expenses	183	64	119	-	(46.2)
Segment Operating Income	70	180	144	(61.1)	25.0
Equity in Net Income of Affiliates	217	61	647	-	(90.6)
Segment Income	\$287	\$241	\$791	19.1%	(69.5)%

Our other segment results consist primarily of corporate and other operations. In November 2005, we sold our paging operations.

Segment operating revenues increased in 2005 as a result of higher revenues from capital leasing subsidiaries. Segment operating revenues decreased in 2004 as a result of lower revenues from paging and capital leasing subsidiaries.

Equity in Net Income of Affiliates primarily represents the equity income from our investment in Cingular.

## **Operating Environment and Trends of the Business**

**2006 Revenue Trends** Our acquisition of ATTC will help change the focus of our company toward broadband/data and business revenues. Cingular's late-2004 acquisition of AT&T Wireless also increased our potential for growth in the wireless area. During 2005, we experienced slight growth in our traditional wireline operations and for 2006 we expect similar growth in these traditional areas. Because of the late 2005 completion date of the ATTC acquisition, we expect reported revenues to increase in 2006 compared to 2005. However, in terms of business trends, we expect our 2006 and 2007 revenues to reflect continuing but diminishing declines from ATTC operations, as we integrate their business operations. If we include our proportionate share of Cingular's revenues in analyzing our overall company prospects, we expect total year-over-year revenue growth to turn positive in 2008. 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 the "Regulatory Developments" section). We also expect to expand services utilizing our broadband network (see "Project Lightspeed" discussed in "Expected Growth Areas") as well as the national business market as a result of the ATTC acquisition. Accordingly, we assume that we will experience continued growth in DSL and additional opportunities in the national data markets (see "Expected Growth Areas"). We also assume continued long-distance subscriber growth in our former SBC long-distance business, but at a lower rate as that long-distance business continues to mature. During the fourth quarter of 2004, Cingular completed its acquisition of AT&T Wireless and is now the largest wireless service provider in the U.S. 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" discussed in "Expected Growth Areas"). 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, as well as the trends at ATTC, will pressure revenue.

**2006 Expense Trends** The ATTC acquisition and related merger costs will adversely affect expenses in 2006 and 2007. We expect our operating income margin, adjusted to exclude these costs, will expand in 2008, due primarily to expected improvement in our revenues and continued cost-control measures. In particular, we expect continuing net workforce reductions over the next three years related to merger synergies and other operational initiatives. Expenses related to growth initiatives, such as Project Lightspeed (see "Expected Growth Areas"), and an expected increase in pension and other postretirement benefits costs to a range of approximately \$1,700 to \$1,800 will apply some pressure to our operating income margin.

## **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, including rules requiring us to unbundle our traditional network, in an effort to jump-start a specific definition of purported competition. However, over the past two years, the FCC has curtailed and, in some cases, eliminated certain of these requirements in order to promote investment and deployment of next-generation broadband services and facilities, and in response to a series of federal court decisions where the FCC's rules (in particular, those requiring ILECs to extensively unbundle their networks) exceeded the FCC's authority. For example, in February 2005, in response to a March 2004 decision by the United States Court of Appeals for the District of Columbia Circuit (D.C. Circuit), which overturned significant portions of the FCC's third set of unbundling rules, including those mandating the availability of the mass-market UNE-P, the FCC released new rules that will eliminate the requirement that our wireline subsidiaries provide the UNE-P at Total Element Long Run Incremental Cost (TELRIC) rates. Those new rules became effective March 11, 2005 and included a year-long transition for eliminating our obligation to provide mass-market UNE-P.

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Additionally, on September 23, 2005, the FCC released its Title I Broadband Order (Broadband Order), which ruled that facilities-based wireline broadband internet access services offered by telephone companies are information services and should be regulated in a similar manner to broadband internet access services offered by cable companies. This order, which became effective on November 16, 2005, substantially deregulates our existing DSL services and prevents the imposition of regulation on broadband internet access services to be offered over Project Lightspeed, discussed below.

We are actively pursuing additional legislative and regulatory measures to reduce or eliminate regulatory requirements that inhibit our ability to provide the full suite of services increasingly demanded by our customers. For example, we are supporting legislative efforts at both the state and federal levels that would offer a streamlined process for new video service providers to compete with traditional cable television providers. In addition, we are supporting efforts to update regulatory treatment for retail services. As discussed in "State Regulation," Texas recently enacted legislation allowing us and other new competitors to file for a state-issued certificate of franchise authority to provide video services. The Oklahoma Corporation Commission has also issued a statewide order, which is under appeal to the Oklahoma Supreme Court by a cable provider and the AARP, that provides for increased pricing flexibility for all intrastate retail services. Other states in the 13-state area in which we operate as an ILEC are considering similar legislation. Several bills are also pending before Congress that would both reform the Telecom Act and promote additional video competition. Passage of legislation is uncertain and depends on many factors, but we believe that the increasing pace of technological change in our industry will encourage lawmakers to remove artificial barriers to competition.

Because of opportunities made available by the continued changing regulatory environment and our acquisition of ATTC, we expect that our capital expenditures in 2006 will increase to a target range of between \$8,000 and \$8,500. This amount includes capital for Project Lightspeed and merger-integration projects (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, products and services offered by ATTC 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," "AT&T Corp. Segment Results" and "Cingular Segment Results"). Over the next few years we expect an increasing percentage of our growth to come from: (1) data/broadband, through existing services, new services to be provided by our Project Lightspeed initiative and our acquisition of ATTC, and (2) Cingular's wireless service. We expect our acquisition of ATTC to strengthen the reach and sophistication of our network facilities, increase our large-business customer base and enhance the opportunity to market wireless 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.

Our data services include DSL/Internet (broadband) as well as services to large businesses. At December 31, 2005, our data revenues represented approximately 30% of our consolidated revenues, and increased 18% from 2004. Our DSL lines continue to grow and were approximately 6.9 million at December 31, 2005 compared to 5.1 million at the end of 2004.

**Project Lightspeed** In June 2004, we announced key advances in developing a network capable of delivering a new generation of integrated digital television, super-high-speed broadband and VoIP services to our residential and small-business customers, referred to as Project Lightspeed. We have been building out this network in numerous locations and began providing services in one limited market, including IP video, in late 2005. Our goal in this controlled initial launch is to ensure that all operating and back-office systems function at a level capable of supporting our targeted mid-2006 scaled-up deployment. To that end, we have restricted the number of customers and services offered to the necessary minimum. Subject to successful

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results from this controlled launch and successful testing of our additional IP video services, we plan to enter additional markets in mid-2006. At that time we expect to add additional services and features to our service offerings. We expect to have the capability to offer service to approximately 18 million households by the end of 2008, as part of our initial deployment, and expect to spend approximately \$4,400 in network-related deployment costs and capital expenditures beginning in 2006 through 2008, as well as additional success-based customer activation capital expenditures.

With respect to our IP video service, we continue to work with our vendors to develop, in a timely manner, the requisite hardware and software technology. Our deployment plans could be delayed if we do not receive required equipment and software on schedule. We also continue to negotiate with programming owners (e.g., movie studios and cable networks) for permission to offer existing television programs and movies and, if applicable, other new interactive services that we could offer in the future using advances in the IP technology we are testing. Our ability to provide an attractive and profitable video offering will depend in large part on the results of these efforts. Also, as discussed in the "Regulatory Developments" section, we are supporting legislation at both the federal and state levels that would streamline the regulatory process for new video competitors to enter the market.

We believe that Project Lightspeed is subject to federal oversight as a "video service" under the Federal Communications Act. Additionally, in September 2005, Texas passed a state telecommunications law that encourages new competitors to enter the video market (see "Texas Telecom Reform and Video Legislation"). However, some cable providers and municipalities have claimed that certain IP services should be treated as a traditional cable service and therefore subject to the applicable state and local regulation, which could include the requirement to pay fees 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 material adverse effect on the cost, timing and extent of our deployment plans.

**Wireless**Cingular, our wireless joint venture with BellSouth, began operations in October 2000. In October 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 U.S. At December 31, 2005, Cingular served approximately 54.1 million customers and had access to licenses to provide wireless communications services covering an aggregate population of potential customers of approximately 294 million, or approximately 99% 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 General Packet Radio Service (GPRS) and Enhanced Data Rates for Global Evolution (EDGE) and Universal Mobile Telecommunications System (UMTS). EDGE technology allows customers to access the Internet from their wireless devices at higher speeds than GPRS and UMTS allows for superior speed for data and video services.

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, or churn, is also important in minimizing customer acquisition costs and maintaining and improving margins.

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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 with access to sales and support professionals focused solely on their specialized needs.
- Continued improvement on the coverage and quality of its network. Cingular continues its process of completing the integration of the Cingular and AT&T Wireless networks under a plan that is designed to achieve network quality and coverage performance exceeding that of either of the former networks.
- Continued deployment of UMTS third-generation (3G) network technology with High-Speed Downlink Packet Access (HSDPA). UMTS and HSDPA provide 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 and will allow Cingular to offer a host of new broadband data applications.

### Regulatory Developments

Set forth below is a summary of the most significant developments in our regulatory environment during 2005. While these issues, for the most part, apply only to certain subsidiaries in our wireline segment or AT&T Corp. segment, the words "we," "AT&T," "ATTC" and "our" are used to simplify the discussion. The following discussions are intended as a condensed summary of the issues rather than a precise legal description of all of those specific issues.

**International Regulation** ATTC subsidiaries operating outside the U.S. are subject to the jurisdiction of national regulatory authorities in the market where service is provided. Regulation is generally limited to operational licensing authority for the provision of enterprise (i.e. large business) services.

**Federal Regulation** A summary of significant 2005 federal regulatory developments follows.

**Triennial Review Remand Order** In December 2004, the FCC adopted its fourth set of rules concerning an ILEC's obligation to make elements of its network available to other local service providers. Each of its previous three sets of rules had been overturned by the federal courts. On February 4, 2005, the FCC released its written order containing the new rules, the Triennial Review Remand Order (TRRO) which became effective on March 11, 2005. The TRRO provides significant relief from unbundling by eliminating our remaining obligation to provide local switching and hence the UNE-P, for mass-market customers, subject to a 12-month transition period. At December 31, 2005, we had approximately 500,000 remaining UNE-P lines subject to the March 2006 transition deadline. Based on our marketing research, we believe that the majority of customers of those competitors who have not signed commercial UNE-P replacements or resale agreements with us have switched to alternative technologies as opposed to returning as our retail customers.

We believe, however, that the FCC's revised rules fail fully to comply with the D.C. Circuit's decision; for example, the FCC largely retained unbundling requirements for many of our high-capacity loop and transport facilities. Therefore, we (together with several other parties) filed an appeal with the D.C. Circuit challenging this portion of the TRRO. Several other parties, including competitive local exchange carriers (CLECs), filed appeals of other portions of the TRRO in other circuits. Those appeals have been consolidated in the D.C. Circuit, which is scheduled to hear oral arguments on March 21, 2006.

In addition, other parties, including CLECs, have asked the FCC to reconsider various other aspects of the FCC's order, such as extending the 12-month transition period for unbundled mass-market switching to 18 months, and modifying the unbundling analysis for high-capacity loops and dedicated transport. Specifically, the CLECs asked the FCC to change the criteria used to determine if an ILEC is required to unbundle high-capacity DS1 loops used to serve small buildings. These parties have also asked the FCC to modify or rescind that portion of the order relating to the eligibility criteria for obtaining access to combinations of unbundled high-capacity loops and transport elements (often referred to as "enhanced extended links" or EELs), which can be used as a substitute for special access services.

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It is unclear how state regulatory commissions will ultimately respond to the TRRO. Under the overturned rules, state commissions had set the rates that we were allowed to charge competitors for the UNE-P and for leasing other unbundled elements of our network. Many of the states in the 13-state area in which we operate as an ILEC have opened or conducted proceedings to consider the FCC's detailed findings and transition plans outlined in the Triennial Review Order (TRO) and TRRO. Some states have taken the position that their relevant state laws have been preempted by the FCC's order and federal court decisions, while other states appear to be taking the position that their state laws have not been preempted. We expect that as the various state commissions issue rulings in these proceedings, various parties, including AT&T, will litigate some or all of these rulings.

The effects on 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.

**Broadband**In June 2005, the Supreme Court of the United States (Supreme Court) ruled that it was reasonable for the FCC to find that internet access services provided by cable companies should be defined as "information services," rather than "telecommunications services." This decision preserves the FCC's deregulatory framework for cable internet access services because providers of information services do not have to comply with rules requiring providers of the services to lease lines to competitors or meet certain service standards and state public utility requirements. In September 2005, the FCC released its Broadband Order, which ruled that facilities-based wireline broadband internet access services offered by telephone companies are information services and should be regulated in a similar manner to broadband internet access services offered by cable companies. The order became effective on November 16, 2005.

The Broadband Order substantially deregulates our existing DSL services and prevents the imposition of regulation on broadband internet access services to be offered over Project Lightspeed. Under the Broadband Order we are no longer required to offer DSL transport service to unaffiliated Internet Service Providers (ISPs). However, we are required to make wholesale broadband transmission service available to existing customers for a 12-month transition period. The FCC also said it expects that after the transition period, telephone companies will make wholesale broadband transmission service available to ISPs on a commercial basis. We are also required to continue contributing to existing universal service support mechanisms for the transmission component of broadband internet access for 270 days after the effective date of the order (and thus until mid-August 2006), unless the FCC orders otherwise in the interim.

**Video Service** In November 2005, the FCC adopted two Notices of Proposed Rule Making (NPRM) that are of interest to us in connection with our provision of video service. First, the FCC adopted an NPRM to consider the adoption of rules that would ensure reasonable franchising requirements and processes for new video market entrants. The FCC's action is generally based on section 621 of Title VI, which prohibits local franchising authorities from unreasonably refusing to award competitive franchises. Second, the FCC adopted an NPRM to consider changing its Emergency Alert System (EAS) rules to take advantage of next-generation digital systems. One of the specific questions the FCC will consider is whether traditional telephone companies that plan to provide high-definition digital content to customers' homes through fiber-optic connections should have public alert and warning responsibilities.

**Voice over Internet Protocol** The term VoIP is generally used to describe the transmission of voice using internet-based technology. A company using this technology often can provide voice services at a lower cost because this technology uses bandwidth more efficiently than a traditional network and because this technology has not been subject to traditional telephone industry regulation. But, depending on the bandwidth allocated, VoIP services are not necessarily of the same quality as a traditional telephone service. 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.

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The FCC has issued a variety of decisions regarding VoIP services. For example, during 2004, the FCC declared that services that do not use the public switched telephone network (a traditional telephone network) to provide "peer-to-peer" service (i.e., a service through which 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 and other IP services, that involve use of a public switched telephone network (PSTN). In this proceeding, the FCC will address various regulatory issues, including universal service, intercarrier compensation, numbering, disability access and consumer protection. Notwithstanding the unresolved regulatory questions before the FCC and various state utility commissions, numerous communications providers, including AT&T, began providing various forms of VoIP in recent years or announced their intentions to do so in the near future. These providers include both established companies as well as new entrants.
- **VoIP E911 Order** In May 2005, the FCC required certain VoIP providers to include E911 capability in their VoIP services. E911 capability enables a subscriber to call public safety authorities (police, fire department, etc.) and have the subscriber's telephone number and location automatically transmitted to those authorities. The FCC's requirement applies to VoIP services that allow a user to send calls to a PSTN, including our wireline subsidiaries' traditional networks, and receive calls from the PSTN. In November 2005, we filed reports with the FCC detailing our compliance with the VoIP 911 rules for our HIPCS and AT&T CallVantage® VoIP services. A group of VoIP providers appealed the FCC's May 2005 order and the appeal is currently pending before the D.C. Circuit.
- **Vonage Decision** In November 2004, the FCC issued an order preempting 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 it would preempt 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 which are pending before the United States Court of Appeals for the Eighth Circuit.

**Inter-carrier Compensation Reform** In October 2004, the Intercarrier Compensation Forum, a diverse group of telecommunications industry participants representing ILECs (including our wireline subsidiaries), CLECs, long-distance companies (including AT&T), 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 U.S. In February 2005, the FCC initiated a rulemaking proceeding to consider the plan and other proposals for intercarrier compensation reform. At this time, we are not able to predict when final rules will be issued or what those rules will require.

**Reciprocal Compensation** In 2001, the FCC ruled that telephone calls placed to ISPs are not subject to the reciprocal compensation requirements of the Telecom Act, which require the carrier that originates and

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transports a call on its network that terminates on another carrier's network in the same local calling area pay a fee to the 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 modify the other restrictions in its 2001 order, including the rate cap. As a result of this 2004 ruling, we have been required to pay reciprocal compensation on additional ISP-bound traffic, which previously was not compensable because of the caps. However, due to our ability to renegotiate contracts with carriers these additional payments have not had a material effect on our financial statements.

**Special Access Pricing Flexibility** In October 2002, ATTC requested the FCC to revoke current pricing rules for special access services, a component of our wireline revenues and our AT&T Corp. segment expenses. ATTC subsequently filed a petition in the D.C. Circuit asking the court to require the FCC to act on ATTC's petition. In January 2004, the FCC filed its opposition to ATTC's petition, which was denied by the D.C. Circuit in January 2005. Also in January 2005, 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 before late 2006.

**Number Portability** 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 (LNP). 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 to grant an exception to the five-year limit on charges to recover LNP implementation costs to allow us to recover our costs over a longer period of time. If our request is granted, we would recover previously authorized costs of approximately \$210. An order is expected by May 2006.

**Settlement with AT&T Corp.** In March 2005, we reached agreement to settle outstanding claims between the pre-merger companies SBC and ATTC. The largest portion of the payment related to ATTC agreeing to reimburse us for the adjustment of the UNE-P rates in California, Michigan, Ohio and Wisconsin. The agreement also settled claims relating to, among other items, traffic compensation, cellular roaming access, collocation (ATTC equipment located on our premises), long-distance presubscription and other transport issues. As part of the agreement, we also settled our pending lawsuit against ATTC for unpaid access charges due on terminating interexchange traffic transported partially over the Internet, with no effect on our financial statements. As a result of the settlement, in the first quarter of 2005 we recorded an increase in operating revenue of approximately \$32 and a decrease in operating expense of approximately \$29.

**Proceeding on Other Postretirement Benefit Costs** In March 2003, the FCC reinstated a proceeding which it claimed to have incorrectly terminated in 2002 relating to the costs of providing postretirement employee benefits other than pensions. The FCC asked local exchange companies, including our wireline subsidiaries, to provide additional information concerning the treatment of these postretirement costs in their 1996 access tariff filings and any other related matters. On March 30, 2005, the FCC issued an order terminating its investigation without requiring any adjustments to our 1996 tariff filings.



**State Regulation** A summary of significant 2005 state regulatory developments follows.

**Texas Telecom Reform and Video Legislation** In September 2005, Texas passed a state telecommunications law that encourages new competitors to enter the video market and reforms existing state telecom laws. Video franchises will be granted by the Public Utilities Commission of Texas (PUCT), territories will be defined by the applicant and fees will be based upon a statewide definition of gross revenues. Franchise holders cannot fail to provide service in local areas based on the income of residents; however, holders will not be subject to mandatory build-out requirements. The PUCT approved our application to become a video service provider in November 2005. The Texas law also established a new regulatory framework for retail price regulation. For telephone exchanges in populations exceeding 100,000 residents, as of January 1, 2006, residential access lines are deregulated by the state and the cap on certain vertical services will be removed beginning July 1, 2006.

In September 2005, the Texas Cable & Telecommunications Association filed a lawsuit in United States District Court, Austin Division, seeking to declare this new law unconstitutional and inconsistent with the Federal Cable Act.

**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 Beneficiary Association (VEBA) trust, which resulted in our March 2004 contribution of approximately \$232. In April 2004, other parties filed petitions for rehearing. In December 2005, the CPUC denied the applications for rehearing.

**California Intrastate Access Charges** In August 2003, the CPUC opened a rulemaking to determine whether certain elements of state access charges (charges that our local exchange carrier receives from long-distance carriers for use of the local exchange network) should be eliminated or reduced. The CPUC, in a December 2004 decision, first addressed the issue whether we should be authorized to increase revenues from other services to offset lost revenues from reduced access charges, and further concluded that if access charges were eliminated it should order offsetting rate increases for us. In a proposed decision issued in December 2005, a CPUC administrative law judge would eliminate certain access charges that we would receive from long-distance carriers (lost annual revenue of approximately \$130), but would authorize offsetting rate increases for recovery of approximately 75% of that amount starting after December 2006. We believe that the proposed decision is unlawful and have filed comments opposing its adoption. The CPUC is expected to address the issue in the first quarter of 2006.

**Market Deregulation** In addition to other state activity to adopt legislation to deregulate retail rates, during 2005, the PUCT adopted our market test evidence in total, despite opposition of the CLEC trade association and the Office of Public Utility Counsel. As a result of this action, as of January 1, 2006, we have the option to raise residential basic local exchange service prices in 40 exchanges in Texas. This action results in pricing flexibility for approximately 66% of our residential local service lines, including all residential lines in major cities. Texas vertical service products have enjoyed pricing flexibility since 1999 and all business lines were afforded local service pricing flexibility earlier this year. Additionally, in November 2005, Michigan updated the Michigan Telecommunications Act, which price deregulated all basic exchange rates except a primary residential service, effectively eliminating price regulation on all business access lines and most residential access lines.

**State UNE Pricing Proceedings** As discussed above in "Triennial Review Remand Order," in March 2005, the FCC issued the TRRO which eliminated our obligation to provide unbundled local switching (and thus the UNE-P) for the mass-market 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 mass-market UNE-P customers and high-capacity

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loops and dedicated transport circuits that no longer will be subject to unbundling. 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. 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. During 2005, the CPUC addressed the issue on remand resulting in a favorable outcome for us.

### 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., cable, wireless and VoIP providers) 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 continued competitive pressure in 2006 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 other telecommunications companies such as Verizon (via recently acquired MCI) 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 this segment, but we expect both losses of market share in local service and gains resulting from 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 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 enter into interconnection agreements with us. Any unresolved issues in negotiating those agreements are subject to arbitration before the appropriate state commission. These agreements (whether fully agreed-upon or arbitrated) are then subject to review and approval by the appropriate state commission. As noted in the "Triennial Review Remand Order" discussion above, in March 2005, the FCC revised its rules and provided significant relief from unbundling by eliminating our obligation to provide local switching, and hence the UNE-P, for mass-market customers, subject to a 12-month transition period. During the 12-month transition period (which ends in March 2006), we are experiencing decreases in the number of UNE-P lines as competitors move to alternate arrangements to serve their customers or their customers choose an alternative technology. We could experience increased pressure on our operating revenues should a customer that was receiving service from a UNE-P provider switch to an alternative technology or facilities-based competitor (a competitor with its own network).

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

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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.

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.

In response to these competitive pressures, for several years we have utilized a bundling strategy that rewards customers who consolidate their services (e.g., local and long-distance telephone, DSL, wireless and video) with us. In 2005, we continued to focus on bundling wireline and wireless services, including combined packages of minutes and video service through an agreement with EchoStar. During 2006, we will continue to develop innovative products that capitalize on our expanding fiber network.

### **AT&T Corp.**

Our AT&T Corp. segment subsidiaries expect continued competition in 2006. As competitive regulatory and technological changes occur, including those occasioned by the Telecom Act, we anticipate that new and different competitors will enter and expand their position in the communications service markets. Our principal competitors include Verizon (via recently acquired MCI) and Sprint, as well as prepaid card providers. In addition, we face a number of international competitors including Equant, British Telecom and SingTel as well as from a number of large systems integrators such as International Business Machines and Electronic Data Systems.

In response to the previously discussed changes in the federal regulatory environment and the deregulation of the long-distance market over recent years, in 2004 ATTC announced that it would no longer actively market to mass-market consumer customers, and therefore is not affected to the same degree by those regulations as our wireline segment.

ATTC provides local, domestic interstate and international wholesale networking capacity and switched services to other service providers, primarily large ISPs using the largest class of nationwide Internet networks (Internet backbone), wireless carriers, CLECs, regional phone ILECs, cable companies and systems integrators. These services are subject to additional competitive pressures from the development of new technologies and the increased availability of domestic and international transmission capacity. As our competitors develop and expand their existing networks, our networks experience excess capacity. The introduction of new products and service offerings and increasing satellite, wireless, fiber-optic and cable transmission capacity for services similar to those provided by us continues to provide competitive pressures.

### **Cingular**

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 three national (Verizon Wireless, Sprint Nextel Corp. 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.

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### Directory

Our directory subsidiaries face competition from approximately 100 publishers of printed directories in their operating areas. Direct and indirect competition also exists from other advertising media, including newspapers, radio, television and direct-mail providers, as well as from directories offered over the Internet. We actively compete on the Internet through our YPC joint venture.

### 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.

**Traffic Compensation** We use various estimates and assumptions to determine the amount of traffic compensation expenses recognized during any reporting period. Switched traffic compensation costs in our AT&T Corp. segment are accrued utilizing estimated rates by product, formulated from historical data and adjusted for known rate changes and volume levels, which are estimated for certain products and known for other products. Such estimates are adjusted monthly to reflect newly available information, such as rate changes and new contractual agreements. Bills reflecting actual incurred information are generally not received until three to nine months following the end of the reporting period, at which point a final adjustment is made to the accrued switched traffic compensation expense. Dedicated traffic compensation costs are estimated based on the number of circuits and the average projected circuit costs, based on historical data adjusted for rate changes. These costs are adjusted to reflect actual expenses over the three months following the end of the reporting period as bills are received. As of December 31, 2005, approximately \$940 was accrued in our AT&T Corp. segment relating to our estimated traffic compensation costs.

**Depreciation** 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, 2005. However, if all other factors were to remain unchanged, we expect a one-year increase in the useful lives of the largest categories of our plant in service (which accounts for more than three-fourths of our total plant in service) would result in a decrease of between \$615 and \$800 in our 2006 depreciation expense and a one-year decrease would result in an increase of between \$745 and \$1,175 in our 2006 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.

**Allowance for Uncollectibles** We maintain an allowance for doubtful accounts for estimated losses that result from the failure or inability of our customers to make required payments. When determining the allowance, we consider the probability of recoverability of accounts receivable based on past experience, taking into account current collection trends that are expected to continue, as well as general economic factors, including bankruptcy rates. Credit risks are assessed based on historical write-offs, net of recoveries, and future estimated net write-offs as well as an analysis of the aged accounts receivable balances with reserves generally increasing as the receivable ages. Accounts receivable may be fully reserved for when specific collection issues are known to exist, such as pending bankruptcy or catastrophes. The analysis of receivables is performed monthly and the bad debt allowances adjusted accordingly. A 10% change in the amounts estimated to be uncollectible would result in a change in uncollectible expense of between approximately \$70 and \$110.

**Pension and Postretirement Benefits** 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 assumptions is the return on assets assumption, which was 8.5% for the year ending December 31, 2005. This assumption will remain unchanged for 2006. If all other factors were to

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remain unchanged, we expect a 1% decrease in the expected long-term rate of return would cause 2006 combined pension and postretirement cost to increase approximately \$579 over 2005 (analogous decrease in retiree benefit costs would result from a 1% increase). The 10-year returns on our pension plan were 9.3% through 2005 including returns in excess of our assumed rate of return for 2005. 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. This methodology did not have a significant additional effect on our 2005 or 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. Note 10 also discusses the effects of certain changes in assumptions related to medical trend rates on retiree health care costs.

**Income Taxes** 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.

**Asset Valuations and Impairments** Under FAS 141, the assets and liabilities of ATTC were recorded at their respective preliminary fair values as of the November 18, 2005 acquisition date. We obtained preliminary third-party valuations of property, plant and equipment, intangible assets (including the AT&T trade name), debt and certain other assets and liabilities. Because of the proximity of this transaction to year end, the values of certain assets and liabilities are based on preliminary valuations and are subject to adjustment as additional information is obtained. Such additional information includes, but is not limited to: valuations and physical counts of property, plant and equipment, valuations of investments and the involuntary termination of employees. Changes to the valuation of property, plant and equipment may result in adjustments to the fair value of certain identifiable intangible assets acquired. When finalized, material adjustments to goodwill may result including the segment allocation of goodwill.

The fair values of intangible assets acquired in our acquisition of ATTC were based on the expected discounted cash flows of the identified customer relationships, patents and licenses and are discussed in Note 2. Customer relationships, which are finite-lived intangible assets are amortized using the "sum of the months digits" method of amortization over the expected period in which those relationships are expected to contribute to our future cash flows, including consideration for demand, competition and other economic factors based in such a way as to allocate it as equitably as possible to periods during which we expect to benefit from those relationships. We have established the useful lives of customer relationships with business customers from 1.5 to 9 years and those with consumer customers from 1.5 to 2.5 years. The sum of the months digits method is a process of allocation, not of valuation and reflects our belief that we expect greater revenue generation from these customer relationships during the earlier years of their lives. We recorded amortization expense of \$184 in 2005 using this method. Alternatively, we could have chosen to amortize customer relationships using the "straight-line" method, which would allocate the cost equally over the amortization period, and would

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have resulted in amortization expense of approximately \$96 in 2005. In 2006, expected amortization using the sum of the months digit method is approximately \$899 and under the straight-line method it would be \$579. Amortization of other intangibles, including patents, is determined using the straight-line method of amortization over the expected remaining useful lives of 2 to 18 years, was approximately \$8 in 2005 and is expected to be approximately \$50 in 2006. We do not amortize indefinite-lived intangibles, such as the trade name.

In accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," we review these types of assets for impairment either annually or whenever events or circumstances indicate that the carrying amount may not be recoverable over the remaining life of the asset or asset group. In order to determine that the asset is recoverable, we verify that the expected future cash flows directly related to that asset exceed its fair value, which is based on the discounted cash flows. The discounted cash flow calculation uses various assumptions and estimates regarding future revenue, expense and cash flows projections over the estimated remaining useful life of the asset.

Cost investments are evaluated to determine 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.

### New Accounting Standards

**FSP FAS No. 143-1** In June 2005, the FASB issued FASB Staff Position FSP FAS No. 143-1, "Accounting for Electronic Equipment Waste Obligations," (FSP FAS 143-1) to address the accounting for obligations associated with the Directive on Waste Electrical and Electronic equipment (the Directive) issued by the European Union (EU). The Directive was enacted in February 2003, and directs EU-member countries to adopt legislation to regulate the collection, treatment, recovery and environmentally sound disposal of electrical and electronic waste equipment. The Directive concludes that commercial users are obligated to retire, in an environmentally sound manner, specific assets that qualify as historical waste. FSP FAS 143-1 is effective for reporting periods ending after June 8, 2005, or the date of adoption of the Directive by the applicable EU-member countries, if later. We have evaluated the impact to our operations in ATTC's EU countries that have adopted the legislation and have deemed the costs immaterial. We will continue to evaluate the effects as other EU-member countries enact legislation. However, if the remaining EU-member countries were to enact similar legislation, we do not expect this to have a material impact on our results of operations.

**FAS 154** In May 2005, the FASB issued Statement of Financial Accounting Standards No. 154, "Accounting for Changes and Error Corrections," (FAS 154) which is a replacement of Accounting Principles Board (APB) Opinion No. 20, "Accounting Changes" and Statement of Financial Accounting Standards No. 3 "Reporting Accounting Changes in Interim Financial Statements" and is effective for fiscal years beginning after December 15, 2005. FAS 154 applies to all voluntary changes in accounting principle and changes the accounting for the reporting of a change in accounting principle. FAS 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle unless it is impracticable. FAS 154 also requires that a change in method of depreciation, amortization or depletion for long-lived nonfinancial assets be accounted for as a change in accounting estimate that is effected by a change in accounting principle.

**FIN 47** In March 2005, the FASB issued FASB Interpretations 47, "Accounting for Conditional Asset Retirement Obligations," (FIN 47) an interpretation of FAS 143 and is effective for fiscal years ended after December 15, 2005. FIN 47 clarifies that the term "conditional asset retirement obligation," as used in FAS 143 refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement is conditional on a future event that may or may not be within the control of

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the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and/or method of settlement. FIN 47 requires a company to recognize the liability for the fair value of the conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. Any liability accrued would be offset by an increase in the value of the asset. Adoption of FIN 47 did not have a material impact on our financial statements.

**FAS 123(R)**In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" (FAS 123(R)), which is a revision of Statement of Financial Accounting Standards 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 Statement of Financial Accounting Standards No. 95, "Statement of Cash Flows."

We adopted FAS 123(R) in September 2005, using the "modified retrospective" method. The modified retrospective method requires that compensation cost be 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 also allowed companies to restate based on the amounts previously recognized under FAS 123 for purposes of pro forma disclosures for all prior years for which FAS 123 was effective.

Accordingly, we have adjusted our December 31, 2004 Consolidated Balance Sheet to increase "Capital in excess of par value" and decrease "Retained earnings" by \$546.

We had previously 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 Statement of Financial Accounting Standards 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), because we adopted using the modified retrospective method, we also restated results for 1995 through 1999 for the effects on our equity. We will continue to use the Black-Scholes option-pricing model to estimate the fair value of stock options granted to employees.

As of December 31, 2005, there was approximately \$143 of total unrecognized compensation cost related to nonvested stock-based compensation arrangements granted. That cost is expected to be recognized over a weighted-average period of 1.6 years.

### Other Business Matters

**Acquisition of AT&T Corp.**In November 2005, we acquired ATTC for approximately \$15,517 including capitalized merger-transaction costs, using shares of common stock. The transaction was approved by the Board of Directors of each company and shareholders of ATTC. The DOJ reviewed the merger's potential impact on relevant product and geographic markets. The DOJ required divestiture (through 10-year indefeasible rights of use) of ATTC's interest in fiber serving certain specified commercial buildings where both companies were the only facilities-based providers. The FCC and numerous state and international regulatory bodies also approved the acquisition. The FCC's order released on November 17, 2005, imposes conditions on us that relate, among other things, to: Unbundled Network Elements (UNE), DS1 and DS3 (high-capacity transport services) and special access pricing; how to account for ATTC collocation arrangements; special access performance reporting; Internet backbone peering arrangements; and annual certifications. As a condition of approval, the CPUC required that we make certain financial commitments, including philanthropic donations, with a present value of \$124 and that we provide our DSL services on a stand-alone basis. These commitments were included as an additional acquisition cost. We do not expect the above-mentioned conditions will have a material impact on our financial statements.

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**2Wire**In January 2006, AT&T, Alcatel and Telmex entered into an agreement and jointly acquired 51% of 2Wire, Inc. (2Wire). The total sum paid by the three companies was approximately \$243. We purchased a 7.52% ownership interest for approximately \$36, Alcatel purchased a 25.0% ownership interest for \$119 and Telmex purchased an 18.5% ownership interest for \$88. Additionally, we executed a prepaid call option (dependent on certain provisions) with Telmex for \$26 to acquire enough shares to give us a total ownership percentage in 2Wire of 13%. We will account for 2Wire as a cost investment. 2Wire is a privately held company that provides services related to Project Lightspeed.

**EchoStar Agreement**In September 2005, we modified and extended our agreement with EchoStar to an agency agreement under which we will continue marketing the co-branded AT&T | DISH Network satellite television service. Under the new terms, we will now receive and record sales commissions as revenues and will no longer record retail revenue on new customers while continuing to serve previously existing customers on the prior terms. EchoStar will record the recurring service revenues and will pay installation and equipment costs for customers under the new agreement. The new agreement is a three-year agreement.

**IRS Settlement** In December 2005, we reached an agreement with the IRS to settle certain claims, principally related to the utilization of capital losses and tax credits for years 1997-1999. Included in the settlement was relief from previous assessments and agreement on multiple items challenged by the IRS in the course of routine audits. The settlement resulted in our recognition of approximately \$902 of reduced income tax expense in 2005 and a corresponding increase in net income. Amounts due to us under the settlement were left on deposit with the IRS.

**Antitrust Litigation**In 2002, two consumer class-action antitrust cases were filed in the United States District Court for the Southern District of New York (District Court) against SBC, Verizon Communications Inc., BellSouth and Qwest Communications International Inc. 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 District Court granted the joint defendants' motion to dismiss and the plaintiffs appealed. In October 2005, the United States Court of Appeals for the Second Circuit Court (Second Circuit) reversed the District Court, thereby allowing the cases to proceed. The Second Circuit noted in its decision that its ruling was procedural in nature and did not address the merits of the cases. Motions for rehearing and rehearing en banc were denied on January 3, 2006, and the case has now been remanded to the District Court for further proceedings. We continue to believe that an adverse outcome having a material effect on our financial statements in these cases is unlikely but will continue to evaluate the potential impact of these suits on our financial results as they progress.

**AT&T Wireless Litigation**Several class-action lawsuits have been filed in the District Court against ATTC asserting claims under the federal securities laws in connection with the offering of AT&T Wireless tracking stock in April 2000 (*In re AT&T Corp. Securities Litigation*). The plaintiffs have demanded damages in excess of \$2,100 related to the offering of AT&T Wireless tracking stock. A trial date has been set for April 2006. In connection with the split-off of AT&T Wireless, certain provisions of the separation agreement between AT&T Wireless and ATTC may result in Cingular, due to its acquisition of AT&T Wireless, being allocated as much as 70% of any liabilities arising out of these actions to the extent they relate to AT&T Wireless tracking stock, with the remaining liability being allocated equally between ATTC and Comcast Cable Communications, Inc. We believe that the possibility of an adverse outcome having a material effect on our financial statements in any of these lawsuits is unlikely. However, we will continue to evaluate the potential impact of these lawsuits on our financial results. During the third quarter, Cingular completed its assessment of the total amount of pre-acquisition liabilities related to pending legal proceedings, including these lawsuits, and increased the amount of the AT&T Wireless purchase price allocated to assumed liabilities by \$172.

**Retiree Phone Concession Litigation**In May 2005, we were served with a purported class action in U.S. District Court, Western District of Texas (*Stoffels v. SBC Communications Inc.*), in which the plaintiffs,



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who are retirees of Pacific Bell Telephone Company, Southwestern Bell, and Ameritech, contend that the telephone concession provided by the company is, in essence, a "defined benefit plan" within the meaning of the Employee Retirement Income Security Act of 1974 (ERISA). Plaintiffs seek to certify a class of persons that are either (1) retirees of the former subsidiaries of SBC or a predecessor thereof, who received the telephone concession benefit after they retired or (2) current or former employees of the former subsidiaries of SBC with more than 5 years of service during the time that they had a policy to provide employees with a telephone concession benefit upon retirement. Plaintiffs seek reformation of the out-of-region phone concession offered under the postemployment benefits plan (the Plan) and the documents governing it to comply with ERISA, an order requiring us to fund the Plan as reformed, the appointment of an independent fiduciary to administer the Plan, an order requiring the Plan to pay benefits to plaintiffs and other class members consistent with the terms of the plan and attorneys' fees and costs pursuant to ERISA. We filed a Motion to Dismiss for failure to state a claim, which was denied by the U.S. District Court, Western District of Texas on February 3, 2006. The case has been set for trial on May 29, 2006. We believe that an adverse outcome having a material effect on our financial statements in this case is unlikely but will continue to evaluate the potential impact of this suit on our financial results as it progresses.

**Hepting Litigation** Plaintiffs filed this purported class action in U.S. District Court in the Northern District of California on behalf of "all individuals in the United States that are current residential subscribers or customers of defendants' telephone services or internet services, or that were residential telephone or internet subscribers or customers at any time after September 2001," (Hepting, et al v. AT&T Corp., AT&T Inc. and Does 1-20). They allege that the defendants have provided and continue to provide the U.S. Government with direct access to databases containing its stored telephone and internet records, and have disclosed and are currently disclosing to the U.S. Government records concerning communications to which Plaintiffs and class members were a party. Plaintiffs seek damages, a declaratory judgment, and injunctive relief for violations of the First and Fourth Amendments to the United States Constitution, the Foreign Intelligence Surveillance Act, the Electronic Communications Privacy Act, and other federal and California statutes. The complaint has not been served on the Defendants.

### Liquidity and Capital Resources

We had \$1,224 in cash and cash equivalents available at December 31, 2005. Cash and cash equivalents included cash of approximately \$709, money market funds of \$257 and other cash equivalents of \$258. The increase in cash and cash equivalents of \$464 since December 31, 2004 was primarily provided by cash receipts from operations, cash received from Cingular and the net cash received upon our acquisition of ATTC. This was partially offset by cash used to meet the financing needs of the business including, but not limited to, payment of operating expenses, funding capital expenditures, dividends to stockholders, net repayment of debt, repurchase of treasury shares, increased tax payments and payment of liabilities (primarily taxes) associated with our discontinued operations. We discuss many of these factors in detail below.

### Cash Provided by Operating Activities

During 2005, our primary source of funds was cash from operating activities of \$12,974 compared to \$10,950 in 2004. Operating cash flows increased in 2005 compared to 2004 primarily due to retirement benefit funding of \$2,232 in 2004, partially offset by increased tax payments in 2005 of approximately \$1,224. The 2005 increased tax payments were mainly related to prior year accrued liabilities. The timing of cash payments for income taxes, which is governed by the IRS and other taxing jurisdictions, will differ from the timing of recording tax expense and deferred income taxes, which are reported in accordance with GAAP. We also made advance tax payments, which we consider to be a refundable deposit, to a certain state jurisdiction. These payments were made in order to avoid potentially onerous interest and penalties. The issues involved are in dispute and we intend to pursue all procedural options available to us in order to obtain refunds of the amounts deposited.

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We reached an agreement with the IRS to settle certain claims resulting in a reduction to income tax expense of \$902. We left a net refund with the IRS as a deposit against federal tax payments.

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 \$2,800 decline in our deferred income tax expense. Our primary source of funds for 2004 and 2003 was cash generated from operating activities, as shown on the Consolidated Statements of Cash Flows.

### Cash Used in and Provided by Investing Activities

During 2005, cash used for investing activities consisted of:

- \$5,576 in construction and capital expenditures.
- \$169 related to the acquisition of Yantra Corp., a provider of distributed order management and supply chain fulfillment solutions.

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 considerations. Our capital expenditures totaled \$5,576 for 2005, \$5,099 for 2004 and \$5,219 for 2003. Capital expenditures in the wireline segment, which represented substantially all of our total capital expenditures, increased by approximately 5.9% in 2005 and decreased by 2.8% in 2004. Substantially all of our capital expenditures made in 2005 were in the wireline segment and were used primarily for our wireline subsidiaries' networks, Project Lightspeed and support systems for our long-distance service.

Because of opportunities made available by the continued changing regulatory environment and our acquisition of ATTC, we expect that our capital expenditures in 2006, which includes Project Lightspeed and excludes Cingular, will increase to a target range of between \$8,000 and \$8,500. We expect to spend approximately \$4,400 on our Project Lightspeed initiative for network related deployment costs and capital expenditures beginning in 2006 through 2008, as well as additional success-based customer activation capital expenditures. We expect that the business opportunities made available, specifically in the data/broadband area, will allow us to expand our products and services (see "Project Lightspeed" discussed in "Expected Growth Areas").

We expect to fund 2006 capital expenditures for our wireline and AT&T Corp. segments, which includes ATTC's international operations, using cash from operations and incremental borrowings, depending on interest rate levels and overall market conditions. Substantially all of our capital spending in 2006 will relate to our wireline and AT&T Corp. segments primarily for their subsidiaries' networks, Project Lightspeed and merger-integration projects. The international segment should be self-funding as it consists substantially of equity investments and not direct AT&T operations. We expect to fund any directory segment capital expenditures using cash from operations. We discuss our Cingular segment below.

During 2005, cash provided by our investing activities primarily consisted of:

- \$2,442 of net repayments from Cingular in accordance with the terms of our agreement with Cingular and BellSouth. See our "Cingular" section below for details.
- \$1,673 in cash received upon closing our acquisition of ATTC, net of merger acquisition costs.
- \$336 of proceeds from a real estate sale lease-back transaction, the gain on which is deferred and amortized over the life of the lease.
- \$154 primarily from the sale of shares of Amdocs, Yahoo, the sale of our entire interest in SpectraSite and the sale of a leasing partnership.
- \$99 related to maturities of other held-to-maturity securities, which have maturities greater than 90 days.
- \$37 related to the repayment of a note receivable from an international investment.

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### Cash Used in Financing Activities

We will fund our 2006 financing activities primarily through a combination of cash from operations and, to a lesser extent than in 2005, cash provided by Cingular. We will continue to examine opportunities to fund our activities with cash from the disposition of certain assets and other investments as well as issuing debt at favorable rates in order to refinance some of our debt maturities in 2006.

We paid cash dividends of \$4,256 in 2005, \$4,141 in 2004 and \$4,539 in 2003. Dividends declared by our Board of Directors totaled \$1.30 per share in 2005, \$1.26 per share in 2004 and \$1.41 per share in 2003. In December 2005, our Board of Directors approved a 3.1% increase in the regular quarterly dividend to \$0.3325 per share. The dividends declared and paid during 2003 included two increases in the regular quarterly dividend and three additional dividends (totaling \$0.25) above our regular quarterly dividend. Our dividend policy considers both the expectations and requirements of stockholders, internal requirements of AT&T and long-term growth opportunities. It is our intent to provide the financial flexibility to allow our Board of Directors the opportunity to continue our historical approach to dividend growth. All dividends remain subject to approval by our Board of Directors.

During 2005, we used our available excess cash to reduce our debt levels and repurchase shares of common stock under our repurchase program. Funds from operations were primarily used to repay our current and long-term debt. During 2005, debt repayments totaled \$6,801 and consisted of:

- \$4,077 related to commercial paper borrowings.
- \$1,077 related to debt maturities with interest rates ranging from 6.25% to 9.50%.
- \$1,347 related to our early redemption of debt, which includes \$26 of call premiums.
- \$238 related to the exercise of a put on our 5.95% notes originally maturing in 2038.
- \$42 related to net repayments on other short-term borrowings.
- \$20 related to scheduled principal payments on other debt.

At December 31, 2005 we had approximately \$4,455 of debt maturing within one year, which includes \$3,990 of long-term debt maturities during 2006, \$320 of commercial paper borrowings and \$108 of bank borrowings. Our long-term debt maturities exclude the remaining excess of the fair value over the recorded value of debt of approximately \$37. Our consolidated commercial paper borrowings totaled approximately \$4,397 at December 31, 2004. All of our commercial paper borrowings are due within 90 days. Our bank borrowings availability is contingent on the level of cash held by some of our foreign subsidiaries. We continue to examine our mix of short- and long-term debt in light of interest rate trends. (See Note 7)

In November 2005, we received net proceeds of \$1,973 from the issuance of \$2,000 of long-term debt consisting of \$500 of three-year floating rate notes with an initial rate of 4.52%; \$1,000 of 5.30% five-year notes; and \$500 from the reopening of our 6.15% 30-year bonds maturing in 2034.

Our Board of Directors has authorized the repurchase of up to 350 million shares of AT&T common stock; this authorization expires at the end of 2008. During 2005, we increased our level of share repurchases of our common stock under our existing share repurchase program. Under this repurchase program, we repurchased 76 million shares at a cost of approximately \$1,843 in 2005 and expect to purchase an additional \$2,000 of shares under our repurchase program in 2006. See our "Issuer Equity Repurchases" table for share repurchase details in the fourth quarter of 2005.

In November 2005, we repaid approximately \$378 of preferred securities previously issued by an AT&T subsidiary, which was related to an internal restructuring of our ownership in several investments. Additionally, in December 2005, we redeemed an additional \$350 of preferred stock in subsidiaries.

In June 2005, we received proceeds of approximately \$234 from a registered offering of 10,000,000 shares of our common stock.

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We have a three-year credit agreement totaling \$6,000 with a syndicate of banks, which expires on 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. We are in compliance with all covenants under the agreement. We had no borrowings outstanding under committed lines of credit as of December 31, 2005. (See Note 7)

### 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 \$17,791 in 2005 compared to \$11,245 in 2004. The 2005 total capital increase was primarily due to the purchase of ATTC (see Note 2). For 2005 our common stock outstanding and capital in excess of par value increased by \$14,781 and our current and long-term debt increased by \$3,605. The increase in total debt of \$3,605 was primarily due to acquired debt from ATTC of approximately \$8,293 and debt issuances of \$2,000, partially offset by debt repayments of \$6,801 during 2005. Stockholders' equity also increased due to our net income and was partially offset by our repurchases of common shares through our stock repurchase program. 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.

Our debt ratio was 35.9%, 40.0% and 32.0% at December 31, 2005, 2004 and 2003. The debt ratio is affected by the same factors that affect total capital. The primary factor that impacted our 2005 debt ratio was the acquisition of ATTC, which increased stockholders' equity and our current and long-term debt.

### Cingular

The upgrade, integration and expansion of the Cingular and AT&T Wireless networks and the networks acquired in a transaction with Triton PCS Holdings, Inc. will require substantial amounts of capital over the next several years. As of December 31, 2005, Cingular has spent \$7,475 primarily for GSM/GPRS/EDGE network upgrades with cash from operations, dispositions and, as needed, advances under the revolving credit agreement mentioned below. Cingular expects to fund its capital requirements for at least the next 12 months from existing cash balances, cash generated from operations and, if necessary, drawing under this revolving credit agreement. In 2006, Cingular expects to spend within a target range of between \$7,000 and \$7,500 primarily for the upgrade, integration and expansion of its networks, the installation of UMTS/HSDPA technology in a number of markets and the construction of network facilities in California and Nevada to replace the facilities sold to T-Mobile upon the termination of our GSMF network infrastructure joint venture.

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. We and BellSouth also 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 (London Interbank Offered Rate) plus 0.05%, which may be renewed upon agreement of the parties. In June 2005, this agreement was renewed through July 31, 2007. This agreement includes a provision for the repayment of our and BellSouth's shareholder loans 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.

Under the revolving credit agreement we received net repayments from Cingular totaling \$2,442 in 2005. These amounts were applied first to reduce the outstanding amount of advances previously made to Cingular, which totaled \$307 at December 31, 2005 and \$1,002 at December 31, 2004 and are reflected in "Investments in and Advances to Cingular Wireless" on our Consolidated Balance Sheets. Our shareholder loan to Cingular totaled approximately \$4,108 at December 31, 2005 and \$5,855 at December 31, 2004.

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In January 2005, Cingular and T-Mobile dissolved their network infrastructure joint venture. In connection with the dissolution, Cingular sold its ownership of the California/Nevada network assets to T-Mobile for approximately \$2,500 in cash. Cingular used a significant portion of the proceeds from the sale to fund capital expenditures through July 2005 and, in the third quarter, used the remaining \$1,488 to repay its shareholder loans from BellSouth and us pursuant to the revolving credit agreement.

In September 2005, Cingular received proceeds of approximately \$300 related to the sale of its entire interest in IDEA Cellular Ltd., a cellular telecommunications company in India.

In June 2005, Cingular agreed to sell former AT&T Wireless operations and licenses in the Caribbean and Bermuda to Digicel Limited for approximately \$61. A majority of this transaction was completed by the fourth quarter of 2005 with the remaining portion contingent upon governmental and regulatory approvals.

In May 2005, we transferred wireless properties to Cingular to settle a liability related to the formation of Cingular. This transfer resulted in a decrease of approximately \$35 to our "Investment in Cingular" account.

### 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. Our contractual obligations do not include expected pension and postretirement payments as we maintain pension funds and VEBAs to fully or partially fund these benefits (see Note 10). 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, 2005. 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. The minimum commitment for certain obligations is based on termination penalties that could be paid to exit the contract. Since termination penalties would not be paid in every year, such penalties are excluded from the table. Other long-term liabilities were included in the table based on the year of required payment or an estimate of the year of payment. Such estimate of payment is based on a review of past trends for these items, as well as a forecast of future activities. Certain items were excluded from the table below as the year of payment is unknown and could not be reliably estimated since past trends were not deemed to be an indicator of future payment.

Substantially all of our purchase obligations are in our wireline and AT&T Corp. segments 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 \$115, with approximately \$13 to be paid in less than one year. The table does not include the fair value of our interest rate swaps. Many of our other noncurrent liabilities have been excluded from the table below due to the uncertainty of the timing of payments, combined with the absence of historical trending to be used as a predictor for such payments. Additionally, certain other long-term liabilities have been excluded since settlement of such liabilities will not require the use of cash. However, we have included in the table below, obligations which primarily relate to benefit funding and severance due to the certainty of the timing of these future payments. Our other long-term liabilities are: deferred income taxes (see Note 9) of \$15,713; postemployment benefit obligations (see Note 10) of \$18,133; unamortized investment tax credits of \$209; and other noncurrent liabilities of \$5,354, which included supplemental retirement plan and certain other postemployment benefit liabilities (see Note 10) and deferred lease revenue from our agreement with SpectraSite, Inc. of \$598 (see Note 5).

# Management's Discussion and Analysis of Financial Condition and Results of Operations, continued

Dollars in millions except per share amounts

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 <sup>1</sup>	\$ 29,482	\$ 3,990	\$ 2,337	\$ 5,242	\$ 17,913
Commercial paper obligations	320	320	-	-	-
Other short-term borrowings	108	108	-	-	-
Purchase obligations <sup>2,3,4</sup>	3,105	1,235	1,234	387	249
Operating lease obligations	2,626	632	926	551	517
Retirement benefit funding obligation	1,000	-	-	1,000	-
Other long-term obligations	937	-	426	79	432
Severance obligations	870	574	296	-	-
<b>Total Contractual Obligations</b>	<b>\$ 38,448</b>	<b>\$ 6,859</b>	<b>\$ 5,219</b>	<b>\$ 7,259</b>	<b>\$ 19,111</b>

<sup>1</sup> Included 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 2006 and \$125 of 6.35% debentures maturing in 2026 with a put option by holder in 2006 (see Note 7). The impact of premiums/discounts and derivative instruments included in debt amounts on the balance sheet are excluded from the table. These debt amounts include revaluations on our foreign currency denominated debt of \$218 in 2006. We have entered into foreign exchange contracts, recorded in other current assets, which hedge our exposure to these foreign currency revaluations.

<sup>2</sup> Includes approximately \$410 of total purchase commitments with WiTel for services to be provided on WiTel's network.

<sup>3</sup> Our AT&T Corp. segment has contractual obligations to utilize network facilities from local exchange carriers with terms greater than one year. Since the contracts have no minimum volume requirements, and are based on an interrelationship of volumes and discounted rates, we assessed our minimum commitment based on penalties to exit the contracts, assuming we exited the contracts on December 31, 2005. At December 31, 2005, the penalties we would have incurred to exit all of these contracts would have been \$536. These termination fees could be \$571 in 2006, \$684 in the aggregate for 2007 and 2008 and \$125 for 2009, assuming all contracts are exited. These termination fees are excluded from the above table as the fees would not be paid in every year and the timing of such payments, if any, is uncertain.

<sup>4</sup> We calculated the minimum obligation for certain agreements to purchase goods or services based on termination fees that can be paid to exit the contract. If we elect to exit these contracts, termination fees for all such contracts in the year of termination could be approximately \$398 in 2006, \$425 in the aggregate for 2007 and 2008, \$90 in the aggregate for 2009 and 2010 and \$3, in the aggregate, thereafter. These termination fees are excluded from the above table as the fees would not be paid in every year and the timing of such payments, if any, is uncertain.

## 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. On a limited basis, we use certain derivative financial instruments, including foreign currency exchange contracts and combined interest rate foreign currency contracts to manage these risks. 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.

We enter into foreign currency contracts to minimize our exposure to risk of adverse changes in currency exchange rates. We are subject to foreign exchange risk for foreign currency-denominated transactions, such

## Management's Discussion and Analysis of Financial Condition and Results of Operations, continued

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as debt issued, recognized payables and receivables and forecasted transactions. At December 31, 2005, our foreign currency exposures were principally Euros, British pound sterling, Danish krone and Japanese Yen.

### Quantitative Information About Market Risk

In order to determine the changes in fair value of our various financial instruments, we use certain financial modeling techniques. We apply rate sensitivity changes directly to our interest rate swap transactions and forward rate sensitivity to our foreign currency-forward contracts.

The changes in fair value, as discussed below, assume the occurrence of certain market conditions, which could have an adverse financial impact on AT&T and do not represent projected gains or losses in fair value that we expect to incur. Future impacts would be based on actual developments in global financial markets. We do not foresee any significant changes in the strategies used to manage interest rate risk, foreign currency rate risk or equity price risk in the near future.

**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, 2005. 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 asset (liability) represents the amount we would receive or pay if we exited the contracts as of December 31, 2005.

	Maturity							Fair Value 12/31/05
	2006	2007	2008	2009	2010	After 2010	Total	
<b>Interest Rate Derivatives</b>								
Interest Rate Swaps:								
Receive Fixed/Pay Variable								
Notional Amount	\$1,000	-	-	-	-	\$3,250	\$4,250	\$(16)
Variable Rate Payable <sup>1</sup>	5.8%	5.9%	6.0%	6.0%	6.1%	5.9%		
Weighted-Average Fixed								
Rate Receivable	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%		

<sup>1</sup> Interest 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.

We had fair value interest rate swaps with a notional value of \$4,250 at December 31, 2005 and 2004, with a net fair value liability of approximately \$16 and a fair value asset of \$79, respectively. The net fair value liability of \$16 at December 31, 2005 was comprised of a fair value liability of \$33 and a fair value asset of \$17.

In November 2005, we entered into an interest rate forward contract with a notional amount of \$500 to partially hedge interest expense related to our debt issuance for refinancing a portion of our debt maturities in 2006. We utilized the notional amount of this interest rate forward contract and incurred settlement costs of approximately \$2 (see Note 8). 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.

**Foreign Exchange Forward Contracts** The fair value of foreign exchange contracts is subject to changes in foreign currency exchange rates. For the purpose of assessing specific risks, we use a sensitivity analysis to determine the effects that market risk exposures may have on the fair value of our financial instruments

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and results of operations. To perform the sensitivity analysis, we assess the risk of loss in fair values from the effect of a hypothetical 10% change in the value of foreign currencies (negative change in the value of the U.S. dollar), assuming no change in interest rates. See Note 8 to the consolidated financial statements for additional information relating to notional amounts and fair values of financial instruments.

For foreign exchange forward contracts outstanding at December 31, 2005, assuming a hypothetical 10% depreciation of the U.S. dollar against foreign currencies from the prevailing foreign currency exchange rates, the fair value of the foreign exchange forward contracts (net liability) would have decreased approximately \$36. Because our foreign exchange contracts are entered into for hedging purposes, we believe that these losses would be largely offset by gains on the underlying transactions.

**Interest Rate Foreign Currency Contracts** We have also entered into combined interest rate foreign currency contracts to hedge foreign currency-denominated debt. At December 31, 2005, assuming a hypothetical 10% depreciation in the U.S. dollar against foreign currencies from the prevailing foreign currency exchange rates, the fair value of the combined interest rate foreign currency contracts (asset) would have increased approximately \$88. Because our foreign exchange contracts are entered into for hedging purposes, we believe that these gains would be largely offset by losses on the underlying foreign currency-denominated debt.

The model to determine sensitivity assumes a parallel shift in all foreign currency exchange rates, although exchange rates rarely move in the same direction. Additionally, the amounts above do not necessarily represent the actual changes in fair value we would incur under normal market conditions because all variables, other than the exchange rates, are held constant in the calculations.

The risk of loss in fair values of all other financial instruments resulting from a hypothetical 10% change in market prices was not significant as of December 31, 2005.

### Qualitative Information About Market Risk

**Foreign Exchange Risk** From time to time, we make investments in businesses in foreign countries, are paid dividends and 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.

We have also entered into foreign currency contracts to minimize our exposure to risk of adverse changes in currency exchange rates. We are subject to foreign exchange risk for foreign currency-denominated transactions, such as debt issued, recognized payables and receivables and forecasted transactions. At December 31, 2005, our foreign currency exposures were principally Euros, British pound sterling, Danish krone and Japanese Yen.

**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 in 2004. 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 the purchase of derivatives.



**Management's Discussion and Analysis of Financial Condition and Results of Operations, continued**

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**Issuer Equity Repurchases**

Our Board of Directors authorized the repurchase of up to 350 million shares of our common stock; this authorization expires at the end of 2008. During 2005, we increased our level of share repurchases of our common stock under our existing share repurchase program. Under this repurchase program, we repurchased 76 million shares at a cost of approximately \$1,843 in 2005 and expect to purchase approximately \$2,000 of additional shares under our repurchase program in 2006. Our fourth-quarter share repurchases are listed below:

Purchase Period	Total Number of Shares Purchased	Average Price Paid per Share <sup>1</sup>	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 26, 2005 – October 31, 2005	7,000,000	\$23.45	7,000,000	294,989,613
November 1, 2005 – November 29, 2005	25,200,000	\$23.86	25,200,000	269,789,613
December 1, 2005 – December 9, 2005	13,260,500	\$25.23	13,260,500	256,529,113
Total	45,460,500	\$24.19	45,460,500	256,529,113

<sup>1</sup> Average Price Paid per Share excludes transaction costs.

**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 2005.

**Risk Factors**

In addition to the other information set forth in this document, including the matters contained under the caption "Cautionary Language Concerning Forward-Looking Statements," you should carefully read the matters described below. We believe each of these matters could materially affect our business. We recognize most of these factors are beyond our ability to control and therefore to predict an outcome. Accordingly, we have organized them by first addressing general factors, then industry factors and, finally, transactions specifically applicable to us.

**Adverse changes in the U.S. securities markets and medical costs could materially increase our benefit plan costs.**

Our pension and postretirement costs are subject to increases, primarily due to continuing increases in medical and prescription drug costs and can be affected by lower returns in prior years on funds held by our pension and other benefit plans which are reflected in our financial statements over several years. For example, in two of the last five years we experienced increased combined pension and postretirement costs. Investment returns on these funds depend largely on trends in the U.S. securities markets and the U.S. economy. In calculating the annual costs included on our financial statements of providing benefits under our plans, we have made certain assumptions regarding future investment returns, medical costs and interest rates. If actual investment returns, medical costs and interest rates are worse than those previously assumed, our annual costs will increase.

**Changes in available technology could increase competition and our capital costs.**

The telecommunications industry has experienced rapid changes in the last several years. The development of wireless, cable and IP technologies has significantly increased the commercial viability of alternatives to traditional wireline telephone service. In order to remain competitive, we have begun to deploy a more sophisticated network and continue to research other new technologies. If the new technologies we have adopted or on which we have focused our research efforts fail to be cost-effective and accepted by customers, our ability to remain competitive could be materially adversely affected.

**Changes to federal and state regulations and decisions in regulatory proceedings could materially adversely affect us.**

Our wireline and ATTC subsidiaries and are subject to significant federal and state regulation while many of our competitors are not. The adoption of new regulations or changes to existing regulations could significantly increase our costs which either would reduce our operating margins or potentially increase customer turnover should we attempt to increase prices to cover our increased costs. In addition, the development of new technologies, such as IP-based services, has created or potentially could create conflicting regulation between the FCC and various state and local authorities, which may involve lengthy litigation to resolve and may result in outcomes unfavorable to us.

**Increasing competition in our wireline markets could adversely affect wireline operating margins.**

We expect competition in the telecommunications industry to continue to intensify. We expect this competition will continue to put pressure on pricing, margins and customer retention. A number of our competitors that rely on alternative technologies (e.g., wireless, cable and VoIP) are typically subject to less (or no) regulation than our wireline and ATTC subsidiaries and therefore are able to operate with lower costs. These competitors also have cost advantages compared to us, due in part to a non-unionized workforce, lower employee benefits and fewer retirees (as most of the competitors are relatively new companies). We believe such advantages can be offset by continuing to increase the efficiency of our operating systems and improving employee training and productivity but there can be no assurance our efforts in these areas will be successful.

**Increasing competition in the wireless industry could adversely affect Cingular's operating results.**

On average, Cingular has three to four other wireless competitors in each of its service areas and competes for customers based principally on price, service offerings, call quality, coverage area and customer service. In addition, Cingular is likely to experience growing competition from providers offering services using alternative wireless technologies and IP-based networks as well as traditional wireline networks. Cingular expects intense industry competition and market saturation likely will cause the wireless industry's customer growth rate to moderate in comparison with historical growth rates. This competition will continue to put

## Management's Discussion and Analysis of Financial Condition and Results of Operations, continued

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pressure on pricing, margins and customer turnover as companies compete for potential customers. Cingular's ability to respond will depend, among other things, on improving customer retention and reducing customer turnover by subsidizing product upgrades and/or reducing pricing to match competitors' initiatives, upgrading Cingular's network and providing improved customer service. These efforts will involve significant expenses and require strategic management decisions on matters such as technology choices, marketing plans and financial budgets. We and BellSouth provide Cingular with its working capital financing; if we or BellSouth were unable or unwilling to finance Cingular's operating and capital needs on a timely basis or permit third-party financing, Cingular would be unable to pursue its business plan. Since we jointly manage Cingular with BellSouth, if we and BellSouth cannot agree, inaction or disputes may result, which could have a material adverse effect on Cingular's operating results.

**The success of our Project Lightspeed broadband initiative will depend on the timing, extent and cost of deployment, the development of attractive and profitable service offerings and the extent to which regulatory, franchise fees and build-out requirements apply to this initiative.**

The trend in telecommunications technology is to shift from the traditional circuit and wire-based technology to Internet Protocol-based technology. IP-based technology can transport voice and data, as well as video, from both wired and wireless networks. IP-based networks also potentially cost less to operate than traditional networks. Our competitors, many of which are newer companies, are deploying this IP-based technology. In order to continue to offer attractive and competitively-priced services, we are deploying a new broadband network to offer IP-based voice, data and video services. Using a new and sophisticated technology on a very large scale entails risks but also presents opportunities to expand service offerings to customers. Should deployment of our network be delayed or costs exceed expected amounts, our margins would be adversely affected and such effects could be material. Should regulatory requirements be different than we anticipated, our deployment could be delayed, perhaps significantly, or limited to only those geographical areas where regulation is not burdensome. In addition, should the delivery of services expected to be deployed on our network be delayed due to technological or regulatory constraints or other reasons, or the cost of providing such services becomes higher than expected, customers may decide to purchase services from our competitors which would adversely affect our revenues and margins, and such effects could be material.

**Our acquisition of ATTC may not be integrated successfully; the expected cost savings and any other synergies from the acquisition may take longer to realize than expected or may not be fully realized; and disruption from the acquisition may adversely affect our relationships with customers, employees, suppliers and other parties.**

We acquired ATTC in order to combine ATTC's global systems capabilities, business and government customers and IP-based business with our local exchange, broadband and wireless services and to create potential cost savings, revenue synergies, technological development and other benefits. Achieving these results will depend in part on successfully combining two large corporations, which could involve significant management attention and create uncertainties for employees. Diversion of attention from ongoing operations on the part of management and employees could adversely affect our customers, suppliers and other parties with whom we have relationships. We also expect to incur substantial expenses related to the integration of ATTC. We must integrate a large number of systems, both operational and administrative. These integration expenses will likely result/have resulted in our taking significant charges against earnings, both cash and noncash, primarily from the amortization of intangibles and one-time impairments. Delays in this process could have a material adverse effect on our revenues, expenses, operating results and financial condition. In addition, events outside of our control, including changes in state and federal regulation and laws as well as economic trends, also could adversely affect our ability to integrate ATTC and such effects may be material.

**Management's Discussion and Analysis of Financial Condition and Results of Operations, continued**

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**Cingular's acquisition of AT&T Wireless may not be integrated successfully; the expected costs savings and any other synergies from the acquisition may take longer to realize than expected or may not be fully realized; and disruption from the acquisition may adversely affect our relationships with customers, employees, suppliers and other parties.**

Cingular acquired AT&T Wireless to add additional spectrum and expand its network coverage and enhance its business customer base. By adding size and scale, Cingular expects to compete more effectively in the wireless industry and procure more significant cost economies from vendors. In order to achieve these goals, Cingular must integrate separate network systems and consolidate other operating and support systems without reducing network service coverage or quality or customer service. Cingular also must develop and offer competitive and attractive services. If Cingular does not accomplish its integration plan in a timely and cost-effective manner, Cingular may lose customers, experience reduced growth and fail to realize the anticipated benefits and synergies of the acquisition to the extent, or in the time frame, expected.

## **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. Many of these factors are discussed in more detail in the "Risk Factors" section. 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.
- Increases in our benefit plans' costs including increases due to adverse changes in the U.S. securities markets, resulting in worse-than-assumed investment returns and discount rates, and adverse medical cost trends.
- The final outcome of Federal Communications Commission proceedings and reopenings of such proceedings 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 the states in which we operate 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 our ability to maintain capital expenditures.
- The extent of competition 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 lower cost structures and regulatory and legislative actions adverse to us, 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; the development of attractive and profitable service offerings; the extent to which regulatory, franchise fees and build-out requirements apply to this initiative, and; the availability and reliability of the various technologies required to provide such 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; and the resolution of disputes with any taxing jurisdictions.
- 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 time frame expected, the capital and expense synergies and other benefits expected from its acquisition of AT&T Wireless.
- The impact of our acquisition of ATTC, including 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, legislative and technological developments.

Readers are cautioned that other factors discussed in this report, although not enumerated here, also could materially affect our future earnings.

**AT&T Inc.****Consolidated Statements of Income**

Dollars in millions except per share amounts

	2005	2004	2003
<b>Operating Revenues</b>			
Voice	\$20,037	\$20,796	\$21,986
Data	12,964	10,984	10,150
Long-distance voice	4,964	3,297	2,561
Directory advertising	3,786	3,832	3,894
Other	2,111	1,878	1,907
Total operating revenues	43,862	40,787	40,498
<b>Operating Expenses</b>			
Cost of sales (exclusive of depreciation and amortization shown separately below)	19,190	17,515	16,857
Selling, general and administrative	10,861	9,807	9,487
Depreciation and amortization	7,643	7,564	7,870
Total operating expenses	37,694	34,886	34,214
<b>Operating Income</b>	6,168	5,901	6,284
<b>Other Income (Expense)</b>			
Interest expense	(1,456)	(1,023)	(1,191)
Interest income	383	492	603
Equity in net income of affiliates	609	873	1,253
Other income (expense) – net	14	922	1,767
Total other income (expense)	(450)	1,264	2,432
<b>Income Before Income Taxes</b>	5,718	7,165	8,716
Income taxes	932	2,186	2,857
<b>Income From Continuing Operations</b>	4,786	4,979	5,859
Income From Discontinued Operations, net of tax	-	908	112
<b>Income Before Extraordinary Item and Cumulative Effect of Accounting Changes</b>	4,786	5,887	5,971
Extraordinary item, net of tax	-	-	(7)
Cumulative effect of accounting changes, net of tax	-	-	2,541
<b>Net Income</b>	\$4,786	\$5,887	\$8,505
<b>Earnings Per Common Share:</b>			
<b>Income From Continuing Operations</b>	\$1.42	\$1.50	\$1.77
<b>Income Before Extraordinary Item and Cumulative Effect of Accounting Changes</b>	\$1.42	\$1.78	\$1.80
<b>Net Income</b>	\$1.42	\$1.78	\$2.56
<b>Earnings Per Common Share – Assuming Dilution:</b>			
<b>Income From Continuing Operations</b>	\$1.42	\$1.50	\$1.76
<b>Income Before Extraordinary Item and Cumulative Effect of Accounting Changes</b>	\$1.42	\$1.77	\$1.80
<b>Net Income</b>	\$1.42	\$1.77	\$2.56

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

**AT&T Inc.****Consolidated Balance Sheets**

Dollars in millions except per share amounts

	December 31,	
	2005	2004
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$1,224	\$760
Accounts receivable - net of allowances for uncollectibles of \$1,176 and \$1,001	9,351	6,901
Prepaid expenses	1,029	746
Deferred income taxes	2,011	566
Other current assets	1,039	989
Total current assets	14,654	9,962
<b>Property, Plant and Equipment – Net</b>	58,727	50,046
<b>Goodwill</b>	14,055	1,625
<b>Intangible Assets – Net</b>	8,503	429
<b>Investments in Equity Affiliates</b>	2,031	1,798
<b>Investments in and Advances to Cingular Wireless</b>	31,404	33,687
<b>Other Assets</b>	16,258	12,718
<b>Total Assets</b>	<b>\$145,632</b>	<b>\$110,265</b>
<b>Liabilities and Stockholders' Equity</b>		
<b>Current Liabilities</b>		
Debt maturing within one year	\$4,455	\$5,734
Accounts payable and accrued liabilities	17,088	11,459
Accrued taxes	2,586	1,787
Dividends payable	1,289	1,065
Liabilities of discontinued operations	-	310
Total current liabilities	25,418	20,355
<b>Long-Term Debt</b>	26,115	21,231
<b>Deferred Credits and Other Noncurrent Liabilities</b>		
Deferred income taxes	15,713	15,621
Postemployment benefit obligation	18,133	9,076
Unamortized investment tax credits	209	188
Other noncurrent liabilities	5,354	3,290
Total deferred credits and other noncurrent liabilities	39,409	28,175
<b>Stockholders' Equity</b>		
Common shares (\$1 par value, 7,000,000,000 authorized: issued 4,065,093,907 at December 31, 2005 and 3,433,124,836 at December 31, 2004)	4,065	3,433
Capital in excess of par value	27,499	13,350
Retained earnings	29,106	28,806
Treasury shares (188,209,761 at December 31, 2005 and 132,212,645 at December 31, 2004, at cost)	(5,406)	(4,535)
Additional minimum pension liability adjustment	(218)	(190)
Accumulated other comprehensive income	(356)	(360)
Total stockholders' equity	54,690	40,504
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$145,632</b>	<b>\$110,265</b>

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

**AT&T Inc.****Consolidated Statements of Cash Flows**

Dollars in millions, increase (decrease) in cash and cash equivalents

	2005	2004	2003
<b>Operating Activities</b>			
Net income	<b>\$4,786</b>	\$5,887	\$8,505
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	<b>7,643</b>	7,564	7,870
Undistributed earnings from investments in equity affiliates	<b>(451)</b>	(542)	(965)
Provision for uncollectible accounts	<b>744</b>	761	846
Amortization of investment tax credits	<b>(21)</b>	(32)	(24)
Deferred income tax (benefit) expense	<b>(658)</b>	646	3,446
Net gain on sales of investments	<b>(135)</b>	(939)	(1,775)
Extraordinary item, net of tax	-	-	7
Cumulative effect of accounting changes, net of tax	-	-	(2,541)
Income from discontinued operations, net of tax	-	(908)	(112)
Retirement benefit funding	-	(2,232)	(1,645)
Changes in operating assets and liabilities:			
Accounts receivable	<b>(94)</b>	282	(2,121)
Other current assets	<b>34</b>	(102)	(14)
Accounts payable and accrued liabilities	<b>84</b>	414	2,293
Stock-based compensation tax benefit	<b>(3)</b>	(5)	(1)
Other – net	<b>1,045</b>	156	(363)
Total adjustments	<b>8,188</b>	5,063	4,901
<b>Net Cash Provided by Operating Activities</b>	<b>12,974</b>	10,950	13,406
<b>Investing Activities</b>			
Construction and capital expenditures	<b>(5,576)</b>	(5,099)	(5,219)
Receipts from (investments in) affiliates – net	<b>2,436</b>	(22,660)	-
Purchases of held-to-maturity securities	-	(135)	(710)
Maturities of held-to-maturity securities	<b>99</b>	499	248
Dispositions	<b>526</b>	6,672	3,020
Acquisitions, net of cash acquired	<b>1,504</b>	(74)	(8)
Proceeds from note repayment	<b>37</b>	50	-
Purchases of other investments	-	-	(436)
<b>Net Cash Used in Investing Activities</b>	<b>(974)</b>	(20,747)	(3,105)
<b>Financing Activities</b>			
Net change in short-term borrowings with original maturities of three months or less	<b>(4,119)</b>	3,398	(78)
Repayment of other short-term borrowings	-	-	(1,070)
Issuance of long-term debt	<b>1,973</b>	6,461	-
Repayment of long-term debt	<b>(2,682)</b>	(881)	(3,148)
Purchase of treasury shares	<b>(1,843)</b>	(448)	(490)
Issuance of treasury shares	<b>432</b>	216	102
Repurchase of preferred shares of subsidiaries	<b>(728)</b>	-	-
Dividends paid	<b>(4,256)</b>	(4,141)	(4,539)
Stock-based compensation tax benefit	<b>3</b>	5	1
Other	<b>(6)</b>	-	-
<b>Net Cash (Used in) Provided by Financing Activities</b>	<b>(11,226)</b>	4,610	(9,222)
Net increase (decrease) in cash and cash equivalents from continuing operations	<b>774</b>	(5,187)	1,079
<b>Net Cash (Used in) Provided by Operating Activities from Discontinued Operations</b>	<b>(310)</b>	(256)	156
<b>Net Cash Provided by Investing Activities from Discontinued Operations</b>	-	1,397	-
Net increase (decrease) in cash and cash equivalents	<b>464</b>	(4,046)	1,235
Cash and cash equivalents beginning of year	<b>760</b>	4,806	3,571
<b>Cash and Cash Equivalents End of Year</b>	<b>\$1,224</b>	\$760	\$4,806

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



**AT&T Inc.**
**Consolidated Statements of Stockholders' Equity**

Dollars and shares in millions, except per share amounts

	2005		2004		2003	
	Shares	Amount	Shares	Amount	Shares	Amount
<b>Common Stock</b>						
Balance at beginning of year	3,433	\$3,433	3,433	\$3,433	3,433	\$3,433
Issuance of shares	632	632	-	-	-	-
Balance at end of year	4,065	\$4,065	3,433	\$3,433	3,433	\$3,433
<b>Capital in Excess of Par Value</b>						
Balance at beginning of year		\$13,350		\$13,556		\$13,545
Issuance of shares		14,087		(315)		(181)
Stock based compensation		62		109		192
Balance at end of year		\$27,499		\$13,350		\$13,556
<b>Retained Earnings</b>						
Balance at beginning of year		\$28,806		\$27,089		\$23,257
Net income (\$1.42, \$1.78 and \$2.56 per share)		4,786		5,887		8,505
Dividends to stockholders (\$1.30, \$1.26 and \$1.41 per share)		(4,480)		(4,170)		(4,674)
Other		(6)		-		1
Balance at end of year		\$29,106		\$28,806		\$27,089
<b>Treasury Shares</b>						
Balance at beginning of year	(132)	\$(4,535)	(128)	\$(4,698)	(115)	\$(4,584)
Purchase of shares	(76)	(1,843)	(17)	(448)	(21)	(490)
Issuance of shares	20	972	13	611	8	376
Balance at end of year	(188)	\$(5,406)	(132)	\$(4,535)	(128)	\$(4,698)
<b>Additional Minimum Pension Liability Adjustment</b>						
Balance at beginning of year		\$(190)		\$(1,132)		\$(1,473)
Required adjustments (net of taxes of \$(17), \$578 and \$210)		(28)		942		341
Balance at end of year		\$(218)		\$(190)		\$(1,132)
<b>Accumulated Other Comprehensive Income, net of tax</b>						
Balance at beginning of year		\$(360)		\$-		\$(978)
Currency translation adjustments:						
Foreign currency translation adjustment, net of taxes of \$27, \$(17) and \$302		50		(31)		561
Less reclassification adjustment for cumulative currency translation adjustments realized in net income, net of taxes of \$(52)		-		(97)		-
Net unrealized gains (losses) on securities:						
Unrealized gains (losses), net of taxes of \$3, \$102 and \$264		5		189		536
Less reclassification adjustment realized in net income, net of taxes of \$(30), \$(121) and \$(64)		(56)		(225)		(119)
Net unrealized gains (losses) on cash flow hedges:						
Unrealized gains (losses), net of taxes of \$(1) and \$(106)		(1)		(196)		-
Less reclassification adjustment realized in net income, net of taxes of \$3		7		-		-
Other		(1)		-		-
Other comprehensive income (loss)		4		(360)		978
Balance at end of year		\$(356)		\$(360)		\$-
<b>Total Comprehensive Income</b>						
Net income		\$4,786		\$5,887		\$8,505
Additional minimum pension liability adjustments per above		(28)		942		341
Other comprehensive income (loss) per above		4		(360)		978
Total Comprehensive Income		\$4,762		\$6,469		\$9,824

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

## Notes to Consolidated Financial Statements

Dollars in millions except per share amounts

### NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Basis of Presentation** Throughout this document, AT&T Inc., formerly known as SBC Communications Inc. (SBC), is referred to as “AT&T,” “we” or the “Company.” On November 18, 2005, we acquired 100 percent of the outstanding common shares of AT&T Corp. (ATTC). In connection with the merger, we changed the name of the company from “SBC Communications Inc.” to “AT&T Inc.” ATTC is a wholly owned subsidiary of the Company and the results of ATTC’s operations have been included in our consolidated financial statements after the November 18, 2005 acquisition date. For a detailed discussion of our acquisition, see Note 2.

The consolidated financial statements include the accounts of the Company and our majority-owned subsidiaries. Our subsidiaries and affiliates operate in the communications services industry both domestically and internationally 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 equity investments accounted for using the equity method are included for periods ended within up to three months of our year end (see Note 6).

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.

**Consolidation of Variable Interest Entities** 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) 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

## Notes to Consolidated Financial Statements, continued

Dollars in millions except per share amounts

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).

**Stock-Based Compensation**In September 2005, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" (FAS 123(R)), which is a revision of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (FAS 123). FAS 123(R) supersedes Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and amends Statement of Financial Accounting Standards No. 95, "Statement of Cash Flows."

We adopted FAS 123(R) using the "modified retrospective" method. The modified retrospective method requires that compensation cost be 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 also allowed companies to restate based on the amounts previously recognized under FAS 123 for purposes of pro forma disclosures for all prior years for which FAS 123 was effective. See Note 12 for a detailed discussion of our stock-based compensation and our adoption of FAS 123(R).

**Conditional Asset Retirement Obligations**In March 2005, the FASB issued Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations," (FIN 47) an interpretation of Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations"(FAS 143) and is effective for fiscal years ended after December 15, 2005. FIN 47 clarifies that the term "conditional asset retirement obligation," as used in FAS 143 refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and/or method of settlement. FIN 47 requires a company to recognize the liability for the fair value of the conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. Any liability accrued is offset by an increase in the value of the asset. Adoption of FIN 47 did not have a material impact on our financial statements.

**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). We have reclassified accounts receivable for our directory segment. Previously we netted accounts receivable from our directory customers against deferred revenue which is recognized ratably over the life of the directory. During 2005, we began reporting accounts receivable from our directory customers on a gross basis as the full amount is receivable from the customer at the time the directory is issued. As a result of this change, accounts receivable and accounts payable and accrued liabilities each increased by \$1,421 at December 31, 2004.

**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. To the extent allowed by GAAP, 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. 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 had denied. We reached a settlement with the IRS regarding almost all issues included in 1997-1999 claims in the fourth quarter of 2005. The 1997-1999 IRS settlement resulted in an income tax benefit that was recognized during 2005. Additionally, the IRS is expected to complete fieldwork for the 2000-2002 period during 2006. The

## Notes to Consolidated Financial Statements, continued

Dollars in millions except per share amounts

completion of the 2000-2002 audit fieldwork is not expected to have an adverse impact on the financial statements.

The IRS has completed its audit of the ATTC Group for 1997 – 2001 and has referred the case to Joint Committee for review and approval which we expect during the first quarter of 2006. Additionally, the IRS is currently reviewing the ATTC Group for 2002 – 2005. Any adjustments required by either Joint Committee or the review of 2002 – 2005 will be subject to the rules under purchase accounting, and it is not expected that either will result in an adverse impact to 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, 2005, we held \$709 in cash, \$257 in money market funds and \$258 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 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. Our investment securities maturing within one year are recorded in "Other current assets" and instruments with maturities more than one year are recorded in "Other Assets" on the Consolidated Balance Sheets.

**Revenue Recognition** Revenues derived from local telephone, long-distance and data services are recognized when services are provided. This is based upon either usage (e.g. minutes of traffic processed), period of time (e.g. monthly service fees) or other established fee schedules. Service revenues also include billings to our customers for various regulatory fees imposed on us by governmental authorities. We record an estimated revenue reduction for future adjustments to customer accounts, other than a provision for doubtful accounts, at the time revenue is recognized based on historical experience. Cash incentives given to customers are recorded as a reduction of revenue. When required as part of providing service, revenues and associated expenses related to nonrefundable, upfront service activation and set-up fees are deferred and recognized over the associated service contract period. If no service contract exists, those fees are recognized over the average customer relationship period. Associated expenses are deferred only to the extent of such deferred revenue. For contracts that involve the bundling of services, revenue is allocated to the services based on their relative fair value. We record the sale of equipment to customers as gross revenue when we are the primary obligor in the arrangement, when title is passed and the products are accepted by customers. For agreements involving the resale of third-party services in which we are not considered the primary obligor of the arrangement, we record the revenue net of the associated costs incurred. For contracts where we provide customers with an indefeasible right to use network capacity, we recognize revenue ratably over the stated life of the agreement.

We recognize revenues and expenses related to publishing directories on the amortization method, which recognizes revenues and expenses ratably over the life of the directory title, typically 12 months. 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.

**Traffic Compensation Expense** We use various estimates and assumptions to determine the amount of traffic compensation expenses recognized during any reporting period. Switched traffic compensation costs in our AT&T Corp. segment are accrued utilizing estimated rates by product, formulated from historical

## Notes to Consolidated Financial Statements, continued

Dollars in millions except per share amounts

data and adjusted for known rate changes and volume levels, which are estimated for certain products and known for other products. Such estimates are adjusted monthly to reflect newly available information, such as rate changes and new contractual agreements. Bills reflecting actual incurred information are generally not received until three to nine months subsequent to the end of the reporting period, at which point a final adjustment is made to the accrued switched traffic compensation expense. Dedicated traffic compensation costs are estimated based on the number of circuits and the average projected circuit costs, based on historical data adjusted for rate changes. These costs are adjusted to reflect actual expenses over the three months following the end of the reporting period as bills are received.

**Allowance for Uncollectibles** We maintain an allowance for doubtful accounts for estimated losses that result from the failure or inability of our customers to make required payments. When determining the allowance, we consider the probability of recoverability of accounts receivable based on past experience, taking into account current collection trends that are expected to continue, as well as general economic factors, including bankruptcy rates. Credit risks are assessed based on historical write-offs, net of recoveries, and future estimated net write-offs as well as an analysis of the aged accounts receivable balances with reserves generally increasing as the receivable ages. Accounts receivable may be fully reserved for when specific collection issues are known to exist, such as pending bankruptcy or catastrophes. The analysis of receivables is performed monthly and the bad debt allowances 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 Statements 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 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

## Notes to Consolidated Financial Statements, continued

Dollars in millions except per share amounts

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 Statements 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 Statements 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).

**Property, Plant and Equipment** Property, plant and equipment is stated at cost, except for assets acquired using purchase accounting, which are recorded at fair value (see Note 2). 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.

Property, plant and equipment is reviewed for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. An impairment loss shall be recognized only if the carrying amount of a long-lived asset is not recoverable and exceeds its fair value. The carrying amount of a long-lived asset is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset.

The fair value of a liability for an asset retirement obligation is recorded in the period in which it is incurred if a reasonable estimate of fair value can be made. In periods subsequent to initial measurement, period-to-period changes in the liability for an asset retirement obligation resulting from the passage of time and revisions to either the timing or the amount of the original estimate of undiscounted cash flows are recognized. The increase in the carrying value of the associated long-lived asset is depreciated over the corresponding estimated economic life.

**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" on our consolidated Balance Sheets and are amortized over three years. Software costs that do not meet capitalization criteria are expensed immediately.

## Notes to Consolidated Financial Statements, continued

Dollars in millions except per share amounts

**Goodwill and Other Intangible Assets** Goodwill represents the excess of consideration paid over the fair value of net assets acquired in business combinations. Goodwill and other indefinite-lived intangible assets are not amortized but are tested at least annually for impairment. We have completed our annual impairment testing for 2005 and determined that no impairment exists. During 2005, the carrying amount of our goodwill increased from our acquisition of ATTC and an acquisition by a subsidiary and decreased from the sale of our paging subsidiary.

Intangible assets that have finite useful lives are amortized over their useful lives, which range from 1.5 to 18 years. Customer relationships are amortized using primarily the "sum of the months digits" method of amortization over the expected period in which those relationships are expected to contribute to our future cash flows, including consideration for demand, competition and other economic factors based in such a way as to allocate it as equitably as possible to periods during which we expect to benefit from those relationships.

**Advertising Costs** Advertising costs for advertising products and services or promoting our corporate image are expensed as incurred.

**Foreign Currency Translation** Our foreign investments and foreign subsidiaries 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.

We have also entered into foreign currency contracts to minimize our exposure to risk of adverse changes in currency exchange rates. We are subject to foreign exchange risk for foreign currency-denominated transactions, such as debt issued, recognized payables and receivables and forecasted transactions. At December 31, 2005, our foreign currency exposures were principally Euros, British pound sterling, Danish krone and Japanese Yen.

**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. These derivatives are designated as either a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment (fair value hedge), or a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability (cash flow hedge). Our derivative financial instruments primarily include interest rate swap agreements and foreign currency exchange contracts. For example, we use interest rate swaps to manage our 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.

All other derivatives are not formally designated for accounting purposes (undesignated). These derivatives, although undesignated for accounting purposes, are entered into to hedge economic risks.

We record changes in the fair value of fair value hedges, along with the changes in the fair value of the hedged asset or liability that is attributable to the hedged risk. Gains or losses upon termination of our fair value hedges are amortized as interest expense over the term of the interest payments of the related debt issuances.

## Notes to Consolidated Financial Statements, continued

Dollars in millions except per share amounts

We record changes in the fair value of cash flow hedges, along with the changes in the fair value of the hedged asset or liability that is attributable to the hedged risk, in "Accumulated other comprehensive income," which is a component of Stockholders' Equity. The settlement gains or costs on our cash flow hedges are amortized as interest expense over the term of the interest payments of the related debt issuances.

Changes in the fair value of undesignated derivatives are recorded in other income (expense), net, along with the change in fair value of the underlying asset or liability, as applicable.

Cash flows associated with derivative instruments are presented in the same category on the Consolidated Statements of Cash Flows as the item being hedged.

When hedge accounting is discontinued, the derivative is adjusted for changes in fair value through other income (expense), net. For fair value hedges, the underlying asset or liability will no longer be adjusted for changes in fair value and any asset or liability recorded in connection with the hedging relationship (including firm commitments) will be removed from the balance sheet and recorded in current period earnings. For cash flow hedges, gains and losses that were accumulated in other comprehensive income as a component of Stockholders' Equity in connection with hedged assets or liabilities or forecasted transactions will be recognized in other income (expense), net, in the same period the hedged item affects earnings.

**Employee Separations** In accordance with Statement of Financial Accounting Standards No. 112, "Employers' Accounting for Postemployment Benefits," we establish obligations for expected termination benefits provided to former or inactive employees after employment but before retirement. These benefits include severance payments, workers' compensation, disability, medical continuation coverage and other benefits. At December 31, 2005, we had severance accruals for legacy SBC employees of approximately \$410, of which \$283 was established as merger-related severance accruals. In accordance with Statement of Financial Accounting Standards No. 141, "Business Combinations" (FAS 141), severance accruals recorded for ATTC employees were included in the purchase price allocation (see Note 2). At December 31, 2004, we had severance accruals of approximately \$147.

**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 AND DISPOSITIONS

### Acquisitions

**AT&T Corp.** In November 2005, we acquired ATTC in a transaction accounted for under FAS 141. ATTC was one of the nation's largest business service communications providers, offering a variety of global communications services, including large domestic and multinational businesses, small and medium-sized businesses and government agencies. ATTC operated one of the largest telecommunications networks in the U.S. with enterprise networking services available in 127 countries at December 31, 2005. ATTC was also a provider of domestic and international long-distance and usage-based-communications services to consumer customers.

Under the merger agreement, each share of ATTC common stock was exchanged for 0.77942 of a share of our common stock. We issued approximately 632 million shares to ATTC shareholders, giving them an approximate 16 percent stake in the combined company, based on common shares outstanding. In addition, immediately prior to the closing of the transaction, ATTC paid each ATTC shareholder a special dividend of \$1.30 per share. Based on the \$24.17 per share closing price of our common stock on the New York Stock Exchange (NYSE) on November 17, 2005, the last trading day before the closing of the merger, combined with the special dividend, consideration received by ATTC shareholders was approximately \$16,300.



## Notes to Consolidated Financial Statements, continued

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Based on the average closing price of our common stock on the NYSE for the two days prior to, including, and two days subsequent to the public announcement of the merger (January 31, 2005) of \$23.87 and capitalized merger-transaction costs, the transaction was valued, for accounting purposes, at approximately \$15,517. ATTC is now a wholly owned subsidiary of AT&T and the results of ATTC's operations have been included in our consolidated financial statements after the November 18, 2005 acquisition date.

We paid a premium (i.e., goodwill) over the fair value of the net tangible and identified intangible assets acquired for a number of reasons, including the following:

### *Strategic Fit*

- Our company will benefit from ATTC's assets and capabilities, including: a state-of-the-art nationwide and global communications network; advanced technological capabilities in data and internet protocol (IP)-based services; sales and service expertise for complex communications services; and significant product and service development capabilities in AT&T Labs, a leading communications research organization.
- The merger will combine our broad consumer and small- and medium-business customer base with ATTC's enterprise and government customer bases.
- The combined company will have a strong, diversified set of products and service offerings.

### *Cost Savings and Revenue Synergies*

- Combined network operations and IT expenses will decrease, as facilities and operations will be consolidated.
- Sales and support functions of the business services organizations will be combined.
- Duplicate corporate functions will be eliminated.

### *Technological Strength*

- In acquiring ATTC's assets, which include an advanced product portfolio as well as a leading communications research organization (AT&T Labs), we will now have additional resources and skills to innovate and more quickly deliver to customers the next generation of advanced, integrated IP-based wireline and wireless communications services.

The application of purchase accounting under FAS 141 requires that the total purchase price be allocated to the fair value of assets acquired and liabilities assumed based on their fair values at the acquisition date, with amounts exceeding the fair values being recorded as goodwill. The allocation process requires an analysis of acquired fixed assets, contracts, customer lists and relationships, contractual commitments, legal contingencies and brand value to identify and record the fair value of all assets acquired and liabilities assumed. In valuing acquired assets and assumed liabilities, fair values were based on, but not limited to: future expected discounted cash flows for trade names and customer relationships; current replacement cost for similar capacity and obsolescence for certain fixed assets; comparable market rates for contractual obligations and certain investments, real estate and liabilities, including pension and postretirement benefits; expected settlement amounts for litigation and contingencies, including the AT&T Wireless litigation, and; appropriate discount rates and growth rates.

Under the purchase method of accounting, the assets and liabilities of ATTC were recorded at their respective fair values as of the date of the acquisition, November 18, 2005, and we recorded goodwill of \$12,343. We have obtained preliminary third-party valuations of property, plant and equipment, intangible assets (including the AT&T trade name), debt and certain other assets and liabilities. Because of the proximity of this transaction to year end, the values of certain assets and liabilities are based on preliminary valuations and are subject to adjustment as additional information is obtained. Such additional information includes, but is not limited to: valuations and physical counts of property, plant and equipment, valuation of investments and the involuntary termination of employees. We will have 12 months from the closing of the acquisition to finalize our valuations. Changes to the valuation of property, plant and equipment may result in adjustments to the fair value of certain identifiable intangible assets acquired. When finalized, material adjustments to goodwill may result.

**Notes to Consolidated Financial Statements, continued**

Dollars in millions except per share amounts

We have not identified any material unrecorded pre-acquisition contingencies where the related asset, liability or impairment is probable and the amount can be reasonably estimated. Prior to the end of the one-year purchase price allocation period, if information becomes available which would indicate it is probable that such events had occurred and the amounts can be reasonably estimated, such items will be included in the final purchase price allocation and may adjust goodwill.

The following table summarizes the preliminary estimated fair values of the ATTC assets acquired and liabilities assumed and related deferred income taxes as of acquisition date.

	ATTC	
<b>Assets acquired</b>		
Current assets	\$	6,295
Property, plant and equipment		10,921
Intangible assets not subject to amortization		
Trade name		4,900
Licenses		40
Intangible assets subject to amortization		
Customer lists and relationships		3,050
Patents		150
Brand licensing agreements		70
Investments in unconsolidated subsidiaries		160
Other assets		4,247
Goodwill		12,343
<b>Total assets acquired</b>		<b>42,176</b>
<b>Liabilities assumed</b>		
Current liabilities, excluding current portion of long-term debt		6,740
Long-term debt		8,293
Deferred income taxes		531
Postemployment benefit obligation		8,807
Other noncurrent liabilities		2,288
<b>Total liabilities assumed</b>		<b>26,659</b>
<b>Net assets acquired</b>	\$	<b>15,517</b>

Goodwill of \$12,343, resulting from the acquisition of ATTC was assigned to the AT&T Corp. segment. However, as part of the final valuation of the acquisition we will determine to which entities and to what extent the benefit of the acquisition applies, and as required by GAAP record the appropriate goodwill to each entity. Goodwill includes a portion of value for assembled workforce which is not separately classified from goodwill in accordance with FAS 141. The purchased intangibles and goodwill are not deductible for tax purposes. However, purchase accounting allows for the establishment of deferred tax liabilities on purchased intangibles (other than goodwill) that will be reflected as a tax benefit on our future Consolidated Statements of Income in proportion to and over the amortization period of the related intangible asset.

Substantially all of the licenses acquired and the trade name of AT&T have an indefinite life, and accordingly, are not subject to amortization. The customer relationships intangible assets are being amortized over a weighted period of 1.5 to 9 years for business customers and 1.5 to 2.5 years for consumer customers, using the sum of the months digits method of amortization. This method best reflects the estimated pattern in which the economic benefits will be consumed. Patent intangible assets include protective and commercialized patents, which are amortized using the straight-line method over 2 to 18 years based on the remaining lives of the patents and have a weighted-average amortization period of 10 years.

**Notes to Consolidated Financial Statements, continued**

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ATTC maintained change-in-control provisions with its employees that allowed for enhanced severance and benefit payments. Included in the assets acquired and liabilities assumed above are severance accruals of approximately \$1,543, of which \$636 will be paid from ATTC's pension plans and \$37 from ATTC's postemployment benefit plans. These severance payments are expected to be paid over the next two years.

The following unaudited pro forma consolidated results of operations assume that the acquisition of ATTC was completed as of January 1 for each of the fiscal years shown below.

	Year Ended December 31,	
	2005	2004 <sup>1</sup>
Revenues	\$ 66,061	\$ 69,367
Net Income (Loss)	6,167	(74)
Earnings Per Common Share	\$ 1.59	\$ (0.02)
Earnings Per Common Share – Assuming Dilution	\$ 1.59	\$ (0.02)

<sup>1</sup> ATTC's 2004 results include an impairment charge on property, plant and equipment of \$11,400. Since the triggering event for assessing impairment of long-lived assets occurred in July 2004, it is not adjusted in the pro forma consolidated results.

Pro forma data may not be indicative of the results that would have been obtained had these events actually occurred at the beginning of the periods presented, nor does it intend to be a projection of future results.

**Yantra Corporation** In January 2005, our subsidiary Sterling Commerce, Inc. (Sterling), acquired Yantra Corporation (Yantra) for approximately \$169 in cash. We recorded goodwill in our wireline segment of approximately \$98 associated with this acquisition. Yantra is a provider of distributed order management and supply chain fulfillment services.

**Dispositions**

Net proceeds from the 2004 dispositions of our international investments were generally used to fund, in part, our share of the purchase price paid by Cingular to acquire AT&T Wireless. See Note 16 for additional information on the Cingular – AT&T Wireless transaction.

**Directory advertising** 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 our interest in the DonTech II Partnership, a partnership between us and Donnelley 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).

**TDC A/S** 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, directors designated by us 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

**Notes to Consolidated Financial Statements, continued**

Dollars in millions except per share amounts

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.

**Telkom S.A. Limited** 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.

**Belgacom S.A.** 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.

**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, 2005, 2004 and 2003 are shown in the table below.

Year Ended December 31,	2005	2004	2003
<b>Numerators</b>			
Numerator for basic earnings per share:			
Income from continuing operations	\$4,786	\$4,979	\$5,859
Dilutive potential common shares:			
Other stock-based compensation	10	9	9
Numerator for diluted earnings per share	\$4,796	\$4,988	\$5,868
<b>Denominators</b>			
Denominator for basic earnings per share:			
Weighted-average number of common shares outstanding (000,000)	3,368	3,310	3,318
Dilutive potential common shares (000,000):			
Stock options	1	2	1
Other stock-based compensation	10	10	10
Denominator for diluted earnings per share	3,379	3,322	3,329
<b>Basic earnings per share</b>			
Income from continuing operations	\$1.42	\$1.50	\$1.77
Income from discontinued operations	-	0.28	0.03
Extraordinary item	-	-	-
Cumulative effect of accounting changes	-	-	0.76
Net income	\$1.42	\$1.78	\$2.56
<b>Diluted earnings per share</b>			
Income from continuing operations	\$1.42	\$1.50	\$1.76
Income from discontinued operations	-	0.27	0.04
Extraordinary item	-	-	-
Cumulative effect of accounting changes	-	-	0.76
Net income	\$1.42	\$1.77	\$2.56

At December 31, 2005, 2004 and 2003, we had issued and outstanding options to purchase approximately 277 million, 214 million and 231 million shares of AT&T common stock. The exercise prices of options to purchase a weighted average of 257 million, 191 million and 212 million shares in 2005, 2004 and 2003 exceeded the average market price of AT&T stock. Accordingly, we did not include these amounts in determining the dilutive potential common shares for the respective periods. At December 31, 2005, the exercise price of 20 million stock options was below market price. Of these options, 5 million will expire by the end of 2007.

## Notes to Consolidated Financial Statements, continued

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### NOTE 4. SEGMENT INFORMATION

Our segments are strategic business units that offer different products and services and are managed accordingly. Due to the proximity of our acquisition of ATTC to year end, we have reported those results in the AT&T Corp. segment even though there may be some overlap in the products and services provided by that segment and our wireline segment. 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 consolidated results. We have six reportable segments that reflect the current management of our business: (1) wireline, (2) AT&T Corp., (3) Cingular, (4) directory, (5) international, and (6) 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 AT&T Corp. segment reflects the results of ATTC for the 43 days following the November 18, 2005 acquisition. ATTC operates as both a retail and wholesale seller of communications services, primarily providing long-distance and local voice, data and managed networking to business customers. ATTC also provides local and long-distance voice and data services to consumers.

The Cingular segment reflects 100% of the results reported by Cingular, our wireless joint venture. 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 reflect the September 2004 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, excluding investments acquired as a result of the ATTC acquisition. The other segment includes results from 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, AT&T Corp., Cingular, Directory, International and Other columns represent the segment results of each such operating segment. The Wireline column includes revenues from services sold to Cingular of \$815 in 2005, \$602 in 2004 and \$539 in 2003. The AT&T Corp. column includes revenues from services sold to Cingular of \$54 in 2005. Since we account for Cingular using the equity method of accounting, these revenues are not eliminated upon consolidation and as such, remain in consolidated revenue. The Consolidation and Elimination column includes 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, we included goodwill and other intangibles from the acquisition of ATTC in the "Segment assets" line item in the AT&T Corp. column and included our investment in Cingular in the "Investment in equity method investees" line item in the Other column (\$26,989 in 2005 and \$26,830 in 2004).

**Notes to Consolidated Financial Statements, continued**

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Segment results, including a reconciliation to AT&amp;T consolidated results, for 2005, 2004 and 2003 are as follows:

At December 31, 2005 or for the year ended									
	AT&T						Consolidation and Elimination	Cingular Elimination	Consolidated Results
	Wireline	Corp.	Cingular	Directory	International	Other			
Revenues from external customers <sup>1</sup>	\$37,219	\$2,880	\$34,433	\$3,625	\$10	\$253	\$(125)	\$(34,433)	\$43,862
Intersegment revenues	226	7	-	89	-	-	(322)	-	-
Total segment operating revenues	37,445	2,887	34,433	3,714	10	253	(447)	(34,433)	43,862
Operations and support expenses	26,319	2,355	26,034	1,715	28	80	(446)	(26,034)	30,051
Depreciation and amortization expenses	7,121	414	6,575	5	-	103	-	(6,575)	7,643
Total segment operating expenses	33,440	2,769	32,609	1,720	28	183	(446)	(32,609)	37,694
Segment operating income	4,005	118	1,824	1,994	(18)	70	(1)	(1,824)	6,168
Interest expense	-	-	1,260	-	-	-	1,456	(1,260)	1,456
Interest income	-	-	49	-	-	-	383	(49)	383
Equity in net income of affiliates	-	2	5	(5)	395	217	-	(5)	609
Other income (expense) – net	-	-	(87)	-	-	-	14	87	14
Segment income before income taxes	4,005	120	531	1,989	377	287	(1,060)	(531)	5,718
Segment assets	65,363	42,252	79,319	4,041	13,685	120,195	(99,904)	(79,319)	145,632
Investment in equity method investees	-	135	7	64	1,797	27,024	-	(7)	29,020
Expenditures for additions to long-lived assets	5,296	167	7,475	2	-	111	-	(7,475)	5,576

<sup>1</sup>The Consolidation and Elimination column includes revenues from external customers of \$(125) due to items classified differently for segment presentation than for consolidated presentation.

At December 31, 2004 or for the year ended									
	AT&T						Consolidation and Elimination	Cingular Elimination	Consolidated Results
	Wireline	Corp.	Cingular	Directory	International	Other			
Revenues from external customers	\$36,857	\$-	\$19,565	\$3,665	\$22	\$243	\$-	\$(19,565)	\$40,787
Intersegment revenues	30	-	-	94	-	1	(125)	-	-
Total segment operating revenues	36,887	-	19,565	3,759	22	244	(125)	(19,565)	40,787
Operations and support expenses	25,809	-	14,960	1,644	31	(37)	(125)	(14,960)	27,322
Depreciation and amortization expenses	7,454	-	3,077	9	-	101	-	(3,077)	7,564
Total segment operating expenses	33,263	-	18,037	1,653	31	64	(125)	(18,037)	34,886
Segment operating income	3,624	-	1,528	2,106	(9)	180	-	(1,528)	5,901
Interest expense	-	-	900	-	-	-	1,023	(900)	1,023
Interest income	-	-	12	-	-	-	492	(12)	492
Equity in net income of affiliates	-	-	(415)	-	812	61	-	415	873
Other income (expense) – net	-	-	(82)	-	-	-	922	82	922
Segment income before income taxes	3,624	-	143	2,106	803	241	391	(143)	7,165
Segment assets	66,086	-	82,238	4,574	14,041	107,825	(82,261)	(82,238)	110,265
Investment in equity method investees	-	-	2,676	63	1,494	27,071	-	(2,676)	28,628
Expenditures for additions to long-lived assets	4,999	-	3,449	1	-	99	-	(3,449)	5,099

**Notes to Consolidated Financial Statements, continued**  
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For the year ended December 31, 2003									
	<div> <div>AT&amp;T</div> <div>Wireline Corp. Cingular Directory International Other Consolidation and Elimination Cingular Elimination</div> </div>								Consolidated Results
Revenues from external customers	\$ 36,508	\$ -	\$ 15,577	\$ 3,701	\$ 30	\$ 259	\$ -	\$ (15,577)	\$ 40,498
Intersegment revenues	32	-	-	72	-	4	(108)	-	-
Total segment operating revenues	36,540	-	15,577	3,773	30	263	(108)	(15,577)	40,498
Operations and support expenses	24,735	-	11,234	1,637	47	33	(108)	(11,234)	26,344
Depreciation and amortization expenses	7,763	-	2,089	21	-	86	-	(2,089)	7,870
Total segment operating expenses	32,498	-	13,323	1,658	47	119	(108)	(13,323)	34,214
Segment operating income	4,042	-	2,254	2,115	(17)	144	-	(2,254)	6,284
Interest expense	-	-	856	-	-	-	1,191	(856)	1,191
Interest income	-	-	14	-	-	-	603	(14)	603
Equity in net income of affiliates	-	-	(333)	-	606	647	-	333	1,253
Other income (expense) - net	-	-	(74)	-	-	-	1,767	74	1,767
Segment income before income taxes	4,042	-	1,005	2,115	589	791	1,179	(1,005)	8,716



**Notes to Consolidated Financial Statements, continued**

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**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,	2005	2004
United States	\$99,547	\$78,806
Mexico	1,564	1,221
Other foreign countries	691	272
Total	\$101,802	\$80,299

Because of the proximity of the ATTC acquisition to year end, the values of certain ATTC assets are based on preliminary valuations and are subject to adjustment as additional information is obtained. (See Note 2)

We also had long-lived intangible assets which were not presented in the table shown above. At December 31, 2005, substantially all of our intangible assets consisted of \$4,900 from the value of the AT&T trade name and \$3,033 of customer lists. (See Note 14)

**NOTE 5. PROPERTY, PLANT AND EQUIPMENT**

Property, plant and equipment is summarized as follows at December 31:

	Lives (years)	2005	2004
Land	-	\$1,169	\$643
Buildings	35-45	15,557	11,909
Central office equipment	3-10	57,254	55,703
Cable, wiring and conduit	10-50	55,858	52,860
Other equipment	5-15	12,111	9,749
Software	3	5,539	4,222
Under construction	-	1,750	1,091
		149,238	136,177
Accumulated depreciation and amortization		90,511	86,131
Property, plant and equipment - net		\$58,727	\$50,046

Our depreciation expense was \$7,372 in 2005, \$7,447 in 2004 and \$7,667 in 2003.

Certain facilities and equipment used in operations are leased under operating or capital leases. Rental expenses under operating leases were \$473 for 2005, \$479 for 2004 and \$420 for 2003. At December 31, 2005, the future minimum rental payments under noncancelable operating leases for the years 2006 through 2010 were \$632, \$514, \$412, \$312 and \$239 with \$517 due thereafter. Capital leases are not significant.

During 2005, we had impairments in our wireline segment of approximately \$349 on assets for which we do not believe we will recover their value due to the acquisition of ATTC. The impairments primarily consisted of \$237 due to the write-down of out-of-region assets to current market value and write-offs of \$45 of collocation assets and \$43 of software. The impairments are reflected as an

**Notes to Consolidated Financial Statements, continued**

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operating expense in the “Selling, general and administrative” line on our Consolidated Statements of Income.

**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 the first quarter of 2004. The balance of deferred revenue was \$598 in 2005, \$628 in 2004 and \$605 in 2003.

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; we disposed of this interest in 2005. 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:

	2005	2004
Beginning of year	\$33,687	\$11,003
Contributions	-	21,688
Equity in net income	200	30
Other adjustments	(2,483)	966
End of year	\$31,404	\$33,687

Undistributed earnings from Cingular were \$2,711 and \$2,511 at December 31, 2005 and 2004. “Other adjustments” in 2005 included the net activity of \$2,442 under our revolving credit agreement with Cingular, consisting of a reduction of \$1,747 (reflecting Cingular’s repayment of their shareholder loan during 2005) and a decrease of \$695 (reflecting Cingular’s net repayment of their revolving credit balance during 2005) (see Note 15).

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

**Notes to Consolidated Financial Statements, continued**

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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).

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 year then ended:

	2005	2004	2003
<b>Income Statements</b>			
Operating revenues	\$34,433	\$ 19,565	\$ 15,577
Operating income	1,824	1,528	2,254
Net income	333	201	977
<b>Balance Sheets</b>			
Current assets	\$6,049	\$ 5,570	
Noncurrent assets	73,270	76,668	
Current liabilities	10,008	7,983	
Noncurrent liabilities	24,333	29,719	

We have made a subordinated loan to Cingular that totaled \$4,108 and \$5,855 at December 31, 2005 and 2004, which matures in June 2008. This loan bears interest at an annual rate of 6.0%. During 2005, Cingular repaid \$1,747 to reduce the balance of this loan in accordance with the terms of a revolving credit agreement. We earned interest income on this loan of \$311 during 2005, \$354 in 2004 and \$397 in 2003. 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. (See Note 15)

**Other Equity Method Investments** Our investments in equity affiliates include primarily international investments. As of December 31, 2005, our investments in equity affiliates included an 8.2% interest in Teléfonos de México, S.A. de C.V. (Telmex), Mexico's national telecommunications company, and a 7.9% interest in América Móvil S.A. de C.V. (América 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 América 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.

The following table is a reconciliation of our investments in equity affiliates as presented on our Consolidated Balance Sheets:

	2005	2004
Beginning of year	\$1,798	\$6,924
Additional investments	6	100
Equity in net income	409	843
Dividends received	(158)	(331)
Currency translation adjustments	66	(53)
Dispositions	(228)	(4,995)
Other adjustments	138	(690)
End of year	\$2,031	\$1,798

**Notes to Consolidated Financial Statements, continued**

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Undistributed earnings from equity affiliates were \$1,615 and \$1,377 at December 31, 2005 and 2004. The currency translation adjustment for 2005 primarily reflects the effect of exchange rate fluctuations on our investments in Telmex and América Móvil. Dispositions for 2005 primarily reflect the dissolution of a wireless partnership. "Other adjustments" for 2005 include equity investment balances at December 31, 2005, acquired as part of our acquisition of ATTC totaling approximately \$135, which includes our 49% economic interest in Alestra S. de R.L. de C.V., a telecommunications company in Mexico.

The currency translation adjustment for 2004 primarily reflects the effect of exchange rate fluctuations on our investments in TDC, 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).

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 November 2004, a subsidiary in our directory segment entered into a joint venture agreement with BellSouth Corporation (BellSouth) and purchased the internet directory publisher YELLOWPAGES.COM (YPC) for approximately \$98, our portion of which was \$65.

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 2005 or 2004 column in the table below.

	2005	2004	2003
<b>Income Statements</b>			
Operating revenues	\$30,521	\$22,800	\$ 34,747
Operating income	7,773	6,487	9,067
Net income	4,254	4,131	4,689
<b>Balance Sheets</b>			
Current assets	\$6,990	\$5,101	
Noncurrent assets	27,801	21,280	
Current liabilities	9,404	5,493	
Noncurrent liabilities	13,588	12,280	

## Notes to Consolidated Financial Statements, continued

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At December 31, 2005, we had goodwill of approximately \$316 related to our significant 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, 2005, was approximately \$2,221. The fair value of our investment in América Móvil, based on the equivalent value of América Móvil L shares at December 31, 2005, was approximately \$4,198. Our weighted-average share of operating revenues shown above was approximately 8% in 2005 and 2004 and 17% in 2003.

### NOTE 7. DEBT

Long-term debt of AT&T and its subsidiaries, including interest rates and maturities, is summarized as follows at December 31:

		2005	2004
Notes and debentures <sup>1</sup>			
Interest Rates	Maturities		
0.00% – 5.98%	2005 – 2054 <sup>2</sup>	\$12,292	\$11,105
6.00% – 7.85%	2005 – 2043 <sup>3</sup>	12,678	11,429
8.25% – 11.08%	2005 – 2031	4,418	141
		29,388	22,675
Unamortized net premium (discount)		639	(142)
Total notes and debentures		30,027	22,533
Capitalized leases		115	35
Total long-term debt, including current maturities		30,142	22,568
Current maturities of long-term debt		(4,027)	(1,337)
Total long-term debt		\$26,115	\$21,231

<sup>1</sup> The fair value of our variable rate interest rate swaps was reported with its corresponding debt (see Note 8).

<sup>2</sup> Includes \$1,000 of 4.18% Puttable Reset Securities (PURS) maturing in 2021 with a put option by holder in 2006. If the option by holder to elect repayment is exercised in 2006, we intend to refinance that amount with long-term debt.

<sup>3</sup> Includes \$125 of 6.35% debentures maturing in 2026 with a put option by holder in 2006. If the option by holder to elect repayment is exercised in 2006, we intend to refinance that amount with long-term debt.

On November 18, 2005, we assumed \$8,293 in long-term debt, including capital leases, related to our acquisition of ATTC. ATTC's debt included both fixed and floating-rate coupons with a weighted average rate of approximately 8.6% (ranging from 3.87% to 9.75%) and had maturities ranging from 2006 to 2054. Included in our "Total notes and debentures" balance in the table above was the face value of acquired debt from ATTC of \$6,910, which had a carrying amount of \$7,694 at December 31, 2005.

Included in the table above at December 31, 2005, was approximately \$784 representing the remaining excess of the fair value over the recorded value of debt in connection with the acquisition of ATTC, of which \$747 was included in our "Unamortized net premium (discount)" and \$37 was included in our "Current maturities of long-term debt." The excess is amortized over the remaining lives of the underlying debt obligations.

At December 31, 2005, 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 and the remaining excess of the fair value over the recorded value of debt of approximately \$37 mentioned above, were \$3,990 (6.2%), \$1,129 (6.6%), \$1,208 (5.6%), \$4,094 (5.0%) and \$1,148 (5.1%) with \$17,913 (6.8%) due thereafter. As of December 31, 2005, we were in

**Notes to Consolidated Financial Statements, continued**

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compliance with all covenants and conditions of instruments governing our debt. Substantially all of our outstanding long-term debt is unsecured.

**Financing Activities**

**Debt** During 2005, we used a portion of our available excess cash from operations to repay our current and long-term debt. Debt repayments totaled \$6,801 and consisted of:

- \$4,077 related to commercial paper borrowings.
- \$1,077 related to debt maturities with interest rates ranging from 6.25% to 9.50%.
- \$1,347 related to our early redemption of debt, which included \$26 of call premiums.
- \$238 related to the exercise of a put option on our 5.95% notes originally maturing in 2038.
- \$42 related to net repayments on other short-term borrowings.
- \$20 related to scheduled principal payments on other debt.

In November 2005, we received net proceeds of \$1,973 from the issuance of \$2,000 of long-term debt consisting of \$500 of three-year floating rate notes, with an initial rate of 4.52%; \$1,000 of 5.30% five-year notes; and \$500 from the reopening of our 6.15% 30-year bonds maturing in 2034.

Debt maturing within one year consists of the following at December 31:

	2005	2004
Current maturities of long-term debt	\$4,027	\$1,337
Commercial paper	320	4,397
Bank borrowings <sup>1</sup>	108	-
Total	\$4,455	\$5,734

<sup>1</sup> Primarily represents borrowings, the availability of which is contingent on the level of cash held by some of our foreign subsidiaries.

The weighted-average interest rate on commercial paper debt at December 31, 2005 and 2004 was 4.31% and 2.26%.

**Credit Facility** We have a three-year credit agreement totaling \$6,000 with a syndicate of banks, which expires on 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. We are in compliance with all covenants under the agreement. We had no borrowings outstanding under committed lines of credit as of December 31, 2005 or 2004.

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 AT&T 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 AT&T common shares or a change of more than a majority of AT&T'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 AT&T or certain affiliates to make certain minimum

**Notes to Consolidated Financial Statements, continued**

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funding payments under the Employee Retirement Income Security Act of 1974, as amended (ERISA); and specified events of bankruptcy or insolvency.

**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:

	2005		2004	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Notes and debentures	\$30,027	\$30,735	\$22,533	\$23,628
Commercial paper	320	320	4,397	4,397
Bank borrowings	108	108	-	-
Cingular shareholder loan	4,108	4,108	5,855	5,855
Available-for-sale equity securities	648	648	732	732
EchoStar note receivable	465	447	453	453
Preferred stock of subsidiaries	43	43	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 value of debt with an original maturity of less than one year approximates market value. The carrying amount of commercial paper borrowings approximates fair value.

Our shareholder loan to Cingular is recorded at face value, and the carrying amounts approximate fair values. The fair value of our EchoStar note receivable was estimated based on a third-party valuation. The carrying amount of this note was based on the present value of cash and interest payments, which will be accreted on the note up to the face value of \$500 on a straight-line basis through August 2008.

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 our available-for-sale equity securities was principally 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 \$110 in 2005, \$323 in 2004 and \$1,775 in 2003. Gross realized losses on these securities were \$1 in 2005, \$191 in 2004 and \$0 in 2003. These gains and losses were determined using the specific identification method. Our proceeds from the sales of our available-for-sale equity securities were \$125 in 2005, \$3,188 in 2004 and \$2,975 in 2003.

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 \$3 at December 31, 2005 compared to \$99 at December 31, 2004.

**Preferred Stock Issuances**In November 2005, we issued 768,391.4 shares of Perpetual Cumulative Preferred Stock (AT&T preferred stock), par value \$1 per share. The AT&T preferred stock was issued to replace each share of ATTC preferred stock that was issued and outstanding prior to the November 18, 2005 acquisition and is held by a subsidiary of ATTC. (See Note 2)

**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

## Notes to Consolidated Financial Statements, continued

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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.

In June 1997 and December 1999, an AT&T subsidiary issued \$250 and \$100 of preferred stock in private placements. In December 2005, we redeemed these subsidiary-issued preferred stock private placements.

In November 2005, we repaid approximately \$378 of preferred securities previously issued by an AT&T subsidiary, which was related to an internal restructuring of our ownership in several investments.

**Letters of Credit** Letters of credit are guarantees we purchase, which ensure our performance or payment to third parties in accordance with specified terms and conditions. Management has determined that our letters of credit do not create additional risk to us. The notional amounts outstanding at December 31, 2005, were approximately \$623 and the fair values of the letters of credit, based on the fees paid to obtain the obligations, were approximately \$1.

**Derivatives** We use interest rate swaps, interest rate forward contracts and foreign currency exchange contracts to manage our market risk changes in interest rates and foreign exchange rates. We do not use financial instruments for trading or speculative purposes. Each swap matches the 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.

*Interest Rate Swaps* We had fair value interest rate swaps with a notional value of \$4,250 at December 31, 2005 and 2004, with a net carrying and fair value liability of approximately \$16 and a carrying and fair value asset of \$79, respectively. The net fair value liability of \$16 at December 31, 2005, was comprised of a liability of \$33 and an asset of \$17.

*Interest Rate Locks* In November 2005, we entered into an interest rate forward contract with a notional amount of \$500 to partially hedge interest expense related to refinancing a portion of our debt maturities in 2006. In November 2005, we utilized the notional amount of this interest rate forward contract, and incurred settlement costs of approximately \$2. During 2004, we utilized a notional amount of \$1,500 of interest rate forward contracts, and incurred settlement costs of approximately \$302 (\$196 net of tax benefit). During 2006, we expect to reclassify into earnings between \$6 to \$7, net of tax, of the previously mentioned settlement expenses.

*Interest Rate Foreign Currency Swaps* We have combined interest rate foreign currency swap agreements for Euro-denominated debt, which hedge our risk to both interest rate and currency movements. At December 31, 2005, the notional amounts related to these contracts were \$636, which were not designated for accounting purposes. The carrying value of these swaps at December 31, 2005 was an asset of \$233. These swaps are valued using current market quotes, which were obtained from dealers.

*Foreign Currency Forward Contracts* We enter into foreign currency forward contracts to manage our exposure to changes in currency exchange rates related to foreign-currency-denominated transactions. At December 31, 2005, our foreign exchange contracts consisted principally of Euros, British pound sterling, Danish krone and Japanese Yen. At December 31, 2005, the notional amounts under contract were \$623, of which \$18 were designated as net investment hedges. The remaining contracts were not designated for accounting purposes. There was no ineffectiveness recognized in earnings for these contracts during 2005. These foreign exchange contracts had a net carrying and



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fair value liability of \$8, comprised of a liability of \$13 and an asset of \$5. These contracts were valued using current market quotes, which were obtained from independent sources.

**NOTE 9. INCOME TAXES**

Significant components of our deferred tax liabilities (assets) are as follows at December 31:

	2005	2004
Depreciation and amortization	\$13,921	\$13,725
Intangibles (nonamortizable)	1,874	-
Equity in foreign affiliates	727	706
Employee benefits	(4,897)	(2,197)
Currency translation adjustments	(272)	(300)
Allowance for uncollectibles	(351)	(320)
Unamortized investment tax credits	(79)	(73)
Other – net	2,146	3,358
Subtotal	13,069	14,899
Deferred tax assets valuation allowance	627	145
Net deferred tax liabilities	\$13,696	\$15,044
Net long-term deferred tax liabilities	\$15,713	\$15,621
Less: net current deferred tax assets	(2,011)	(566)
Less: other assets	(6)	(11)
Net deferred tax liabilities	\$13,696	\$15,044

At December 31, 2005 and 2004, net deferred tax liabilities include a deferred tax asset of \$542 and \$605 relating to compensation expense under FAS 123(R). 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(R), 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 AT&T 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(R).

The change in the valuation allowance for 2005 is primarily the result of the acquisition of ATTC. Other changes are the result of an evaluation of the uncertainty associated with the realization of certain deferred tax assets unrelated to FAS 123(R). Future adjustments to the valuation allowance attributable to the ATTC opening balance sheet items may be required to be allocated to goodwill and other purchased intangibles. The valuation allowance is maintained in deferred tax assets for certain federal and state loss carryforwards, expiring through 2025, that may not be realized.

**Notes to Consolidated Financial Statements, continued**

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The components of income tax expense are as follows:

	2005	2004	2003
Federal:			
Current	\$1,385	\$1,145	\$(528)
Deferred – net	(681)	843	3,046
Amortization of investment tax credits	(21)	(32)	(24)
	683	1,956	2,494
State, local and foreign:			
Current	226	427	(37)
Deferred – net	23	(197)	400
	249	230	363
Total	\$932	\$2,186	\$2,857

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 changes is as follows:

	2005	2004	2003
Taxes computed at federal statutory rate	\$2,001	\$2,508	\$3,051
Increases (decreases) in income taxes resulting from:			
State and local income taxes – net of federal income tax benefit	176	213	241
Effects of international operations	(70)	(222)	(230)
Medicare reimbursements	(95)	(89)	(8)
Tax settlements	(902)	(65)	(41)
Other – net	(178)	(159)	(156)
Total	\$932	\$2,186	\$2,857

In December 2005, we reached an agreement with the IRS to settle certain claims, principally related to the utilization of capital losses and tax credits for years 1997-1999. Included in the settlement was relief from previous assessments and agreement on multiple items challenged by the IRS in the course of routine audits. As we had previously paid the assessments in full and filed refund claims with the IRS, the settlement resulted in our recognition of approximately \$902 of reduced income tax expense in 2005 and a corresponding increase in net income.

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**

We acquired ATTC on November 18, 2005. ATTC sponsored noncontributory defined benefit pension plans covering the majority of its U.S. employees. In accordance with Statement of Financial Accounting Standards No. 87, “Employers’ Accounting for Pensions” (FAS 87) and Statement of Financial Accounting Standards No. 106 “Employers’ Accounting for Postretirement Benefits Other Than Pensions” (FAS 106), when an employer is acquired as part of a merger, any excess of projected benefit obligation over the plan assets is recognized as a liability and any excess of plan assets over the projected benefit obligation is recognized as a plan asset. The recognition of a new liability or a new asset by the acquirer, at the date of the merger, results in the elimination of any (a) previously existing unrecognized net gain or loss, (b) unrecognized prior service cost and (c) unrecognized net transition obligation. In addition, the accumulated postretirement benefit obligations are to be measured using actuarial assumptions and terms of the substantive plans, as determined by the

**Notes to Consolidated Financial Statements, continued**

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purchaser. As such, and consistent with our practice, we did not account for the annual dollar value cap of labor contracts in the value of the accumulated postretirement benefit obligation for the ATTC postretirement benefit plans (i.e., we assumed the cap would be waived for all future contract periods). All other significant weighted-average assumptions used were determined based on our policies that are discussed below in "Assumptions."

The reconciliation of the December 31, 2004 funded status of ATTC's U.S. plans, excluding supplemental retirement plans, and status of those plans subsequent to the merger are as follows:

	Pension Benefits		Postretirement Benefits	
	Pre-merger	Post-merger	Pre-merger	Post-merger
Benefit obligations	\$(16,178)	\$ (16,942)	\$ (5,813)	\$ (9,129)
Fair value of plan assets	18,510	18,917	2,313	2,429
Funded (unfunded) benefit obligation	2,332	1,975	(3,500)	(6,700)
Unrecognized net loss	949	-	1,298	-
Unrecognized prior service cost	356	-	53	-
Net amount recorded	\$3,637	\$ 1,975	\$ (2,149)	\$ (6,700)

In subsequent periods, net periodic pension cost for ATTC will exclude any amortization of either the unrecognized loss or the unrecognized prior service cost existing at the date of the merger. However, the funding of ATTC's plans is not directly affected by the merger. The basis of funding, over time, will reflect the past amendments and losses that underlie those amounts. As they are reflected in the funding process, contributions will, in some periods, exceed the net pension cost, and that will reduce the liability (unfunded accrued pension cost) recognized at the date of acquisition.

**Pension Benefits**

Substantially all of our U.S. employees are covered by one of our noncontributory pension and death benefit plans. At December 31, 2005, management employees from the legacy SBC operations participated in pension plans that 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). Effective January 15, 2005, the management pension plan for those employees was amended to freeze benefit accruals previously earned under a cash balance formula. Each employee's existing cash balance continues to earn interest at a variable annual rate. After this change, those 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. ATTC management employees participate in a cash balance pension plan. 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.

**Postretirement Benefits**

We provide certain medical, dental and life insurance benefits to certain retired employees under various plans and accrue actuarially determined postretirement benefit costs as active employees earn these benefits.

**Obligations and Funded Status**

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 amount of benefit to be paid depends on a number of future events incorporated into the pension benefit formula, including estimates of the

**Notes to Consolidated Financial Statements, continued**

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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.

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.

We use a December 31 measurement date for calculating the values reported for plan assets and benefit obligations for our plans. The following table presents this reconciliation and shows the change in the projected benefit obligation for the years ended December 31:

	Pension Benefits		Postretirement Benefits	
	2005	2004	2005	2004
Benefit obligation at beginning of year	\$28,189	\$ 27,617	\$ 25,114	\$27,231
Service cost - benefits earned during the period	804	818	390	383
Interest cost on projected benefit obligation	1,725	1,642	1,496	1,495
Amendments	(2)	(87)	(442)	(2,320)
Actuarial loss (gain)	1,182	774	613	(423)
Special termination benefits	15	29	2	3
Curtailments	-	-	(77)	-
Benefits paid	(2,679)	(2,604)	(1,234)	(1,255)
Merger with ATTC	16,942	-	9,129	-
Other	-	-	234	-
Benefit obligation at end of year	\$46,176	\$ 28,189	\$ 35,225	\$25,114

The following table presents the change in the value of plan assets for the years ended December 31 and the plans’ funded status at December 31:

	Pension Benefits		Postretirement Benefits	
	2005	2004	2005	2004
Fair value of plan assets at beginning of year	\$29,813	\$ 28,154	\$ 8,692	\$6,967
Actual return on plan assets	2,704	3,259	677	830
Employer contribution	-	1,001	-	1,232
Benefits paid <sup>1</sup>	(2,679)	(2,601)	(381)	(337)
Merger with ATTC	18,917	-	2,429	-
Fair value of plan assets at end of year	\$48,755	\$ 29,813	\$ 11,417	\$8,692

Funded (unfunded) status (fair value of

plan assets less benefit obligation)<sup>2</sup>

Unrecognized prior service cost (benefit)

Unrecognized net loss

Unamortized transition asset

Net amount recognized	\$11,151	\$ 9,329	\$ (16,458)	\$ (9,271)
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<sup>1</sup> Pension benefits paid include benefits transferred between plans during the year. At our discretion, certain postretirement benefits are paid from AT&T cash accounts and do not reduce Voluntary Employee Beneficiary Association (VEBA) assets. Future benefit payments may be made from VEBA trusts and thus reduce those asset balances.

<sup>2</sup> Funded status is not indicative of our ability to pay ongoing pension benefits nor of our obligation to fund retirement trusts. Required pension funding is determined in accordance with ERISA regulations.

**Notes to Consolidated Financial Statements, continued**

Dollars in millions except per share amounts

Amounts recognized on our Consolidated Balance Sheets at December 31 are listed below:

	Pension Benefits		Postretirement Benefits	
	2005	2004	2005	2004
Prepaid pension cost <sup>1</sup>	\$12,699	\$9,329	\$ -	\$ -
Additional minimum pension liability <sup>2</sup>	(1)	(1)	-	-
Intangible asset	-	-	-	-
Deferred tax asset	-	-	-	-
Employee benefit obligation <sup>2</sup>	(1,548)	-	(16,458)	(9,271)
Accumulated other comprehensive income	1	1	-	-
Net amount recognized	\$11,151	\$9,329	\$ (16,458)	\$ (9,271)

<sup>1</sup> Included in "Other Assets."

<sup>2</sup> Included in "Postemployment benefit obligation."

Included in "Postemployment benefit obligation" on our Consolidated Balance Sheets at December 31, 2004 was a reduction in the liability associated with the "1983 Unfunded Postretirement Benefits Cost Sharing Agreement" and "1983 Force Adjustment Cost-Reimbursement and Indemnification Agreement" (Agreements). Under the Agreements, the Bell System Companies (RBOCs) (which included the former SBC) agreed to provide postemployment benefits to those employees of ATTC who retired prior to the 1983 reorganization that divided ATTC. As part of the Agreement, ATTC agreed to reimburse RBOCs for postemployment benefits paid to these retirees. Since ATTC agreed to provide reimbursement, the accumulated postemployment benefits recorded on our Consolidated Balance Sheets prior to the November 18, 2005 acquisition of ATTC did not include these expected payments. Upon the merger, we no longer will receive third-party reimbursement for these liabilities and have accordingly increased our benefit obligation by \$234. ATTC maintains the Agreements with the remaining RBOCs and we include estimated amounts subject to reimbursement on our Consolidated Balance Sheets as "Other noncurrent liabilities."

Also included in "Postemployment benefit obligation" on our Consolidated Balance Sheets at December 31, 2004 were phone concessions for out-of-region retirees of the former SBC. The out-of-region phone concession, which is not part of the pension plan and not subject to ERISA, allowed for out-of-region retirees to receive reimbursements for phone services provided by a carrier other than the former SBC. During 2005, we notified out-of-region retirees of changes which allowed us to reduce this obligation by approximately \$96.

In December 2004, we announced a prospective change in the calculation of pension benefits provided to legacy SBC management employees. Effective January 15, 2005, the pension calculation formula for management employees is now based upon a stated percentage of employees' adjusted career income. 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 2004.

Effective January 1, 2005, medical coverage for legacy SBC nonmanagement retirees was amended to increase co-pays and deductibles for prescription drugs and certain medical services.

In December 2005, we agreed to new contracts with the Communications Workers of America (CWA) and International Brotherhood of Electrical Workers (IBEW) for certain employees covered under labor agreements previously negotiated by ATTC. The new labor agreements are for three years and four months, cover approximately 11,000 employees and replace three-year contracts that expired in December 2005. The union members ratified the labor agreements which provide for

**Notes to Consolidated Financial Statements, continued**

Dollars in millions except per share amounts

employment security and changes to active nonmanagement employees' pension benefits and medical coverage.

During 2004, we agreed to new five-year labor agreements with the CWA and the IBEW for legacy SBC nonmanagement employees. The agreements provided 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 2004.

Shown below is a summary of our pension obligations and the fair value of pension assets for the years ended December 31:

	2005	2004
Projected benefit obligation	\$46,176	\$28,189
Accumulated benefit obligation	44,139	26,849
Fair value of plan assets	48,755	29,813

The accumulated benefit obligation for our pension plans 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 for our pension plan exceeds that plan's 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. At December 31, 2005, for one of our pension plans, the accumulated benefit obligation exceeded plan assets by less than \$1. This resulted in an additional minimum liability of \$1 (net of deferred taxes of \$1). At December 31, 2004, for one of our pension plans, the accumulated benefit obligation of \$2 exceeded plan assets of \$1. This resulted in an additional minimum liability of \$1 (net of deferred taxes of less than \$1). These reclassifications in equity, while adjusting comprehensive income, will not affect our future results of operations or cash flows.

**Net Periodic Benefit Cost**

Our combined net pension and postretirement cost recognized in our Consolidated Statements of Income was \$1,336, \$1,287 and \$1,835 for the years ended December 31, 2005, 2004 and 2003. The following table presents the components of net pension and postemployment benefit cost (gains are denoted with parentheses and losses are not):

	Pension Benefits			Postretirement Benefits		
	2005	2004	2003	2005	2004	2003
Service cost - benefits earned during the period	\$ 804	\$ 818	\$ 732	\$ 390	\$ 383	\$ 378
Interest cost on projected benefit obligation	1,725	1,642	1,666	1,496	1,495	1,602
Expected return on plan assets	(2,736)	(2,684)	(2,456)	(781)	(720)	(525)
Amortization of prior service cost (benefit) and transition asset	186	188	94	(344)	(349)	(122)
Recognized actuarial loss	156	44	53	440	470	413
Net pension and postretirement cost <sup>1</sup>	\$ 135	\$ 8	\$ 89	\$ 1,201	\$ 1,279	\$ 1,746

<sup>1</sup> During 2005, 2004 and 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (Medicare Act) reduced postretirement benefit cost by \$304, \$255 and \$22. This effect is included in several line items above.

**Notes to Consolidated Financial Statements, continued**

Dollars in millions except per share amounts

During 2005, 2004 and 2003, 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 who accepted this offer and terminated employment before December 31 totaled approximately 71 in 2005, 144 in 2004 and 339 in 2003. In addition to the net costs reported in the tables above, enhanced pension benefits related to this program were recognized as an expense of approximately \$11 in 2005, \$22 in 2004 and \$42 in 2003; enhanced benefits related to the PTG nonmanagement early retirement program were recognized as expenses of \$1, \$3 and \$2 in 2005, 2004 and 2003.

The IRS determines monthly interest rates applicable for calculations of lump sum payments from pension plans (plan sponsors may elect whether the interest rate changes apply monthly, quarterly or annually). 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 reported in the tables above. We recognized expenses of approximately \$7 in 2004 and \$28 in 2003 associated with these special termination benefits.

**Assumptions**

In determining the projected benefit obligation and the net pension and postemployment benefit cost, we used the following significant weighted-average assumptions:

	2005	2004	2003
Discount rate for determining projected benefit obligation at December 31	5.75%	6.00%	6.25%
Discount rate in effect for determining net cost (benefit) <sup>1</sup>	6.00%	6.25%	6.75%
Long-term rate of return on plan assets	8.50%	8.50%	8.50%
Composite rate of compensation increase for determining projected benefit obligation at December 31	4.00%	4.00%	4.25%
Composite rate of compensation increase for net pension cost (benefit)	4.00%	4.25%	4.25%

<sup>1</sup> Discount rate in effect for determining net cost (benefit) of ATTC pension and postretirement plans for the 43-day period ended December 31, 2005 was 5.75%.

Primarily resulting from assumption changes for 2006, we expect combined net pension and postretirement costs of between \$1,700 and \$1,800 in 2006. 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, 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.

**Discount Rate** Our assumed discount rate of 5.75% at December 31, 2005 reflects the hypothetical rate at which the projected benefit obligations 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

**Notes to Consolidated Financial Statements, continued**

Dollars in millions except per share amounts

related expected duration for the obligations. For each year, at December 31, 2005 and 2004 we reduced the discount rate by 0.25%, resulting in an increase in our pension plan benefit obligation of approximately \$609 in 2005 and \$575 in 2004 and an increase in our postretirement benefit obligation of approximately \$844 in 2005 and \$803 in 2004. Should actual experience differ from actuarial assumptions, the projected pension benefit obligation and net pension cost, and accumulated postretirement benefit obligation and postretirement benefit cost would be affected in future years.

*Expected Long-Term Rate of Return* Our expected long-term rate of return on plan assets of 8.50% for 2006 and 2005 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. This assumption, which is based on our long-term expectations of market returns in future years, is one of the most significant of the weighted-average assumptions used to determine our actuarial estimates of pension and postretirement benefit expense. If all other factors were to remain unchanged, we expect a 1% decrease in the expected long-term rate of return would cause 2006 combined pension and postretirement cost to increase approximately \$579 over 2005 (analogous decrease in cost 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. 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 2005 combined net pension and postretirement benefit costs and we do not expect a significant incremental impact on our combined net pension and postretirement cost in 2006.

*Composite Rate of Compensation Increase* Our expected composite rate of compensation increase of 4.0% for 2005 and 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.

*Health Care Cost Trend* The following table provides the medical cost trend.

	2006		2005	
Health care cost trend rate assumed for following year				
Retirees 64 and under	7.0	%	8.0	%
Retirees 65 and over	8.0	%	9.0	%
Rate to which the cost trend is assumed to decline (the ultimate trend rate)	5.0	%	5.0	%
Year that rate reaches the ultimate trend rate	2009		2009	



**Notes to Consolidated Financial Statements, continued**

Dollars in millions except per share amounts

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	\$291	\$(228)
Increase (decrease) in accumulated postretirement benefit obligation	4,200	(3,442)

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**

Plan assets consist primarily of private and public equity, government and corporate bonds and real estate. The asset allocations of the pension plans are maintained to meet ERISA requirements. Any plan contributions, as determined by ERISA regulations, are made to a pension trust for the benefit of plan participants. We maintain VEBA trusts to partially fund postretirement benefits; however, there are no ERISA or regulatory requirements that these postretirement benefit plans be funded annually.

The principal investment objectives are: to ensure the availability of funds to pay pension and 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 based on our pension and postretirement 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 sought to be 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 market conditions, 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 projected expenses. The current asset allocation policy is based on a forecasting study conducted in 2004 for our pension plan and 2005 for our postretirement benefit plan.

The table below presents the asset targets by asset category as determined by AT&T and does not reflect updated targets for the November 18, 2005 acquisition of ATTC due to the proximity of that transaction to year end. It is our intention to perform forecasting studies during 2006 that will establish appropriate investment strategies for all AT&T plan assets.

**Notes to Consolidated Financial Statements, continued**

Dollars in millions except per share amounts

The plans' weighted-average asset target and actual allocations as a percentage of plan assets, including the notional exposure of future contracts by asset categories at December 31 are as follows:

	Pension Assets					Postretirement (VEBA) Assets			
	Target	2005		2004		Target	2005		2004
Equity securities									
Domestic	40%– 50%	41	%	47	%	40%– 50%	51	%	51
International	12%– 18%	17		17		12%– 18%	16		14
Debt securities	25%– 35%	29		29		20%– 30%	28		32
Real estate	3%– 6%	6		2		0%– 10%	1		-
Other	4%– 7%	7		5		5%– 15%	4		3
Total		100	%	100	%		100	%	100

At December 31, 2005, the pension assets included 2.3 million shares of AT&T common stock with a fair value of approximately \$57 and AT&T bonds with a notional amount of \$51 and fair value of \$60. As a result of our acquisition of ATTC, pension assets increased by 2.1 million shares of AT&T stock with a fair value of \$51 and AT&T bonds with a notional value of \$41 and fair value of \$49. During 2005, the pension plans purchased and sold AT&T bonds totaling approximately \$13 and \$3, respectively, and sold AT&T common stock of \$1. Pension plan holdings in AT&T securities represented approximately 0.2% of total plan assets at December 31, 2005.

At December 31, 2005, the VEBA assets included 352,700 shares of AT&T common stock with a fair value of approximately \$9 and AT&T bonds with a notional amount and fair value of \$1. As a result of our acquisition of ATTC, the VEBA assets increased by 68,000 shares of AT&T stock with a fair value of \$2. During 2005, the VEBAs did not purchase any bonds and sold approximately \$2. VEBA holdings in AT&T securities represented approximately 0.1% of total plan assets at December 31, 2005.

**Estimated Future Benefit Payments**

Expected benefit payments are estimated using the same assumptions used in determining our benefit obligation at December 31, 2005. Because benefit payments will depend on future employment and compensation levels, average years employed and average life spans, among other factors, changes in any of these factors could significantly affect these expected amounts. The following table provides expected benefit payments under our pension and postretirement plans:

	Pension Benefits		Postretirement Benefits		Medicare Subsidy Receipts
2006	\$3,649	\$	1,884	\$	(90)
2007	3,519		1,945		(102)
2008	3,597		2,028		(112)
2009	3,716		2,105		(121)
2010	3,767		2,172		(130)
Years 2011 – 2015	18,873		11,414		(863)

**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.

**Notes to Consolidated Financial Statements, continued**

Dollars in millions except per share amounts

We use the same significant assumptions for the discount rate and composite rate of compensation increase used in determining the projected benefit obligation and the net pension and postemployment benefit cost. The following tables provide the plans' benefit obligations and fair value of assets, a statement of the funded status at December 31 and the components of the supplemental retirement pension benefit cost.

	2005	2004
(Unfunded) benefit obligations at end of year	<b>\$(1,800)</b>	\$ (1,181)
Unrecognized net loss	<b>404</b>	371
Unrecognized prior service cost	<b>15</b>	24
Net amount recorded	<b>\$(1,381)</b>	\$ (786)

Amounts recognized on our Consolidated Balance Sheets at December 31 are listed below:

	2005	2004
Employee benefit obligation <sup>1</sup>	<b>\$(1,747)</b>	\$ (1,116)
Intangible asset	<b>15</b>	24
Accumulated other comprehensive income	<b>351</b>	306
Net amount recognized	<b>\$(1,381)</b>	\$ (786)

<sup>1</sup> Included in "Other noncurrent liabilities."

At December 31, 2005, the accumulated benefit obligation of certain of the plans exceeded the recorded liability, requiring us to recognize a direct charge to equity of \$217 (net of deferred taxes of \$134). 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).

	2005	2004
Service cost - benefits earned during the period	<b>\$ 8</b>	\$ 6
Interest cost on projected benefit obligation	<b>73</b>	70
Amortization of prior service cost	<b>9</b>	9
Recognized actuarial loss	<b>23</b>	21
Net supplemental retirement pension cost	<b>\$ 113</b>	\$ 106

In addition to the supplemental retirement pension benefit cost, we had other supplemental retirement benefit expenses of \$1, with a projected benefit obligation of \$84 included as "Other noncurrent liabilities." Deferred compensation expense was \$46 in 2005 and \$44 in 2004, with liability balances of \$574 and \$610, respectively, also included in "Other noncurrent liabilities."

**Notes to Consolidated Financial Statements, continued**

Dollars in millions except per share amounts

**Non-U.S. Plans**

As part of our ATTC acquisition, we acquired certain non-U.S. operations that have varying types of pension programs providing benefits for substantially all of their employees. As described earlier, in accordance with FAS 106 we eliminated previously existing unrecognized net gains or losses, unrecognized prior service costs and unrecognized net transition obligations. The following table provides the plans' benefit obligations and fair value of assets, and a statement of the funded status at December 31:

	2005
Benefit obligations at end of year	<b>\$(906)</b>
Fair value of plan assets	<b>650</b>
(Unfunded) benefit obligation	<b>(256)</b>
Unrecognized net loss	<b>20</b>
Net amount recorded <sup>1</sup>	<b>\$(236)</b>

<sup>1</sup> Included in "Postemployment benefit obligation" on our Consolidated Balance Sheet.

The following table provides information for certain non-U.S. defined benefit pension plans with accumulated benefit obligations in excess of plan assets:

	2005
Projected benefit obligation	<b>\$906</b>
Accumulated benefit obligation	<b>765</b>
Fair value of plan assets	<b>650</b>

The benefit obligations were determined using a weighted-average discount rate of 4.55% and a weighted-average rate of compensation increase of 4.25%. Net periodic pension cost was approximately \$4 for the 43 days ended December 31, 2005 and was determined using the following weighted-average assumptions: discount rate of 4.90%, compensation increase of 4.25% and return on plan assets of 6.15%.

**NOTE 11. EMPLOYEE STOCK OWNERSHIP PLANS (ESOP)**

We maintain contributory savings plans that cover substantially all employees. Under the savings plans, we match in company stock a stated percentage of eligible employee contributions, subject to a specified ceiling. There are no debt-financed shares held by the ESOPs, allocated or unallocated.

In November 2005, we completed our acquisition of ATTC and intend to maintain its savings plans, which provide for a match of a percentage of the employee contributions up to certain limits.

Our match of employee contributions to the savings plans is fulfilled with purchases of our stock on the open market. Benefit cost is based on the cost of shares allocated to participating employees' accounts and was \$334, \$316 and \$300 for the years ended December 31, 2005, 2004 and 2003.

**Notes to Consolidated Financial Statements, continued**

Dollars in millions except per share amounts

**NOTE 12. STOCK-BASED COMPENSATION**

In September 2005, we adopted FAS 123(R), which is a revision of FAS 123. FAS 123(R) supersedes Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and amends Statement of Financial Accounting Standards No. 95, "Statement of Cash Flows."

We adopted FAS 123(R) using the "modified retrospective" method. The modified retrospective method requires that compensation cost be 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 also allowed for companies to restate based on the amounts previously recognized under FAS 123 for purposes of pro forma disclosures for all prior years for which FAS 123 was effective. Accordingly, we have adjusted our December 31, 2004 Consolidated Balance Sheets to increase "Capital in excess of par value" and decrease "Retained earnings" by \$546.

We had previously 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 Statement of Financial Accounting Standards 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), because we elected to use the modified retrospective method, we also restated results for 1995 through 1999 for the effects on our equity. We will continue to use the Black-Scholes option pricing model to estimate the fair value of stock options granted to employees.

By using the modified retrospective method to adopt FAS 123(R), we increased the amount of excess tax benefits we had previously recorded on our Consolidated Balance Sheets. Our accounting under FAS 123(R) may affect our ability to fully realize the value shown on our balance sheet of deferred tax assets associated with compensation expense. Full realization of these deferred tax assets 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(R) 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 current stock price of our common shares will rise to levels sufficient to realize the entire tax benefit currently reflected in our balance sheet. However, to the extent that additional tax benefits are generated in excess of the deferred taxes associated with compensation expense previously recognized, the potential future impact on income would be reduced.

Because of the requirements of FAS 123(R) to estimate forfeitures, our December 31, 2005 income before income taxes and income from continuing operations increased by approximately \$9 and our net income increased by \$6. Adopting FAS 123(R) did not affect any prior period income before income taxes, income from continuing operations and net income. Our adoption of FAS 123(R) did not affect our basic and diluted earnings per share for any period reported.

When the tax deduction exceeds the compensation cost resulting from the exercise of options, a tax benefit is created. Prior to the adoption of FAS 123(R), we presented all such tax benefits as operating cash flows on our Consolidated Statements of Cash Flows. FAS 123(R) requires the cash flows resulting from such tax benefits to be classified as financing cash flows. Had we not adopted FAS 123(R), we would have classified excess tax benefits of \$3, \$5 and \$1 for the years ended December 31, 2005, 2004 and 2003, respectively, as operating cash inflows.

**Notes to Consolidated Financial Statements, continued**

Dollars in millions except per share amounts

In connection with the November 2005 acquisition of ATTC, all outstanding ATTC stock-based compensation plans were restructured based on the 0.77942 per share conversion rate and the special dividend, and subsequently issued in AT&T shares of stock or stock units. We converted and recorded approximately 86 million stock options.

At December 31, 2005, we had various stock-based compensation plans, which are described below. The compensation cost recognized for those plans for the years ended December 31 was approximately \$143 in 2005, \$153 in 2004 and \$244 in 2003 and are included in "Selling, general and administrative" on our Consolidated Statements of Income. The total income tax benefit recognized on the Consolidated Statements of Income for stock-based compensation arrangements for the years ended December 31, 2005, 2004 and 2003 was approximately \$54, \$58 and \$93.

Under our various plans, legacy SBC 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, 2005 carry exercise prices equal to the market price of our stock at the date of grant and have maximum terms ranging from five to ten years. Beginning in 1994 and ending in 1999, certain employees of SBC Teleholdings, Inc. (formerly known as Ameritech) 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, which are nonvested stock units, are granted to key employees based upon the 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. Other nonvested stock units are valued at the market price of our stock at the date of grant and vest over a three- to five-year period. As of December 31, 2005, we were authorized to issue up to 81 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 grants 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.

The compensation cost that has been charged against income for our stock-based compensation plans is as follows:

		2005	2004	2003
Stock option expense	\$	19	\$ 75	\$ 183
Performance stock units		116	65	27
Mark-to-market effect on dividend equivalents		2	-	4
Other		6	13	30
<b>Total</b>	<b>\$</b>	<b>143</b>	<b>\$ 153</b>	<b>\$ 244</b>

**Notes to Consolidated Financial Statements, continued**

Dollars in millions except per share amounts

The estimated fair value of the options when granted is amortized to expense over the options' vesting period. The fair value for these options was estimated at the date of grant based on the expected life of the option and historical exercise experience, using a Black-Scholes option pricing model with the following weighted-average assumptions:

	2005	2004	2003
Risk-free interest rate	4.15%	4.21%	3.64%
Dividend yield	5.38%	5.00%	4.40%
Expected volatility factor	22.47%	23.78%	22.38%
Expected option life in years	8.00	7.00	6.74

A summary of option activity as of December 31, 2005, and changes during the period then ended, is presented below (shares in millions):

Options	Shares	Weighted Average Exercise Price	Weighted- Average Remaining Contractual Term	Aggregate Intrinsic Value <sup>1</sup>
Outstanding at January 1, 2005	214	\$ 37.46		
Granted	3	23.96		
Converted from ATTC <sup>2</sup>	86	43.90		
Exercised	(8)	21.60		
Forfeited or expired	(18)	38.48		
Outstanding at December 31, 2005	277	\$ 39.74	4.8 years	\$ 73
Exercisable at December 31, 2005	270	\$ 40.07	4.8 years	\$ 71

<sup>1</sup> Aggregate intrinsic value includes only those options with intrinsic value (options where the exercise price is below the market price).

<sup>2</sup> Options converted from ATTC used the following weighted-average assumptions: risk-free interest rate of 4.35%, dividend yield of 5.16%, expected volatility factor of 22.47% and had an expected option life of 2.7 years. The weighted-average fair value of each option converted was \$1.34.

The weighted-average fair value of each option granted during the year ended December 31 was \$3.39 in 2005, \$4.06 in 2004 and \$3.88 in 2003. The total intrinsic value of options exercised during the year was approximately \$24 in 2005, \$33 in 2004 and \$10 in 2003.

A summary of the status of our nonvested stock units, which includes performance stock units as of December 31, 2005, and changes during the period then ended is presented below (shares in millions):

Nonvested Stock Units	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2005	10	\$ 25.61
Granted	6	23.75
Vested	(1)	24.54
Forfeited	-	-
Nonvested at December 31, 2005	15	\$ 24.91

As of December 31, 2005, there was approximately \$143 of total unrecognized compensation cost related to nonvested stock-based compensation arrangements granted. That cost is expected to be recognized over a weighted-average period of 1.6 years. The total fair value of shares vested during the years ended December 31, 2005, 2004 and 2003 was approximately \$38, \$24 and \$24.

**Notes to Consolidated Financial Statements, continued**

Dollars in millions except per share amounts

Cash received from option exercise under all stock-based payment arrangements for year ended December 31 was approximately \$192 in 2005, \$234 in 2004 and \$112 in 2003. The actual tax benefit realized for the tax deductions from option exercise from these arrangements for the years ended December 31, 2005, 2004 and 2003 totaled approximately \$9, \$12 and \$4.

It is our policy to satisfy share option exercises using our treasury shares.

**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 our common stock. This authorization replaced previous authorizations and will expire on December 31, 2008. As of December 31, 2005, we had repurchased approximately 93.5 million shares under the program.

**NOTE 14. ADDITIONAL FINANCIAL INFORMATION**

	December 31,		
	2005	2004	2003
<b>Balance Sheets</b>			
Deferred directory expenses (included in Other current assets)	\$ 500	\$	505
Accounts payable and accrued liabilities:			
Accounts payable	\$4,466		\$2,241
Accrued payroll	2,104		1,138
Current portion of postemployment benefit obligation	1,883		1,117
Deferred directory revenue	1,832		1,876
Advance billing and customer deposits	1,717		1,325
Compensated future absences	875		798
Accrued interest	473		376
Other	3,738		2,588
Total accounts payable and accrued liabilities	\$17,088		\$11,459
Deferred compensation (included in Other noncurrent liabilities)	\$ 1,127	\$	900
<b>Statements of Income</b>			
	2005	2004	2003
Advertising expense	\$812	\$862	\$867
Interest expense incurred	\$1,492	\$1,054	\$1,228
Capitalized interest	(36)	(31)	(37)
Total interest expense	\$1,456	\$1,023	\$1,191
<b>Statements of Cash Flows</b>			
	2005	2004	2003
Cash paid during the year for:			
Interest	\$1,395	\$1,043	\$1,310
Income taxes, net of refunds	2,038	506	1,321
<b>Statements of Stockholders' Equity</b>			
	2005	2004	2003
Accumulated other comprehensive income is comprised of the following components, net of taxes, at December 31:			
Foreign currency translation adjustment	\$(505)	\$(555)	\$(427)
Unrealized gains on securities	340	391	427
Unrealized (losses) on cash flow hedges	(191)	(196)	-
Accumulated other comprehensive (loss)	\$(356)	\$(360)	\$-

No customer accounted for more than 10% of consolidated revenues in 2005, 2004 or 2003.



**Notes to Consolidated Financial Statements, continued**

Dollars in millions except per share amounts

**Goodwill and Other Intangible Assets**

Changes in the carrying amounts of goodwill for the years ended December 31, 2005 and 2004 are as follows:

	Wireline Segment	AT&T Corp. Segment	Directory Segment	Other Segment	Total
Balance as of January 1, 2004	\$ 717	\$ -	\$ 8	\$ 886	\$ 1,611
Goodwill acquired	7	-	-	-	7
Goodwill reclassification	-	-	-	7	7
Balance as of December 31, 2004	724	-	8	893	1,625
Goodwill acquired	98	12,343	-	-	12,441
Goodwill written off related to sale of business unit	-	-	-	(11)	(11)
<b>Balance as of December 31, 2005</b>	<b>\$ 822</b>	<b>\$ 12,343</b>	<b>\$ 8</b>	<b>\$ 882</b>	<b>\$ 14,055</b>

Goodwill is tested annually for impairment, with any impairments being expensed in that period's income statement. Goodwill recorded in our AT&T Corp. segment relates to our November acquisition of ATTC and, as allowed by GAAP, is subject to adjustment for one-year as we finalize the valuations of assets acquired and liabilities assumed in that transaction. As part of the final valuation we will determine to which entities and to what extent the benefit of the acquisition applies, and will record the appropriate goodwill to that entity, which may affect our segment presentation.

Our other intangible assets are summarized as follows:

	December 31, 2005		December 31, 2004	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
<b>Other Intangible Assets</b>				
Amortized intangible assets:				
Customer lists and relationships	\$ 3,430	\$ 397	\$ 365	\$ 174
Other	1,100	589	758	545
Total	\$ 4,530	\$ 986	\$ 1,123	\$ 719
Indefinite life intangible assets:				
Trade name	\$ 4,900		\$ -	
Licenses	59		25	
Total	\$ 4,959		\$ 25	

Amortized intangible assets are definite-life assets, and as such we record amortization expense based on a method that most appropriately reflects our expected cash flows from these assets with a weighted-average amortization period of 8.1 years (7.8 years for customer lists and relationships and 9.9 years for other). Amortization expense for definite-life intangible assets was \$271, \$117 and \$203 for the years ended December 31, 2005, 2004 and 2003, respectively. Amortization expense is estimated to be \$1,010 in 2006, \$680 in 2007, \$490 in 2008, \$410 in 2009 and \$320 in 2010.

Indefinite life intangible assets are not subject to amortization.

**Notes to Consolidated Financial Statements, continued**

Dollars in millions except per share amounts

**NOTE 15. TRANSACTIONS WITH CINGULAR**

We and BellSouth, the two owners of Cingular, have each made a subordinated loan to Cingular (shareholder loans). Our shareholder loan to Cingular totaled approximately \$4,108 at December 31, 2005 and \$5,855 at December 31, 2004, reflecting repayments under the revolving credit agreement discussed below. This loan bears interest at an annual rate of 6.0% and matures in June 2008. We earned interest income on this loan of \$311 during 2005, \$354 in 2004 and \$397 in 2003.

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. 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 (London Interbank Offered Rate) plus 0.05% which may be renewed upon agreement of the parties. This agreement includes a provision for the repayment of our and BellSouth's shareholder loans 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. Effective June 28, 2005, this agreement was amended to extend the termination date of the agreement to July 31, 2007. All other terms of the agreement remain substantially identical.

Under the revolving credit agreement we received net repayments from Cingular totaling \$2,442 in 2005. After applying the net repayments, our share of advances to Cingular under the revolving credit agreement was approximately \$307 at December 31, 2005 and \$1,002 at December 31, 2004 and is reflected in "Investments in and Advances to Cingular Wireless" on our Consolidated Balance Sheets. Under the terms of the agreement, approximately \$1,747 of net repayments were applied to reduce the balance of our shareholder loan to Cingular.

In May 2005, we transferred wireless properties to Cingular to settle a liability related to the formation of Cingular. This transfer resulted in a decrease of approximately \$35 to our "Investment in Cingular" account and resulted in a gain of \$24, which was reflected in our "Other Income" account.

We generated revenues of \$869 in 2005, \$602 in 2004 and \$539 in 2003 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 AT&T 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 on our Consolidated Statements of Income 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

**Notes to Consolidated Financial Statements, continued**

Dollars in millions except per share amounts

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."

**NOTE 17. DISCONTINUED OPERATIONS**

In September 2004, we sold our interest in the directory advertising business in Illinois and northwest Indiana to Donnelley and received net proceeds of approximately \$1,397. As part of this transaction we recorded a gain of approximately \$1,357 (\$827 net of tax) in our 2004 results.

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,	2005	2004	2003
Operating revenues	\$-	\$ 311	\$ 481
Operating income	-	132	186
Income taxes	-	51	74
Net income from operations	-	81	112
Gain on disposal, net of tax	-	827	-

At December 31, 2005 and 2004, the assets of the discontinued operations were \$0. The liabilities of the discontinued operations were \$0 at December 31, 2005 and \$310 at December 31, 2004 and are presented separately under the caption "Liabilities of discontinued operations" on our Consolidated Balance Sheets. The December 31, 2004, liabilities of \$310 were primarily tax liabilities associated with the gain on the disposition. These liabilities were all paid in 2005, as reflected on the Consolidated Statements of Cash Flows. Except for the net proceeds of \$1,397, which related to discontinued investing activities in 2004, all other amounts reflected on the Consolidated Statements of Cash Flows related to discontinued operations relate to cash provided by or used in operating activities.

**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 accordance with Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies," in evaluating these matters on an ongoing basis, we take into account amounts already accrued on the balance sheet. 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.

We have contractual obligations to purchase certain goods or services from various other parties. Our purchase obligations are expected to be approximately \$1,235 in 2006, \$1,234 in total for 2007 and 2008, \$387 in total for 2009 and 2010 and \$249 in total for years thereafter.

Included in our purchase obligations was approximately \$410 of total purchase commitments with WiTel for services to be provided on WiTel's network. Our AT&T Corp. segment has contractual obligations to utilize network facilities from local exchange carriers with terms greater than one year. These contracts have no minimum volume requirements and are based on an interrelationship of volumes and discounted rates.

**Notes to Consolidated Financial Statements, continued**  
Dollars in millions except per share amounts

**NOTE 19. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)**

The following table represents our quarterly financial results:

Calendar Quarter	Total Operating Revenues	Operating Income	Net Income	Basic Earnings Per Share¹	Diluted Earnings Per Share¹	Discontinued Operations			Stock Price		
							Basic	Diluted			
						Income	Earnings Per Share¹	Earnings Per Share¹	High	Low	Close
2005											
First	\$10,248	\$1,556	\$885	\$0.27	\$0.27	\$-	\$-	\$-	\$25.98	\$22.99	\$23.69
Second	10,328	1,518	1,000	0.30	0.30	-	-	-	24.33	22.78	23.75
Third	10,320	1,962	1,246	0.38	0.38	-	-	-	24.97	23.20	23.97
Fourth	12,966	1,132	1,655	0.46	0.46	-	-	-	25.60	21.75	24.49
Annual	\$43,862	\$6,168	\$4,786	1.42	1.42	\$-	-	-			
2004											
First²	\$10,012	\$1,516	\$1,937	\$0.59	\$0.58	\$26	\$0.01	\$-	\$27.73	\$23.18	\$24.54
Second	10,196	1,440	1,168	0.35	0.35	33	0.01	0.01	25.68	23.50	24.25
Third	10,292	1,698	2,094	0.63	0.63	849	0.25	0.25	26.88	22.98	25.95
Fourth	10,287	1,247	688	0.21	0.21	-	-	-	27.29	24.55	25.77
Annual	\$40,787	\$5,901	\$5,887	1.78	1.77	\$908	0.28	0.27			

<sup>1</sup> Quarterly earnings per share impacts may not add to full-year earnings per share impacts due to the difference in weighted-average shares for the quarters versus the weighted-average shares for the year.

<sup>2</sup> The first-quarter 2004 diluted earnings per share was reduced by \$0.01 in the Discontinued Operations column to correct a miscalculation.

## Report of Management

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 AT&T Inc. (AT&T) have been audited by Ernst & Young LLP, Independent Registered Public Accounting Firm. Management has made available to Ernst & Young LLP all of AT&T'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 AT&T 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 AT&T 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. AT&T'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.

AT&T management assessed the effectiveness of its internal control over financial reporting as of December 31, 2005. In making this assessment, AT&T management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control—Integrated Framework. We have excluded from the scope of our assessment of internal control over financial reporting the operations and related assets of AT&T Corp., which we acquired on November 18, 2005. At December 31, 2005 and for the period from November 18 through December 31, 2005, total assets and total segment revenues subject to AT&T Corp.'s internal control over financial reporting represented 29.0% and 6.6% of AT&T's consolidated total assets and total revenues as of and for the year ended December 31, 2005. Based on our assessment we believe that, as of December 31, 2005, AT&T'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 86.

/s/ Edward E. Whitacre Jr.  
Edward E. Whitacre Jr.  
Chairman of the Board and  
Chief Executive Officer

/s/ Richard G. Lindner  
Richard G. Lindner  
Senior Executive Vice President and  
Chief Financial Officer

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders  
AT&T Inc.

We have audited the accompanying consolidated balance sheets of AT&T Inc. (AT&T, formerly SBC Communications Inc.) as of December 31, 2005 and 2004, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of AT&T'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 AT&T at December 31, 2005 and 2004, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, in 2003 AT&T 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.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of AT&T's internal control over financial reporting as of December 31, 2005, 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 16, 2006 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP  
San Antonio, Texas  
February 16, 2006

## Report of Independent Registered Public Accounting Firm on Internal Control over Financial Reporting

The Board of Directors and Stockholders  
AT&T Inc.

We have audited management's assessment as described in the "Assessment of Internal Control", included in the accompanying Report of Management, that AT&T Inc. (AT&T, formerly SBC Communications Inc.) maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). AT&T'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 AT&T'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.

As indicated in the accompanying "Assessment of Internal Control", management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of AT&T Corp., which was acquired on November 18, 2005 and is included in the 2005 consolidated financial statements of AT&T and constituted 29.0% of total assets as of December 31, 2005 and 6.6% of revenues for the year then ended. Our audit of internal control over financial reporting of AT&T also did not include an evaluation of the internal control over financial reporting of AT&T Corp.

In our opinion, management's assessment that AT&T maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, AT&T maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, 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 AT&T as of December 31, 2005 and 2004, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2005 of AT&T and our report dated February 16, 2006 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP  
San Antonio, Texas  
February 16, 2006



**PRINCIPAL SUBSIDIARIES OF  
AT&T INC., AS OF DECEMBER 31, 2005**

<b><u>Legal Name</u></b>	<b><u>State of Incorporation/Formation</u></b>	<b><u>Conducts Business Under</u></b>
Illinois Bell Telephone Company	Illinois	AT&T Illinois
Indiana Bell Telephone Company, Incorporated	Indiana	AT&T Indiana
Michigan Bell Telephone Company	Michigan	AT&T Michigan
Nevada Bell Telephone Company	Nevada	AT&T Nevada
Pacific Bell Telephone Company	California	AT&T California
Pacific Telesis Group	Nevada	AT&T West
SBC International, Inc.	Delaware	AT&T International
Southern New England Telecommunications Corporation	Connecticut	AT&T East
SBC Internet Services, Inc.	California	AT&T Internet Services
SBC Long Distance, LLC	Delaware	AT&T Long Distance
SBC Teleholdings, Inc (f/k/a Ameritech Corporation)	Delaware	AT&T Midwest
Southwestern Bell Telephone, L.P.	Texas	AT&T Arkansas; AT&T Kansas; AT&T Missouri; AT&T Oklahoma; AT&T Texas; AT&T Southwest
Southwestern Bell Yellow Pages, Inc.	Missouri	AT&T Yellow Pages - Southwest AT&T Yellow Pages - Arkansas AT&T Yellow Pages – Kansas AT&T Yellow Pages – Missouri AT&T Yellow Pages – Texas AT&T Directory Operations

<b><u>Legal Name</u></b>	<b><u>State of Incorporation/Formation</u></b>	<b><u>Conducts Business Under</u></b>
Sterling Commerce, Inc.	Delaware	same
The Ohio Bell Telephone Company	Ohio	AT&T Ohio
The Southern New England Telephone Company	Connecticut	AT&T Connecticut
The Woodbury Telephone Company	Connecticut	AT&T Woodbury
Wisconsin Bell, Inc.	Wisconsin	AT&T Wisconsin
AT&T Corp.	New York	same; AT&T; Conference Operator-AT&T; Connect N'Save; ACC Business; AT&T Worldnet Services; AT&T Worldnet; SmarTalk; GTI; prepaid-serviceguide.com; ConQuest; CQTalk!; Unispeak Service
AT&T Communications of California, Inc.	California	same
AT&T Communications of the Mountain States, Inc.	Colorado	same
AT&T Communications of NJ, LP	Delaware	same
AT&T Communications of New York, Inc.	New York	same
AT&T Communications of Illinois, Inc.	Illinois	same
AT&T Communications of the Southern States, LLC	Delaware	ACC Business; SmarTalk; prepaid-serviceguide.com; GTI; AT&T; Conquest; CQTalk
Teleport Communications New York	New York	same

**Consent of Independent Registered Public Accounting Firm**

We consent to the incorporation by reference in this Annual Report (Form 10-K) of AT&T Inc. (AT&T, formerly SBC Communications Inc.) of our reports dated February 16, 2006, with respect to the consolidated financial statements of AT&T, AT&T management's assessment of the effectiveness of internal control over financial reporting, and the effectiveness of internal control over financial reporting of AT&T, included in the 2005 Annual Report to Stockholders of AT&T.

Our audits also included the financial statement schedules of AT&T listed in Item 15(a). These schedules are the responsibility of AT&T's management. Our responsibility is to express an opinion based on our audits. In our opinion, the financial statement schedules referred to above, when considered in relation to the basic financial statements taken as a whole, present fairly in all material respects the information set forth therein.

We consent to the incorporation by reference in the following Registration Statements:

- (1) Registration Statement (Form S-8 No. 333-111026) pertaining to the AT&T Savings Plan and other certain plans,
- (2) Registration Statements (Form S-8 No. 33-54291 and 333-34062) pertaining to the Stock Savings Plan,
- (3) Registration Statement (Form S-8 No. 33-49855) pertaining to the 1992 Stock Option Plan,
- (4) Registration Statements (Form S-8 No. 333-49343 and 333-95887) pertaining to the 1995 Management Stock Option Plan,
- (5) Registration Statements (Form S-8 No. 333-30669 (1996 Plan only) and 333-54398) pertaining to the 1996 Stock and Incentive Plan and the 2001 Incentive Plan,
- (6) Registration Statement (Form S-8 No. 333-58332) pertaining to the 2001 Stock Option Grant to Bargained-for and Certain Other Employees,
- (7) Registration Statement (Form S-8 No. 33-120894) pertaining to the AT&T Stock Purchase and Deferral Plan and Cash Deferral Plan,
- (8) Registration Statement (Form S-8 No. 333-99359) pertaining to the AT&T PAYSOP, Pacific Telesis Group Employee Stock Ownership Plan, and Tax Reduction Act Stock Ownership Plan,
- (9) Registration Statement (Form S-8 No. 333-129814) pertaining to the AT&T Savings Plan and other certain plans, and
- (10) Registration Statement (Form S-3 No. 333-118476) of AT&T and the related Prospectuses;

of our reports dated February 16, 2006, with respect to the consolidated financial statements of AT&T, AT&T management's assessment of the effectiveness of internal control over financial reporting and the effectiveness of internal control over financial reporting of AT&T, incorporated herein by reference, and our report included in the preceding paragraph with respect to the financial statement schedules of AT&T included in this Annual Report (Form 10-K) of AT&T.

/s/ Ernst & Young LLP

San Antonio, Texas  
February 27, 2006

**Consent of Independent Registered Public Accounting Firm**

We consent to the incorporation by reference in the Registration Statements listed below of AT&T Inc.:

- (1) Registration Statement (Form S-8 No. 333-111026) pertaining to the AT&T Savings Plan and other certain plans,
- (2) Registration Statements (Form S-8 No. 33-54291 and 333-34062) pertaining to the Stock Savings Plan,
- (3) Registration Statement (Form S-8 No. 33-49855) pertaining to the 1992 Stock Option Plan,
- (4) Registration Statements (Form S-8 No. 333-49343 and 333-95887) pertaining to the 1995 Management Stock Option Plan,
- (5) Registration Statements (Form S-8 No. 333-30669 (1996 Plan only) and 333-54398) pertaining to the 1996 Stock and Incentive Plan and the 2001 Incentive Plan,
- (6) Registration Statement (Form S-8 No. 333-58332) pertaining to the 2001 Stock Option Grant to Bargained-for and Certain Other Employees,
- (7) Registration Statement (Form S-8 No. 33-120894) pertaining to the AT&T Stock Purchase and Deferral Plan and Cash Deferral Plan,
- (8) Registration Statement (Form S-8 No. 333-99359) pertaining to the AT&T PAYSOP, Pacific Telesis Group Employee Stock Ownership Plan, and Tax Reduction Act Stock Ownership Plan,
- (9) Registration Statement (Form S-8 No. 333-129814) pertaining to the AT&T Savings Plan and other certain plans, and
- (10) Registration Statement (Form S-3 No. 333-118476) of AT&T and the related Prospectuses;

of our report dated February 24, 2006, with respect to the consolidated financial statements of Cingular Wireless LLC, included in this Annual Report (Form 10-K) of AT&T Inc. for the year ended December 31, 2005.

/s/ Ernst & Young LLP

Atlanta, Georgia  
February 24, 2006

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the following Registration Statements of AT&T Inc.

- Form S-8 (File No. 333-111026),
- Form S-8 (File No. 33-54291),
- Form S-8 (File No. 333-34062),
- Form S-8 (File No. 33-49855),
- Form S-8 (File No. 333-49343),
- Form S-8 (File No. 333-95887)
- Form S-8 (File No. 333-30669),
- Form S-8 (File No. 333-54398),
- Form S-8 (File No. 333-58332),
- Form S-8 (File No. 33-120894),
- Form S-8 (File No. 333-99359),
- Form S-8 (File No. 333-129814), and
- Form S-3 (File No. 333-118476)

of our report dated March 3, 2005, relating to the financial statements of Omnipoint Facilities Network II, LLC (not included separately therein), which appears in AT&T Inc.'s Annual Report on Form 10-K for the year ended December 31, 2005.

/s/ PricewaterhouseCoopers LLP

Seattle, Washington  
February 27, 2006

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS:

THAT, WHEREAS, AT&T INC., a Delaware corporation, hereinafter referred to as the "Corporation," proposes to file with the Securities and Exchange Commission, under the provisions of the Securities Exchange Act of 1934, as amended, an annual report on Form 10-K; and

WHEREAS, the undersigned is an officer and a director of the Corporation;

NOW, THEREFORE, the undersigned hereby constitutes and appoints James D. Ellis, Jon P. Klug, Richard G. Lindner, John J. Stephens, or any one of them, all of the City of San Antonio and State of Texas, his attorneys for him and in his name, place and stead, and in each of his offices and capacities in the Corporation, to execute and file such annual report, and thereafter to execute and file any amendment or amendments thereto, hereby giving and granting to said attorneys full power and authority to do and perform each and every act and thing whatsoever requisite and necessary to be done in and concerning the premises, as fully to all intents and purposes as the undersigned might or could do if personally present at the doing thereof, hereby ratifying and confirming all that said attorneys may or shall lawfully do, or cause to be done, by virtue hereof.

IN WITNESS WHEREOF, the undersigned executed this Power of Attorney the 27 day of January 2006.

/s/Edward E. Whitacre, Jr.  
Edward E. Whitacre, Jr.  
Chairman of the Board, Director  
and Chief Executive Officer

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS:

THAT, WHEREAS, AT&T INC., a Delaware corporation, hereinafter referred to as the "Corporation," proposes to file with the Securities and Exchange Commission, under the provisions of the Securities Exchange Act of 1934, as amended, an annual report on Form 10-K; and

WHEREAS, the undersigned is an officer of the Corporation;

NOW, THEREFORE, the undersigned hereby constitutes and appoints Edward E. Whitacre, Jr., James D. Ellis, Jon P. Klug, John J. Stephens, or any one of them, all of the City of San Antonio and State of Texas, his attorneys for him and in his name, place and stead, and in his office and capacity in the Corporation, to execute and file such annual report, and thereafter to execute and file any amendment or amendments thereto, hereby giving and granting to said attorneys full power and authority to do and perform each and every act and thing whatsoever requisite and necessary to be done in and concerning the premises, as fully to all intents and purposes as the undersigned might or could do if personally present at the doing thereof, hereby ratifying and confirming all that said attorneys may or shall lawfully do, or cause to be done, by virtue hereof.

IN WITNESS WHEREOF, the undersigned executed this Power of Attorney the 27 day of January 2006.

/s/ Richard G. Lindner

Richard G. Lindner  
Senior Executive Vice President and  
Chief Financial Officer

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS:

THAT, WHEREAS, AT&T INC., a Delaware corporation, hereinafter referred to as the "Corporation," proposes to file with the Securities and Exchange Commission, under the provisions of the Securities Exchange Act of 1934, as amended, an annual report on Form 10-K; and

WHEREAS, the undersigned is a director of the Corporation;

NOW, THEREFORE, the undersigned hereby constitutes and appoints Edward E. Whitacre, Jr., James D. Ellis, Jon P. Klug, Richard G. Lindner, John J. Stephens, or any one of them, all of the City of San Antonio and State of Texas, the attorneys for the undersigned and in the undersigned's name, place and stead, and in the undersigned's office and capacity in the Corporation, to execute and file such annual report, and thereafter to execute and file any amendment or amendments thereto, hereby giving and granting to said attorneys full power and authority to do and perform each and every act and thing whatsoever requisite and necessary to be done in and concerning the premises, as fully to all intents and purposes as the undersigned might or could do if personally present at the doing thereof, hereby ratifying and confirming all that said attorneys may or shall lawfully do, or cause to be done, by virtue hereof.

IN WITNESS WHEREOF, the undersigned executed this Power of Attorney the 27 day of January 2006.

/s/ Gilbert F. Amelio  
Gilbert F. Amelio  
Director



POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS:

THAT, WHEREAS, AT&T INC., a Delaware corporation, hereinafter referred to as the "Corporation," proposes to file with the Securities and Exchange Commission, under the provisions of the Securities Exchange Act of 1934, as amended, an annual report on Form 10-K; and

WHEREAS, the undersigned is a director of the Corporation;

NOW, THEREFORE, the undersigned hereby constitutes and appoints Edward E. Whitacre, Jr., James D. Ellis, Jon P. Klug, Richard G. Lindner, John J. Stephens, or any one of them, all of the City of San Antonio and State of Texas, the attorneys for the undersigned and in the undersigned's name, place and stead, and in the undersigned's office and capacity in the Corporation, to execute and file such annual report, and thereafter to execute and file any amendment or amendments thereto, hereby giving and granting to said attorneys full power and authority to do and perform each and every act and thing whatsoever requisite and necessary to be done in and concerning the premises, as fully to all intents and purposes as the undersigned might or could do if personally present at the doing thereof, hereby ratifying and confirming all that said attorneys may or shall lawfully do, or cause to be done, by virtue hereof.

IN WITNESS WHEREOF, the undersigned executed this Power of Attorney the 27 day of January 2006.

/s/ William F. Aldinger III  
William F. Aldinger III  
Director

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS:

THAT, WHEREAS, AT&T INC., a Delaware corporation, hereinafter referred to as the "Corporation," proposes to file with the Securities and Exchange Commission, under the provisions of the Securities Exchange Act of 1934, as amended, an annual report on Form 10-K; and

WHEREAS, the undersigned is a director of the Corporation;

NOW, THEREFORE, the undersigned hereby constitutes and appoints Edward E. Whitacre, Jr., James D. Ellis, Jon P. Klug, Richard G. Lindner, John J. Stephens, or any one of them, all of the City of San Antonio and State of Texas, the attorneys for the undersigned and in the undersigned's name, place and stead, and in the undersigned's office and capacity in the Corporation, to execute and file such annual report, and thereafter to execute and file any amendment or amendments thereto, hereby giving and granting to said attorneys full power and authority to do and perform each and every act and thing whatsoever requisite and necessary to be done in and concerning the premises, as fully to all intents and purposes as the undersigned might or could do if personally present at the doing thereof, hereby ratifying and confirming all that said attorneys may or shall lawfully do, or cause to be done, by virtue hereof.

IN WITNESS WHEREOF, the undersigned executed this Power of Attorney the 27 day of January 2006.

/s/ August A. Busch III  
August A. Busch III  
Director

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS:

THAT, WHEREAS, AT&T INC., a Delaware corporation, hereinafter referred to as the "Corporation," proposes to file with the Securities and Exchange Commission, under the provisions of the Securities Exchange Act of 1934, as amended, an annual report on Form 10-K; and

WHEREAS, the undersigned is a director of the Corporation;

NOW, THEREFORE, the undersigned hereby constitutes and appoints Edward E. Whitacre, Jr., James D. Ellis, Jon P. Klug, Richard G. Lindner, John J. Stephens, or any one of them, all of the City of San Antonio and State of Texas, the attorneys for the undersigned and in the undersigned's name, place and stead, and in the undersigned's office and capacity in the Corporation, to execute and file such annual report, and thereafter to execute and file any amendment or amendments thereto, hereby giving and granting to said attorneys full power and authority to do and perform each and every act and thing whatsoever requisite and necessary to be done in and concerning the premises, as fully to all intents and purposes as the undersigned might or could do if personally present at the doing thereof, hereby ratifying and confirming all that said attorneys may or shall lawfully do, or cause to be done, by virtue hereof.

IN WITNESS WHEREOF, the undersigned executed this Power of Attorney the 27 day of January 2006.

/s/ Jon C. Madonna  
Jon C. Madonna  
Director

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS:

THAT, WHEREAS, AT&T INC., a Delaware corporation, hereinafter referred to as the "Corporation," proposes to file with the Securities and Exchange Commission, under the provisions of the Securities Exchange Act of 1934, as amended, an annual report on Form 10-K; and

WHEREAS, the undersigned is a director of the Corporation;

NOW, THEREFORE, the undersigned hereby constitutes and appoints Edward E. Whitacre, Jr., James D. Ellis, Jon P. Klug, Richard G. Lindner, John J. Stephens, or any one of them, all of the City of San Antonio and State of Texas, the attorneys for the undersigned and in the undersigned's name, place and stead, and in the undersigned's office and capacity in the Corporation, to execute and file such annual report, and thereafter to execute and file any amendment or amendments thereto, hereby giving and granting to said attorneys full power and authority to do and perform each and every act and thing whatsoever requisite and necessary to be done in and concerning the premises, as fully to all intents and purposes as the undersigned might or could do if personally present at the doing thereof, hereby ratifying and confirming all that said attorneys may or shall lawfully do, or cause to be done, by virtue hereof.

IN WITNESS WHEREOF, the undersigned executed this Power of Attorney the 27 day of January 2006.

/s/ Martin K. Eby, Jr.  
Martin K. Eby, Jr.  
Director

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS:

THAT, WHEREAS, AT&T INC., a Delaware corporation, hereinafter referred to as the "Corporation," proposes to file with the Securities and Exchange Commission, under the provisions of the Securities Exchange Act of 1934, as amended, an annual report on Form 10-K; and

WHEREAS, the undersigned is a director of the Corporation;

NOW, THEREFORE, the undersigned hereby constitutes and appoints Edward E. Whitacre, Jr., James D. Ellis, Jon P. Klug, Richard G. Lindner, John J. Stephens, or any one of them, all of the City of San Antonio and State of Texas, the attorneys for the undersigned and in the undersigned's name, place and stead, and in the undersigned's office and capacity in the Corporation, to execute and file such annual report, and thereafter to execute and file any amendment or amendments thereto, hereby giving and granting to said attorneys full power and authority to do and perform each and every act and thing whatsoever requisite and necessary to be done in and concerning the premises, as fully to all intents and purposes as the undersigned might or could do if personally present at the doing thereof, hereby ratifying and confirming all that said attorneys may or shall lawfully do, or cause to be done, by virtue hereof.

IN WITNESS WHEREOF, the undersigned executed this Power of Attorney the 27 day of January 2006.

/s/ James A. Henderson  
James A. Henderson  
Director

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS:

THAT, WHEREAS, AT&T INC., a Delaware corporation, hereinafter referred to as the "Corporation," proposes to file with the Securities and Exchange Commission, under the provisions of the Securities Exchange Act of 1934, as amended, an annual report on Form 10-K; and

WHEREAS, the undersigned is a director of the Corporation;

NOW, THEREFORE, the undersigned hereby constitutes and appoints Edward E. Whitacre, Jr., James D. Ellis, Jon P. Klug, Richard G. Lindner, John J. Stephens, or any one of them, all of the City of San Antonio and State of Texas, the attorneys for the undersigned and in the undersigned's name, place and stead, and in the undersigned's office and capacity in the Corporation, to execute and file such annual report, and thereafter to execute and file any amendment or amendments thereto, hereby giving and granting to said attorneys full power and authority to do and perform each and every act and thing whatsoever requisite and necessary to be done in and concerning the premises, as fully to all intents and purposes as the undersigned might or could do if personally present at the doing thereof, hereby ratifying and confirming all that said attorneys may or shall lawfully do, or cause to be done, by virtue hereof.

IN WITNESS WHEREOF, the undersigned executed this Power of Attorney the 27 day of January 2006.

/s/ Charles F. Knight  
Charles F. Knight  
Director

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS:

THAT, WHEREAS, AT&T INC., a Delaware corporation, hereinafter referred to as the "Corporation," proposes to file with the Securities and Exchange Commission, under the provisions of the Securities Exchange Act of 1934, as amended, an annual report on Form 10-K; and

WHEREAS, the undersigned is a director of the Corporation;

NOW, THEREFORE, the undersigned hereby constitutes and appoints Edward E. Whitacre, Jr., James D. Ellis, Jon P. Klug, Richard G. Lindner, John J. Stephens, or any one of them, all of the City of San Antonio and State of Texas, the attorneys for the undersigned and in the undersigned's name, place and stead, and in the undersigned's office and capacity in the Corporation, to execute and file such annual report, and thereafter to execute and file any amendment or amendments thereto, hereby giving and granting to said attorneys full power and authority to do and perform each and every act and thing whatsoever requisite and necessary to be done in and concerning the premises, as fully to all intents and purposes as the undersigned might or could do if personally present at the doing thereof, hereby ratifying and confirming all that said attorneys may or shall lawfully do, or cause to be done, by virtue hereof.

IN WITNESS WHEREOF, the undersigned executed this Power of Attorney the 27 day of January 2006.

/s/ Lynn M. Martin  
Lynn M. Martin  
Director

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS:

THAT, WHEREAS, AT&T INC., a Delaware corporation, hereinafter referred to as the "Corporation," proposes to file with the Securities and Exchange Commission, under the provisions of the Securities Exchange Act of 1934, as amended, an annual report on Form 10-K; and

WHEREAS, the undersigned is a director of the Corporation;

NOW, THEREFORE, the undersigned hereby constitutes and appoints Edward E. Whitacre, Jr., James D. Ellis, Jon P. Klug, Richard G. Lindner, John J. Stephens, or any one of them, all of the City of San Antonio and State of Texas, the attorneys for the undersigned and in the undersigned's name, place and stead, and in the undersigned's office and capacity in the Corporation, to execute and file such annual report, and thereafter to execute and file any amendment or amendments thereto, hereby giving and granting to said attorneys full power and authority to do and perform each and every act and thing whatsoever requisite and necessary to be done in and concerning the premises, as fully to all intents and purposes as the undersigned might or could do if personally present at the doing thereof, hereby ratifying and confirming all that said attorneys may or shall lawfully do, or cause to be done, by virtue hereof.

IN WITNESS WHEREOF, the undersigned executed this Power of Attorney the 27 day of January 2006.

/s/ John B. McCoy  
John B. McCoy  
Director



POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS:

THAT, WHEREAS, AT&T INC., a Delaware corporation, hereinafter referred to as the "Corporation," proposes to file with the Securities and Exchange Commission, under the provisions of the Securities Exchange Act of 1934, as amended, an annual report on Form 10-K; and

WHEREAS, the undersigned is a director of the Corporation;

NOW, THEREFORE, the undersigned hereby constitutes and appoints Edward E. Whitacre, Jr., James D. Ellis, Jon P. Klug, Richard G. Lindner, John J. Stephens, or any one of them, all of the City of San Antonio and State of Texas, the attorneys for the undersigned and in the undersigned's name, place and stead, and in the undersigned's office and capacity in the Corporation, to execute and file such annual report, and thereafter to execute and file any amendment or amendments thereto, hereby giving and granting to said attorneys full power and authority to do and perform each and every act and thing whatsoever requisite and necessary to be done in and concerning the premises, as fully to all intents and purposes as the undersigned might or could do if personally present at the doing thereof, hereby ratifying and confirming all that said attorneys may or shall lawfully do, or cause to be done, by virtue hereof.

IN WITNESS WHEREOF, the undersigned executed this Power of Attorney the 27 day of January 2006.

/s/ Mary S. Metz  
Mary S. Metz  
Director

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS:

THAT, WHEREAS, AT&T INC., a Delaware corporation, hereinafter referred to as the "Corporation," proposes to file with the Securities and Exchange Commission, under the provisions of the Securities Exchange Act of 1934, as amended, an annual report on Form 10-K; and

WHEREAS, the undersigned is a director of the Corporation;

NOW, THEREFORE, the undersigned hereby constitutes and appoints Edward E. Whitacre, Jr., James D. Ellis, Jon P. Klug, Richard G. Lindner, John J. Stephens, or any one of them, all of the City of San Antonio and State of Texas, the attorneys for the undersigned and in the undersigned's name, place and stead, and in the undersigned's office and capacity in the Corporation, to execute and file such annual report, and thereafter to execute and file any amendment or amendments thereto, hereby giving and granting to said attorneys full power and authority to do and perform each and every act and thing whatsoever requisite and necessary to be done in and concerning the premises, as fully to all intents and purposes as the undersigned might or could do if personally present at the doing thereof, hereby ratifying and confirming all that said attorneys may or shall lawfully do, or cause to be done, by virtue hereof.

IN WITNESS WHEREOF, the undersigned executed this Power of Attorney the 27 day of January 2006.

/s/ Toni Rembe  
Toni Rembe  
Director

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS:

THAT, WHEREAS, AT&T INC., a Delaware corporation, hereinafter referred to as the "Corporation," proposes to file with the Securities and Exchange Commission, under the provisions of the Securities Exchange Act of 1934, as amended, an annual report on Form 10-K; and

WHEREAS, the undersigned is a director of the Corporation;

NOW, THEREFORE, the undersigned hereby constitutes and appoints Edward E. Whitacre, Jr., James D. Ellis, Jon P. Klug, Richard G. Lindner, John J. Stephens, or any one of them, all of the City of San Antonio and State of Texas, the attorneys for the undersigned and in the undersigned's name, place and stead, and in the undersigned's office and capacity in the Corporation, to execute and file such annual report, and thereafter to execute and file any amendment or amendments thereto, hereby giving and granting to said attorneys full power and authority to do and perform each and every act and thing whatsoever requisite and necessary to be done in and concerning the premises, as fully to all intents and purposes as the undersigned might or could do if personally present at the doing thereof, hereby ratifying and confirming all that said attorneys may or shall lawfully do, or cause to be done, by virtue hereof.

IN WITNESS WHEREOF, the undersigned executed this Power of Attorney the 27 day of January 2006.

/s/ S. Donley Ritchey  
S. Donley Ritchey  
Director

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS:

THAT, WHEREAS, AT&T INC., a Delaware corporation, hereinafter referred to as the "Corporation," proposes to file with the Securities and Exchange Commission, under the provisions of the Securities Exchange Act of 1934, as amended, an annual report on Form 10-K; and

WHEREAS, the undersigned is a director of the Corporation;

NOW, THEREFORE, the undersigned hereby constitutes and appoints Edward E. Whitacre, Jr., James D. Ellis, Jon P. Klug, Richard G. Lindner, John J. Stephens, or any one of them, all of the City of San Antonio and State of Texas, the attorneys for the undersigned and in the undersigned's name, place and stead, and in the undersigned's office and capacity in the Corporation, to execute and file such annual report, and thereafter to execute and file any amendment or amendments thereto, hereby giving and granting to said attorneys full power and authority to do and perform each and every act and thing whatsoever requisite and necessary to be done in and concerning the premises, as fully to all intents and purposes as the undersigned might or could do if personally present at the doing thereof, hereby ratifying and confirming all that said attorneys may or shall lawfully do, or cause to be done, by virtue hereof.

IN WITNESS WHEREOF, the undersigned executed this Power of Attorney the 27 day of January 2006.

/s/ Joyce M. Roché  
Joyce M. Roché  
Director

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS:

THAT, WHEREAS, AT&T INC., a Delaware corporation, hereinafter referred to as the "Corporation," proposes to file with the Securities and Exchange Commission, under the provisions of the Securities Exchange Act of 1934, as amended, an annual report on Form 10-K; and

WHEREAS, the undersigned is a director of the Corporation;

NOW, THEREFORE, the undersigned hereby constitutes and appoints Edward E. Whitacre, Jr., James D. Ellis, Jon P. Klug, Richard G. Lindner, John J. Stephens, or any one of them, all of the City of San Antonio and State of Texas, the attorneys for the undersigned and in the undersigned's name, place and stead, and in the undersigned's office and capacity in the Corporation, to execute and file such annual report, and thereafter to execute and file any amendment or amendments thereto, hereby giving and granting to said attorneys full power and authority to do and perform each and every act and thing whatsoever requisite and necessary to be done in and concerning the premises, as fully to all intents and purposes as the undersigned might or could do if personally present at the doing thereof, hereby ratifying and confirming all that said attorneys may or shall lawfully do, or cause to be done, by virtue hereof.

IN WITNESS WHEREOF, the undersigned executed this Power of Attorney the 27 day of January 2006.

/s/ Randall L. Stephenson  
Randall L. Stephenson  
Director

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS:

THAT, WHEREAS, AT&T INC., a Delaware corporation, hereinafter referred to as the "Corporation," proposes to file with the Securities and Exchange Commission, under the provisions of the Securities Exchange Act of 1934, as amended, an annual report on Form 10-K; and

WHEREAS, the undersigned is a director of the Corporation;

NOW, THEREFORE, the undersigned hereby constitutes and appoints Edward E. Whitacre, Jr., James D. Ellis, Jon P. Klug, Richard G. Lindner, John J. Stephens, or any one of them, all of the City of San Antonio and State of Texas, the attorneys for the undersigned and in the undersigned's name, place and stead, and in the undersigned's office and capacity in the Corporation, to execute and file such annual report, and thereafter to execute and file any amendment or amendments thereto, hereby giving and granting to said attorneys full power and authority to do and perform each and every act and thing whatsoever requisite and necessary to be done in and concerning the premises, as fully to all intents and purposes as the undersigned might or could do if personally present at the doing thereof, hereby ratifying and confirming all that said attorneys may or shall lawfully do, or cause to be done, by virtue hereof.

IN WITNESS WHEREOF, the undersigned executed this Power of Attorney the 27 day of January 2006.

/s/ Laura D'Andrea Tyson  
Laura D'Andrea Tyson  
Director

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS:

THAT, WHEREAS, AT&T INC., a Delaware corporation, hereinafter referred to as the "Corporation," proposes to file with the Securities and Exchange Commission, under the provisions of the Securities Exchange Act of 1934, as amended, an annual report on Form 10-K; and

WHEREAS, the undersigned is a director of the Corporation;

NOW, THEREFORE, the undersigned hereby constitutes and appoints Edward E. Whitacre, Jr., James D. Ellis, Jon P. Klug, Richard G. Lindner, John J. Stephens, or any one of them, all of the City of San Antonio and State of Texas, the attorneys for the undersigned and in the undersigned's name, place and stead, and in the undersigned's office and capacity in the Corporation, to execute and file such annual report, and thereafter to execute and file any amendment or amendments thereto, hereby giving and granting to said attorneys full power and authority to do and perform each and every act and thing whatsoever requisite and necessary to be done in and concerning the premises, as fully to all intents and purposes as the undersigned might or could do if personally present at the doing thereof, hereby ratifying and confirming all that said attorneys may or shall lawfully do, or cause to be done, by virtue hereof.

IN WITNESS WHEREOF, the undersigned executed this Power of Attorney the 27 day of January 2006.

/s/ Patricia P. Upton  
Patricia P. Upton  
Director

**CERTIFICATION**

I, Edward E. Whitacre Jr., certify that:

1. I have reviewed this report on Form 10-K of AT&T Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 28, 2006

/s/ Edward E. Whitacre Jr.

Edward E. Whitacre Jr.  
Chairman and Chief Executive Officer



**CERTIFICATION**

I, Richard G. Lindner, certify that:

1. I have reviewed this report on Form 10-K of AT&T Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 28, 2006

/s/ Richard G. Lindner

Richard G. Lindner  
Senior Executive Vice President  
and Chief Financial Officer

**Certification of Periodic Financial Reports**

Pursuant to 18 U.S.C. Section 1350, each of the undersigned officers of AT&T Inc. (the "Company") hereby certifies that the Company's Annual Report on Form 10-K for the year ended December 31, 2005 (the "Report") fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934 and that information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

February 28, 2006

February 28, 2006

By: /s/ Edward E. Whitacre Jr.  
Edward E. Whitacre Jr.  
Chairman and Chief Executive Officer

By: /s/ Richard G. Lindner  
Richard G. Lindner  
Senior Executive Vice President

and Chief Financial Officer

The foregoing certification is being furnished solely pursuant to 18 U.S.C. Section 1350 and is not being filed as part of the Report or as a separate disclosure document. This certification shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934 ("Exchange Act") or otherwise subject to liability under that section. This certification shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Exchange Act except to the extent this Exhibit 32 is expressly and specifically incorporated by reference in any such filing.

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to AT&T Inc. and will be retained by AT&T Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

**CONSOLIDATED FINANCIAL STATEMENTS**  
**CINGULAR WIRELESS LLC**

*Years Ended December 31, 2003, 2004 and 2005*  
*with Report of Independent Registered Public Accounting Firm*

**CONSOLIDATED FINANCIAL STATEMENTS**  
**Years Ended December 31, 2003, 2004 and 2005**

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## **REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Shareowners  
Cingular Wireless Corporation, Manager of  
Cingular Wireless LLC

We have audited the accompanying consolidated balance sheets of Cingular Wireless LLC as of December 31, 2004 and 2005 and the related consolidated statements of income, changes in members' capital, comprehensive income and cash flows for each of the three years in the period ended December 31, 2005. 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. The financial statements of Omnipoint Facilities Network II, LLC (Omnipoint), a wholly-owned subsidiary of GSM Facilities, LLC (an equity investee in which the Company had an approximate 60% interest at December 31, 2004), have been audited by other auditors whose report has been furnished to us; insofar as our opinion on the consolidated financial statements relates to the 2003 and 2004 amounts included for Omnipoint, it is based solely on their report. In the consolidated financial statements, the Company's indirect investment in Omnipoint is stated at \$880 million at December 31, 2004, and the Company's equity in net losses of Omnipoint is stated at \$100 million for the year ended December 31, 2003 and \$135 million for the year ended December 31, 2004.

We conducted our audits in accordance with 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 and the report of other auditors for 2003 and 2004 provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors for 2003 and 2004, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Cingular Wireless LLC at December 31, 2004 and 2005, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

/s/ Ernst & Young LLP

Atlanta, Georgia  
February 24, 2006

## **REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Members and Board of Directors of GSM Facilities, LLC:

In our opinion, the accompanying balance sheet and the related statements of operations, of member's equity and of cash flows (not presented separately herein) present fairly, in all material respects, the financial position of Omnipoint Facilities Network II, LLC (the "Company") at December 31, 2004, and the results of its operations and its cash flows for the years ended December 31, 2004 and 2003 in conformity with accounting principles generally accepted in the United States of America. 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 of these statements 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Notes 1 and 5, the Company's transactions are substantially with related parties, who are the Company's member owners. Additionally, as described in Note 1, the Company relies on its member owners for funding requirements.

As described in Notes 1 and 6, the Company's assets were contributed to T-Mobile USA, Inc. ("T-Mobile") on January 5, 2005, as part of an agreement between T-Mobile and Cingular Wireless LLC to unwind the operations of their joint venture, GSM Facilities, LLC.

/s/ PricewaterhouseCoopers LLP

Seattle, Washington  
March 3, 2005

**CINGULAR WIRELESS LLC**  
**CONSOLIDATED BALANCE SHEETS**

	December 31,	
	2004	2005
	(Dollars in millions)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 352	\$ 472
Accounts receivable, net of allowance for doubtful accounts of \$348 and \$286	3,448	3,622
Due from affiliates, net	138	—
Inventories	690	536
Prepaid assets	346	320
Current deferred tax assets	2	767
Other current assets	594	332
Total current assets	5,570	6,049
Property, plant and equipment, net	21,958	21,745
Licenses, net	24,762	25,242
Goodwill	21,637	22,359
Customer relationship intangibles, net	4,698	2,998
Other intangible assets, net	241	174
Investments in and advances to equity affiliates	2,676	7
Other assets	696	745
Total assets	\$ 82,238	\$ 79,319
LIABILITIES AND MEMBERS' CAPITAL		
Current liabilities:		
Debt maturing within one year	\$ 2,158	\$ 2,036
Accounts payable	1,383	1,920
Due to affiliates, net	—	54
Advanced billing and customer deposits	728	946
Accrued liabilities	3,714	5,052
Total current liabilities	7,983	10,008
Long-term debt:		
Debt due to members	9,628	6,717
Other long-term debt, net of premium	14,229	12,623
Total long-term debt	23,857	19,340
Deferred tax liabilities, net	3,997	3,086
Other noncurrent liabilities	1,256	1,364
Total liabilities	37,093	33,798
Commitments and contingencies		
Minority interests in consolidated entities	609	543
Members' capital:		
Members' capital	44,714	44,988
Receivable for properties to be contributed	(178)	—
Accumulated other comprehensive loss, net of taxes	—	(10)
Total members' capital	44,536	44,978
Total liabilities and members' capital	\$ 82,238	\$ 79,319

See accompanying notes.

**CINGULAR WIRELESS LLC**  
**CONSOLIDATED STATEMENTS OF INCOME**

	<b>Year Ended December 31,</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
	<b>(Dollars in millions)</b>		
Operating revenues:			
Service revenues	\$ 14,317	\$ 17,602	\$ 30,638
Equipment sales	1,260	1,963	3,795
Total operating revenues	15,577	19,565	34,433
Operating expenses:			
Cost of services (excluding depreciation of \$1,670, \$2,259 and \$4,112, which is included below)	3,775	4,737	9,318
Cost of equipment sales	2,031	2,874	5,069
Selling, general and administrative	5,428	7,349	11,647
Depreciation and amortization	2,089	3,077	6,575
Total operating expenses	13,323	18,037	32,609
Operating income	2,254	1,528	1,824
Other income (expenses):			
Interest expense	(856)	(900)	(1,260)
Minority interest in earnings of consolidated entities	(101)	(86)	(102)
Equity in net (loss) earnings of affiliates	(333)	(415)	5
Other, net	41	16	64
Total other income (expenses)	(1,249)	(1,385)	(1,293)
Income before provision (benefit) for income taxes	1,005	143	531
Provision (benefit) for income taxes	28	(58)	198
Net income	\$ 977	\$ 201	\$ 333

See accompanying notes.



**CINGULAR WIRELESS LLC**  
**CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' CAPITAL**

	(Dollars in millions)
Balance at December 31, 2002,	\$ 7,435
Net income	977
Distributions to members, net	(79)
Balance at December 31, 2003	8,333
Net income	201
Contributions from members, net	36,000
Other, net	2
Balance at December 31, 2004,	44,536
Net income	333
Contributions from members, net	117
Other, net	(8)
Balance at December 31, 2005	\$ 44,978

See accompanying notes.

# CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Year Ended December 31,		
	2003	2004	2005
	(Dollars in millions)		
<b>Comprehensive Income</b>			
Net income	\$ 977	\$ 201	\$ 333
Other comprehensive income (loss):			
Minimum pension liability adjustment, net of taxes of \$1 in 2004 and 2005	—	(4)	(4)
Net foreign currency translation adjustment, net of taxes of (\$4) and \$4 in 2004 and 2005	—	6	(6)
Total comprehensive income	<u>\$ 977</u>	<u>\$ 203</u>	<u>\$ 323</u>

See accompanying notes.

**CINGULAR WIRELESS LLC**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>Year Ended December 31,</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
	(Dollars in millions)		
<b>Operating activities</b>			
Net income	\$ 977	\$ 201	\$ 333
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	2,089	3,077	6,575
Provision for doubtful accounts	259	423	570
Minority interest in earnings of consolidated entities	101	86	102
Equity in net loss (earnings) of affiliates	333	415	(5)
Amortization of debt discount (premium), net	1	(43)	(231)
Deferred income taxes	(1)	(74)	90
Changes in operating assets and liabilities:			
Accounts receivable	(331)	(336)	(732)
Inventories	(147)	(189)	163
Other current assets	(83)	(18)	181
Accounts payable and other current liabilities	278	(512)	999
Pensions and post-employment benefits	55	88	103
Other, net	155	202	253
Net cash provided by operating activities	3,686	3,320	8,401
<b>Investing activities</b>			
Construction and capital expenditures	(2,734)	(3,449)	(7,475)
Investments in and advances to equity affiliates	(616)	(422)	(199)
Proceeds from dispositions of assets	7	188	3,874
Acquisition of AT&T Wireless, net of cash received	—	(35,543)	—
Acquisitions of other businesses and licenses, net of cash received	(25)	(1,632)	(155)
(Purchase) Redemption of held-to-maturity investments	—	(219)	219
Other	—	—	50
Net cash used in investing activities	(3,368)	(41,077)	(3,686)
<b>Financing activities</b>			
Net borrowings (repayments) under revolving credit agreement	—	1,667	(1,156)
Repayment of long-term debt	(64)	(530)	(482)
Repayment of long-term debt due to members	—	(50)	(2,911)
Net distributions to minority interests	(33)	(141)	(46)
Contributions from members	10	36,024	—
Net cash (used in) provided by financing activities	(87)	36,970	(4,595)
Net increase (decrease) in cash and cash equivalents	231	(787)	120
Cash and cash equivalents at beginning of period	908	1,139	352
Cash and cash equivalents at end of period	\$ 1,139	\$ 352	\$ 472

See accompanying notes.

## CINGULAR WIRELESS LLC

PART II (Dollars in Millions)

### CINGULAR WIRELESS LLC NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Years Ended December 31, 2003, 2004 and 2005 (Dollars in Millions)

#### 1. Summary of Significant Accounting Policies

##### *Background and Basis of Presentation*

Cingular Wireless LLC (the Company) is a Delaware limited liability company formed in 2000 by SBC Communications Inc. (SBC) and BellSouth Corporation (BellSouth) as the operating company for their U.S. wireless joint venture. (On November 18, 2005, SBC acquired through merger AT&T Corp. and changed the name of the surviving entity to AT&T Inc. When used herein, "AT&T" will refer to the surviving entity and, prior to November 18, 2005, to SBC. AT&T Corp. will be referred to as "Old AT&T" prior to November 18, 2005.) AT&T and BellSouth, through their wholly-owned subsidiaries, respectively, own approximate 60% and 40% economic interests in the Company. Cingular Wireless Corporation (the Manager), which is directed equally by AT&T and BellSouth, acts as the Company's manager and controls the Company's management and operations. The Company provides wireless voice and data communications services, including local, long-distance and roaming services using both cellular and personal communications services (PCS) frequencies licensed by the Federal Communications Commission (FCC), and equipment to customers in 46 states, including service to all 100 of the largest U.S. metropolitan areas. All of the Company's operations, which primarily serve customers in the U.S., are conducted through subsidiaries or joint ventures. Through roaming arrangements with other carriers, the Company provides its customers service in regions where it does not have network coverage and is thus able to serve customers in virtually the entire U.S. and over 180 foreign countries.

In October 2004, the Company acquired AT&T Wireless Services, Inc. (AT&T Wireless) for an aggregate consideration of approximately \$41,000 in cash. AT&T Wireless, which has been renamed New Cingular Wireless Services, Inc. but will continue to be referred to herein as AT&T Wireless, is now a direct wholly-owned subsidiary of the Company. The operations of AT&T Wireless are integrated with those of the Company, and the business is conducted under the "Cingular" brand name.

As provided for in the original Contribution and Formation Agreement among the Company, AT&T and BellSouth, the majority of contributions of wireless operations and assets in certain markets were made during 2000 and 2001. The contribution by AT&T of wireless operations and assets in certain Arkansas markets occurred on May 1, 2005, and was recorded as "Receivable for properties to be contributed" in the consolidated balance sheets through the contribution date. Prior to the contribution, the Company managed the properties for a fee. Fees received for managing the Arkansas markets for the years ended December 31, 2003, 2004 and 2005 were \$30, \$40 and \$30, respectively.

These consolidated financial statements include charges from AT&T and BellSouth for certain expenses pursuant to various agreements (see Note 11). These expenses are considered to be a reasonable reflection of the value of services provided or the benefits received by the Company.

##### *Use of Estimates*

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 reflected in the consolidated financial statements and accompanying notes. The Company bases its estimates on experience, where applicable and other assumptions that management believes are reasonable under the circumstances. Actual results could differ from those estimates under different assumptions or conditions. Estimates are used when accounting for certain items such as accrued and deferred revenues, allowance for

## CINGULAR WIRELESS LLC

PART II (*Dollars in Millions*)

### CINGULAR WIRELESS LLC

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

doubtful accounts, useful lives of property, plant and equipment, amortization periods for intangible assets, legal and tax contingencies, employee benefit programs, evaluation of minimum lease terms for operating leases, fair values of investments and intangible assets, asset impairment charges and deferred income taxes, including income tax valuation allowances. Additionally, estimates are used when recording the fair values of assets acquired and liabilities assumed in a purchase business combination.

#### *Principles of Consolidation*

The consolidated financial statements include the accounts of the Company, variable interest entities in which the Company is the primary beneficiary as defined by Financial Accounting Standards Board (FASB) Interpretation No. 46R, *Consolidation of Variable Interest Entities, an interpretation of ARB No. 51* (FIN 46R), and voting interest entities in which the Company exercises control. Other parties' interests in consolidated entities are reported as minority interests. All significant intercompany transactions are eliminated in the consolidation process.

The equity method is used to account for investments that are not consolidated but in which the Company exercises significant influence. Investments in which the Company does not have the ability to exercise significant influence are accounted for under the cost method.

#### *Segments*

The Company manages the business as one reportable business segment, wireless communications services, which also is a single operating segment. The Company operates primarily in the U.S.

#### *Revenue Recognition*

The Company earns service revenues by providing access to its wireless network (access revenue) and for usage of its wireless system (airtime revenue). Access revenue from postpaid subscribers is billed either in advance or arrears and recognized ratably over the service period. Airtime revenue, including roaming revenue and long-distance revenue, is billed in arrears based on minutes of use and is recognized when the service is rendered. Data airtime revenue, also billed in arrears, is based upon either number of messages or kilobytes used and is recognized when the service is rendered. Prepaid airtime sold to subscribers and revenue collected from pay-in-advance subscribers is recorded as deferred revenue prior to the commencement of services, and revenue is recognized when airtime is used or expires. Access and airtime services provided are billed throughout the month according to the bill cycle in which a particular subscriber is placed. As a result of bill cycle cut-off times, the Company is required to make estimates for service revenues earned but not yet billed at the end of each month, and for advanced billings. Estimates for access revenues are based upon the most current bill cycle revenues. Estimates for airtime revenues are based upon historical minutes/messages/kilobytes of use.

The Company's ROLLOVER® rate plans include a feature whereby unused anytime minutes do not expire each month but rather are available, under certain conditions, for future use for a period not to exceed one year from the date of purchase. The Company defers revenue based on an estimate of the portion of unused minutes expected to be utilized prior to expiration. Historical subscriber usage patterns, which have been consistent and which the Company views to be reliable for purposes of gauging predictive behavior, allow the Company to estimate the number of unused minutes to be utilized, as well as those which are likely to expire or be forfeited. No deferral of revenue is recorded for the minutes expected to expire or be forfeited, as no future performance is expected to be required by the Company, nor is there any obligation

## CINGULAR WIRELESS LLC

PART II (Dollars in Millions)

### CINGULAR WIRELESS LLC

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

to refund or redeem for value the expired minutes. The balance of the deferral as of December 31, 2004 and 2005 was \$146 and \$234, respectively, and has been included in “Advanced billing and customer deposits” in the consolidated balance sheets.

Service revenues include revenues from Company subscribers who roam outside their selected home coverage area, referred to as “incollect” roaming revenues, and revenues from other wireless carriers for roaming by their subscribers on the Company’s network, referred to as “outcollect” roaming revenues.

The Company offers enhanced services including caller ID, call waiting, call forwarding, three-way calling, no answer/busy transfer, text messaging and voice mail. Generally, these enhanced features generate additional service revenues through monthly subscription fees or increased wireless usage through utilization of the features. Other optional services, such as mobile-to-mobile calling, roadside assistance and handset insurance, may also be provided for a monthly fee. These enhanced features and optional services may be bundled with package rate plans or sold separately. Revenues for enhanced services and optional features are recognized as earned. Service revenues also include billings to our subscribers for Universal Service Fund (USF) and other regulatory fees.

Equipment sales consist principally of revenues from the sale of wireless handsets and accessories to new and existing subscribers and to agents and other third-party distributors. The revenue and related expenses associated with the sale of wireless handsets and accessories through our indirect sales channels are recognized when the products are delivered and accepted by the agent or third-party distributor, as this is considered to be a separate earnings process from the sale of wireless services and probability of collection is likely. Shipping and handling costs for wireless handsets sold to agents and other third-party distributors are classified as costs of equipment sales.

The Company has determined that the sale of wireless services through its direct sales channels with an accompanying handset constitutes a revenue arrangement with multiple deliverables in accordance with Emerging Issues Task Force (EITF) No. 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables*. The Company accounts for these arrangements as separate units of accounting, including the wireless service and handset. Arrangement consideration received for the handset is recognized as equipment sales when the handset is delivered and accepted by the subscriber. Arrangement consideration received for the wireless service is recognized as service revenues when earned. As the non-refundable, up-front activation fee charged to the subscriber does not meet the criteria as a separate unit of accounting, the Company allocates the additional arrangement consideration received from the activation fee to the handset (the delivered item) to the extent that the aggregate handset and activation fee proceeds do not exceed the fair value of the handset. Any activation fees not allocated to the handset would be deferred upon activation and recognized as service revenue on a straight-line basis over the expected customer relationship period. The Company determined that the sale of wireless services through its indirect sales channels (agents) does not constitute a revenue arrangement with multiple deliverables. For indirect channel sales, the Company continues to defer non-refundable, up-front activation fees and associated costs to the extent of the related revenues in accordance with Staff Accounting Bulletin No. 104 (SAB 104). These deferred fees and costs are amortized on a straight-line basis over the estimated customer relationship period. The Company has recorded deferred revenues and deferred expenses of equal amounts in the consolidated balance sheets. As of December 31, 2004 and 2005, deferred revenues and expenses were \$124 and \$187, respectively.

**CINGULAR WIRELESS LLC**

PART II (Dollars in Millions)

**CINGULAR WIRELESS LLC  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)*****Income Taxes***

The Company is not a taxable entity for federal income tax purposes. Rather, federal taxable income or loss is included in the Company's respective members' federal income tax returns. However, the Company's provision (benefit) for income taxes includes federal and state income taxes for certain of its corporate subsidiaries, as well as for certain states which impose income taxes upon non-corporate legal entities. The acquisition of AT&T Wireless resulted in a significant increase in its pre-tax income (loss) from its corporate subsidiaries since AT&T Wireless retained its corporation status. However, after the acquisition, AT&T Wireless contributed the majority of its assets and liabilities to Cingular Wireless II, LLC (CW II), which it owns jointly with Cingular Wireless LLC. In exchange for the assets and liabilities contributed to CW II, AT&T Wireless received a 43% ownership interest in CW II, from which any income (loss) is allocated and is subject to federal and state income taxes. The remaining income (loss) from CW II is allocated to the Company and flows through to the members who are taxed at their level pursuant to federal and state income tax laws.

The Company recognizes deferred tax assets and liabilities based on differences between the financial reporting and tax bases of assets and liabilities, applying enacted statutory rates. Pursuant to the provisions of Statement of Financial Accounting Standards No. 109, *Accounting For Income Taxes* (SFAS 109), the Company provides valuation allowances for deferred tax assets for which it does not consider realization of such assets to be more likely than not. See Note 13 for further information.

***Required Distributions***

The Company is required to make periodic distributions to its members on a pro rata basis in accordance with each member's ownership interest in amounts sufficient to permit members to pay the tax liabilities resulting from allocations of income tax items from the Company. Since the Company did not generate taxable income in 2003, 2004 or 2005, the Company made no distributions for tax liabilities in 2003, 2004 or 2005.

***Cash and Cash Equivalents***

Cash and cash equivalents include all highly liquid investments with original maturities of three months or less. Outstanding checks and drafts of \$169 and \$336 have been included in "Accounts payable" in the consolidated balance sheets as of December 31, 2004 and 2005, respectively.

***Accounts Receivable***

Accounts receivable consist principally of trade accounts receivable from subscribers and are generally unsecured and due within 30 days. Credit losses relating to these receivables consistently have been within management's expectations. Expected credit losses are recorded as an allowance for doubtful accounts in the consolidated balance sheets. Estimates of expected credit losses are based primarily on write-off experience, net of recoveries, and on the aging of the accounts receivable balances. The collection policies and procedures of the Company vary by credit class and payment history of customers. Provisions for uncollectible receivables are included in selling, general and administrative expenses.

***Inventories***

Inventories consist principally of wireless handsets and accessories and are valued at the lower of cost or market value. Market value is determined using current replacement cost.

## CINGULAR WIRELESS LLC

PART II (Dollars in Millions)

### CINGULAR WIRELESS LLC NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

#### *Property, Plant and Equipment*

Property, plant and equipment are stated at cost, less accumulated depreciation and amortization. The cost of additions and substantial improvements is capitalized. Interest expense and network engineering costs incurred during the construction phase of the Company's wireless network are capitalized as part of property, plant and equipment until the projects are completed and the assets are placed into service. The cost of maintenance and repairs is charged to operating expenses. Property, plant and equipment are depreciated using the straight-line method over their estimated useful lives. Leasehold improvements, including cell site acquisition and other site construction improvements, are depreciated over the shorter of their estimated useful lives or lease terms that are reasonably assured. Depreciation lives may be accelerated due to changes in technology, the rate of migration of the Company's subscriber base from its Time Division Multiple Access (TDMA) network to its Global System for Mobile Communication (GSM) network or other industry conditions. Upon sale or retirement of an asset, the related costs and accumulated depreciation are removed from the accounts and any gain or loss is recognized and principally included in "Cost of services" in the consolidated statements of income.

#### *Software Capitalization*

The Company capitalizes certain costs incurred in connection with developing or obtaining internal use software in accordance with American Institute of Certified Public Accountants Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*. Capitalized costs include direct development costs associated with internal use software, including internal direct labor costs and external costs of materials and services. These capitalized software costs are included in "Property, plant and equipment, net" in the consolidated balance sheets and are being amortized on a straight-line basis over a period not to exceed five years. Costs incurred during the preliminary project stage, as well as maintenance and training costs, are expensed as incurred.

#### *Intangible Assets*

Intangible assets consist primarily of customer relationships, FCC spectrum licenses and the excess of consideration paid over the fair value of net assets acquired in purchase business combinations (goodwill). In conjunction with the Company's acquisition of AT&T Wireless, the Company also recorded intangible assets associated with trade names, trade marks and lease contracts.

Customer relationships represent values placed on subscribers of acquired businesses and have a finite life. The majority of the Company's customer relationship intangible assets are amortized over a five-year period using the sum-of-the-months digits method.

In accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* (SFAS 142), goodwill and other indefinite-lived intangible assets are not amortized. The Company has determined that its FCC spectrum licenses should be treated as indefinite-lived intangible assets (see Note 4). The FCC issues spectrum licenses for up to ten years that authorize wireless carriers to provide service in specific geographic service areas. In 1993, the FCC adopted specific standards to apply to wireless renewals, concluding it will award a license renewal to a licensee that meets certain standards of past performance. Historically, the FCC has granted license renewals routinely. The licenses held by the Company expire at various dates and the Company believes it will be able to meet all requirements necessary to secure renewal of its wireless licenses.



## CINGULAR WIRELESS LLC

### PART II (Dollars in Millions)

## CINGULAR WIRELESS LLC

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The Company tests goodwill and other indefinite-lived intangible assets for impairment on an annual basis. Additionally, goodwill will be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the Company's fair value below its carrying value. Indefinite-lived intangible assets will be tested between annual tests if events or changes in circumstances indicate that the asset might be impaired. These events or circumstances would include a significant change in the business climate, legal factors, operating performance indicators, competition, sale or disposition of a significant portion of the business or other factors. See Note 4 for description of the goodwill and indefinite-lived intangible asset impairment tests.

#### *Valuation of Long-lived Assets*

Long-lived assets, including property, plant and equipment and intangible assets with finite lives, are reviewed for impairment in accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. It is reasonably possible that these assets could become impaired as a result of technological or other industry changes. In analyzing potential impairment, the Company uses projections of future cash flows from the asset group. These projections are based on the Company's views of forecasted growth rates, anticipated future economic conditions, appropriate discount rates relative to risk and estimates of residual values. If the total of the expected future undiscounted cash flows from the asset group the Company intends to hold and use is less than the carrying amount of the asset group, a loss is recognized for the difference between the fair value and carrying amount of the asset group. The asset group to be held and used represents the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets and liabilities. The Company has determined the lowest level for which cash flows are largely independent of the cash flows of other groups is the consolidated company level. For assets the Company intends to dispose of, a loss is recognized if the carrying amount of the assets in the disposal group is more than fair value, net of the costs of disposal. The Company principally uses the discounted cash flow method to estimate the fair value of its long-lived assets. The discount rate applied to the undiscounted cash flows is consistent with the Company's weighted-average cost of capital.

#### *Asset Retirement Obligations*

In accordance with Statement of Financial Accounting Standards No. 143, *Accounting for Asset Retirement Obligations* (SFAS 143), the Company records the fair value of a liability for an asset retirement obligation in the period in which it is incurred and capitalizes that amount as part of the book value of the long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the estimated useful life of the related asset. Upon settlement of the liability, the Company either settles the obligation for its recorded amount or incurs a gain or loss.

The Company has certain legal obligations related to network infrastructure, principally tower and related assets, certain administrative facilities and battery disposal, which fall within the scope of SFAS 143. These legal obligations include obligations to remediate leased land on which the Company's network infrastructure and administrative assets are located. The significant assumptions used in estimating the Company's asset retirement obligations include the following: a probability, depending upon the type of operating lease, that the Company's assets with asset retirement obligations will be remediated at the lessor's directive; expected settlement dates that coincide with lease expiration dates plus estimates of lease extensions; remediation costs that are indicative of what third party vendors would charge the Company to

## CINGULAR WIRELESS LLC

PART II (*Dollars in Millions*)

### CINGULAR WIRELESS LLC

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

remediate the sites; expected inflation rates that are consistent with historical inflation rates; and credit-adjusted risk-free rates that approximate the Company's incremental borrowing rates.

##### *Advertising Costs*

Costs for advertising are expensed as incurred. Total advertising expenses were \$643, \$973 and \$1,249 for the years ended December 31, 2003, 2004 and 2005, respectively.

##### *Operating Leases*

Rent expense is recorded on a straight-line basis over the initial lease term and those renewal periods that are reasonably assured. The difference between rent expense and rent paid is recorded as deferred rent and is included in "Accrued liabilities" and "Other noncurrent liabilities" in the consolidated balance sheets.

##### *Derivative Financial Instruments*

In accordance with Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133), the Company recognizes all derivatives as either assets or liabilities in the consolidated balance sheets and measures those instruments at fair value. Gains and losses resulting from changes in the fair values of those derivative instruments will be recorded to earnings or other comprehensive income (loss) depending on the use of the derivative instrument and whether it qualifies for hedge accounting. The Company also assesses, both at the inception of the hedge and on an on-going basis, whether the derivatives used in hedging transactions are effective. Should it be determined that a derivative is not effective as a hedge, the Company would discontinue the hedge accounting prospectively.

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objectives and strategies for undertaking various hedge transactions.

##### *New Accounting Standards*

In March 2005, the FASB issued Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations (an interpretation of FASB Statement No. 143)* (FIN 47). This Interpretation clarifies that the term conditional asset retirement obligation, as used in FASB Statement No. 143, *Accounting for Asset Retirement Obligations*, refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty may exist about the timing and (or) method of settlement. Accordingly, an entity is required to recognize the fair value of a liability for the conditional asset retirement obligation when incurred and the uncertainty about the timing and (or) method of settlement should be factored into the measurement of the liability when sufficient information exists. This Interpretation is effective no later than December 31, 2005. Retrospective application of interim financial information is permitted but is not required. Additionally, companies shall recognize the cumulative effect of initially applying this Interpretation as a change in accounting principle. The Company adopted this new pronouncement effective December 31, 2005. The impact to the Company's consolidated financial statements as a result of adopting this new statement is not material.

## CINGULAR WIRELESS LLC

PART II (Dollars in Millions)

### CINGULAR WIRELESS LLC NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

#### *Reclassifications*

Certain amounts have been reclassified in the consolidated financial statements to conform to the current year presentation. The consolidated statements of income for 2003 and 2004 have been reclassified to reflect certain billings to the Company's subscribers related to gross receipts taxes as "Service revenues" and the related payments to the associated taxing authorities and regulatory agencies as "Cost of services" expense. Operating income and net income for both years were unaffected by the reclassification. The amounts reclassified for 2003 and 2004 were \$94 and \$129, respectively.

## 2. Acquisitions and Dispositions

During 2003, 2004 and 2005, the Company completed certain transactions as part of its overall strategy to expand its wireless footprint and divest itself of nonstrategic assets, as well as divestitures required by regulatory agencies.

### **Acquisitions**

#### *AT&T Wireless*

In October 2004, the Company acquired AT&T Wireless in a transaction accounted for under the purchase method prescribed in SFAS No. 141, *Business Combinations* (SFAS 141). AT&T Wireless was a provider of wireless voice and data services and products primarily in the U.S. and served nearly 22 million subscribers as of the acquisition date. AT&T Wireless also held equity interests in Triton PCS Holdings, Inc. (Triton), Cincinnati Bell, Inc. (Cincinnati Bell), TeleCorp PCS, Inc. (TeleCorp) and other U.S. and international communications ventures, corporations and partnerships. The acquisition formed the largest wireless communications company in the U.S., based upon the number of subscribers.

The aggregate consideration paid to AT&T Wireless shareholders to complete the AT&T Wireless acquisition was approximately \$41,000 in cash. The Company received \$36,024 in equity funding from AT&T and BellSouth to finance the acquisition in proportion to their respective economic interests. The remaining portion of the purchase price was funded with AT&T Wireless cash on hand. The results of AT&T Wireless' operations have been included in the Company's consolidated financial statements since the acquisition date.

The acquisition was structured as a merger of a wholly-owned subsidiary of the Manager with and into AT&T Wireless, following which AT&T Wireless became a direct wholly-owned subsidiary of the Manager, and as the surviving entity, AT&T Wireless retained all of its assets and liabilities. Following the merger, the Manager sold all its interests in AT&T Wireless to the Company for \$36,024, and AT&T Wireless then became its direct wholly-owned subsidiary. Subsequently, a significant portion of the operations, including assets, liabilities and subsidiary entities, were transferred from the Company and AT&T Wireless to CW II. The Company and CW II executed supplemental indentures to AT&T Wireless's two indentures under which its Senior Notes are outstanding to become co-obligated for all obligations thereunder. Further, AT&T Wireless and CW II executed supplemental indentures to the Company's indenture governing the Company's Senior Notes to become co-obligated for all obligations thereunder. As a result, CW II, AT&T Wireless and the Company are co-obligated on all of the Company's and AT&T Wireless' Senior Notes.

## CINGULAR WIRELESS LLC

PART II (*Dollars in Millions*)

### CINGULAR WIRELESS LLC

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The Company paid a premium (*i.e.*, goodwill) over the fair value of the net tangible and identified intangible assets acquired for a number of reasons, including but not limited to the following:

- AT&T Wireless fills in the Company's licensed spectrum and network footprints by covering areas where it did not have licenses or network infrastructure;
- AT&T Wireless adds depth to the Company's licensed spectrum position in existing markets, enhancing the Company's ability to offer high-speed data services and reduce capital expenditures;
- AT&T Wireless' subscriber base, which has a stronger business subscriber component than that of the Company, adds a complementary subscriber mix to the Company's subscriber base;
- AT&T Wireless' average revenue per user, or "ARPU", had historically been higher than that of the Company's subscribers;
- AT&T Wireless gives the Company added size and scale to compete more effectively in the industry and to procure more significant cost economies from vendors; and
- the acquisition will reduce the Company's incollect roaming costs because of the broader post-acquisition footprint.

#### *Allocation of Purchase Price*

The application of purchase accounting under SFAS 141 required that the total purchase price be allocated to the fair value of assets acquired and liabilities assumed based on their fair values at the acquisition date. The allocation process required an analysis of all such assets and liabilities including acquired contracts, customer relationships, FCC licenses, contractual commitments and legal contingencies to identify and record the fair value of all assets acquired and liabilities assumed. In valuing acquired assets and assumed liabilities, fair values were based on, but were not limited to: future expected cash flows; current replacement cost for similar capacity for certain property, plant and equipment; market rate assumptions for contractual obligations; estimates of settlement costs for litigation and contingencies; and appropriate discount rates and growth rates.

The approach to the estimation of the fair values of the AT&T Wireless intangible assets involved the following steps:

- Preparation of discounted cash flow analyses;
- Deduction of the fair values of tangible assets;
- Determination of the fair value of identified significant intangible assets;
- Reconciliation of the individual assets' returns with the weighted average cost of capital; and
- Allocation of the excess purchase price over the fair value of the identifiable assets and liabilities acquired to goodwill.

The amounts reported as of December 31, 2004 in the table below reflect the estimated fair values as of the acquisition date of October 26, 2004 plus adjustments made during the fourth quarter of 2004. The

**CINGULAR WIRELESS LLC**

**PART II** (Dollars in Millions)

**CINGULAR WIRELESS LLC**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

adjustments summarized in the table below include purchase price allocation adjustments made during 2005 prior to the end of the allocation period.

	<b>Purchase Price Allocation</b>		
	<b>As of December 31, 2004</b>	<b>Adjustments(2)</b>	<b>As of October 26, 2005</b>
<b>Assets acquired:</b>			
Current assets	\$ 8,457(1)	\$ 2	\$ 8,459
Property, plant and equipment	10,314	(2,310)	8,004
Intangible assets not subject to amortization			
Licenses	15,540	649	16,189
Intangible assets subject to amortization			
Customer relationships	5,010	(23)	4,987
Other intangible assets	312	—	312
Investments in unconsolidated subsidiaries	898	103	1,001
Other assets	447	(12)	435
Goodwill	20,468	774	21,242
Total assets acquired	61,446	(817)	60,629
<b>Liabilities assumed:</b>			
Current liabilities, excluding current portion of long-term debt	3,261	934	4,195
Long-term debt	12,172	4	12,176
Deferred income taxes	3,938	(1,763)	2,175
Other non-current liabilities	811	8	819
Total liabilities assumed	20,182	(817)	19,365
Net assets acquired	\$ 41,264	\$ —	\$ 41,264

(1) Includes \$5,240 of cash used to finance the acquisition.

(2) Adjustments include the impact of integration plans approved by management in June and October 2005, wherein the utility and expected lives of certain network and non-network property, plant and equipment and internal-use software acquired were reduced as a result of management decisions and refinements to assumptions and/or data used to assign asset values in the purchase price allocation. The impact of these plans and refinements resulted in a reduction to the valuation of these former AT&T Wireless assets as of the acquisition date. Included in our 2005 operating results is a \$35 reduction of depreciation expense attributable to the fourth quarter of 2004 related to a \$1,645 reduction in the valuation of property, plant and equipment resulting from the integration plans approved and management decisions made in 2005. Changes to the valuation of property, plant and equipment resulted in adjustments to the fair value of certain identifiable intangible assets acquired and goodwill and associated deferred taxes. The integration plans also resulted in the recognition of liabilities under EITF Issue No. 95-3, *Recognition of Liabilities in Connection with a Purchase Business Combination* (EITF 95-3), that adjusted the purchase price allocation (see also Note 12 for further detail); adjustments to these liabilities have been recorded as of December 31, 2005, and may

## CINGULAR WIRELESS LLC

### PART II (Dollars in Millions)

#### CINGULAR WIRELESS LLC NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

continue as the integration plans are executed and completed in 2006. The purchase price allocation has also been adjusted to record preacquisition contingencies. In addition to the deferred tax impacts associated with valuation adjustments, a net reduction in deferred taxes was recorded to reflect revisions to the tax bases of the assets acquired and liabilities assumed in the purchase, and correspondingly reduced goodwill.

In accordance with SFAS 141, goodwill includes a portion of value for assembled workforce which is not separately classified from goodwill. Deferred tax liabilities have been recorded on all intangible assets except non-deductible goodwill. Tax benefits will be reflected in the consolidated statements of income in future periods as the book basis of finite-lived intangible assets is amortized over their associated useful lives or if any intangible assets except non-deductible goodwill are impaired.

Substantially all of the licenses acquired have an indefinite life, and accordingly, are not subject to amortization. The majority of customer relationship intangible assets are being amortized over a weighted-average period of five years using the sum-of-the-months digits method. This method best reflects the estimated pattern in which the economic benefits will be consumed. Other intangible assets and other noncurrent liabilities include lease and sublease contracts, which are amortized over the remaining terms of the underlying leases and have a weighted-average amortization period of seven years. Other intangibles also includes the right to use the AT&T Wireless brand trade name, which was amortized over a six month period following the acquisition, and represented the use period under the Brand License Agreement with Old AT&T, as amended. Trademarks are amortized over their expected remaining economic lives, ranging from five to six years, and have a weighted-average amortization period of 5.6 years.

The Company completed an assessment of any preacquisition contingencies where the related liability was probable and the amount of the liability could be reasonably estimated. In connection with this assessment, the Company recorded preacquisition liabilities of \$172 related to pending legal proceedings in the final purchase price allocation.

#### *Triton Wireless Properties*

In September 2004, the Company and AT&T Wireless and Triton signed an agreement providing for the acquisition by the Company of Triton's wireless properties in Virginia (the "Virginia properties") in exchange for certain of AT&T Wireless' properties in North Carolina, Puerto Rico and the U.S. Virgin Islands (the "NC/ PR properties"). In addition, the Company agreed to pay Triton \$176 in cash. The exchange of network properties closed on December 1, 2004, and was accounted for as a purchase in accordance with SFAS 141. The FCC licenses were retained by the respective parties pending FCC approval for the transfer, which occurred in November 2005. The results of the Virginia properties have been included in, and the results of the exchanged properties have been excluded from, the Company's consolidated financial statements since the respective closing dates.

**CINGULAR WIRELESS LLC**

PART II (Dollars in Millions)

**CINGULAR WIRELESS LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Under the purchase method of accounting, the assets and liabilities of the Virginia properties were recorded at their respective fair values as of the date of acquisition. The following table summarizes the estimated fair values of the assets and liabilities exchanged as of the acquisition date.

	<u>Virginia Properties</u>	<u>NC/PR Properties</u>	<u>Combined Totals</u>
Assets acquired (disposed):			
Current assets	\$ 32	\$ (62)	\$ (30)
Property, plant and equipment	147	(285)	(138)
Customer relationships	48	(68)	(20)
FCC Licenses	301	(227)	74
Goodwill	364	(117)	247
Total assets acquired (disposed)	892	(759)	133
Liabilities assumed (disposed):			
Current liabilities	13	4	17
Noncurrent liabilities	—	(60)	(60)
Total liabilities assumed (disposed)	13	(56)	(43)
Net assets acquired (disposed)	\$ 879	\$ (703)	\$ 176

In addition to the wireless property exchange, AT&T Wireless and Triton, through wholly-owned subsidiaries, signed an agreement in July 2004 to terminate their stockholders' agreement which would terminate a market exclusivity arrangement between the parties. As of the close of the AT&T Wireless acquisition, the Company had wireless operations in markets where AT&T Wireless was prohibited from operating under the exclusivity arrangement. In exchange for the termination of the stockholders' agreement, AT&T Wireless agreed to surrender to Triton its equity interest in Triton valued at \$194. This transaction closed on October 26, 2004, immediately following the acquisition of AT&T Wireless. With the consummation of this agreement, the Company is able to provide on its network continuing service in areas where Triton currently has operations. The Company recognized no gain or loss on the transaction.

*Pro Forma Financial Information*

The following unaudited pro forma consolidated results of operations of the Company for the years ended December 31, 2003 and 2004 assume that the acquisitions of AT&T Wireless and the Virginia properties were completed as of January 1 in each fiscal year shown below:

	<u>Year Ended December 31,</u>	
	<u>2003</u>	<u>2004</u>
	<u>(Unaudited)</u>	
Revenues	\$ 31,238	\$ 32,179
Income before provision for income taxes	1,626	232
Net income	1,353	193

The pro forma amounts represent the historical operating results of AT&T Wireless and the Virginia properties with appropriate adjustments that give effect to depreciation and amortization, interest expense, income taxes, and the elimination of intercompany roaming activity among the Company, AT&T Wireless



## CINGULAR WIRELESS LLC

PART II (Dollars in Millions)

### CINGULAR WIRELESS LLC

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

and the Virginia properties. The effects of other non-acquisition related items are included in the pro forma amounts presented above. The pro forma amounts are not necessarily indicative of the operating results that would have occurred if the acquisitions and related transactions had been completed at the beginning of the applicable periods presented. In addition, the pro forma amounts are not necessarily indicative of operating results in future periods, in which the Company might realize revenue enhancements and cost savings.

#### *Acquisition of NextWave Licenses*

In August 2003, the Company executed an agreement with NextWave Telecom, Inc. and certain of its affiliates for the purchase of FCC licenses for wireless spectrum in 34 markets for \$1,400 in cash. The transaction closed in April 2004, and the Company recorded this cost as additional licenses in the consolidated balance sheet.

#### **Dispositions**

#### *Termination of GSMF Network Infrastructure Joint Venture*

In May 2004, the Company and T-Mobile entered into an agreement, subject to the closing of the acquisition of AT&T Wireless, to dissolve GSM Facilities, LLC (GSMF), sell to T-Mobile certain spectrum licenses and other assets and exchange certain other spectrum licenses. The first stage of these transactions closed in January 2005.

Pursuant to the agreement, the joint venture was dissolved and the Company sold its ownership of the California/ Nevada Major Trading Area (MTA) network assets to T-Mobile for approximately \$2,500 in cash. Also, as part of the dissolution, the Company was required to contribute an additional \$200 to the venture to restore a capital account deficit. The Company retained the right to utilize the California/ Nevada and New York T-Mobile networks during a four-year transition period and has committed to purchase a minimum number of minutes over this term with a purchase commitment value of \$1,200 (see Note 15). The Company and T-Mobile retained all of their respective customers in each market. Additionally, in January 2005, the Company sold 10 megahertz (MHz) of spectrum to T-Mobile in each of the San Francisco, Sacramento and Las Vegas Basic Trading Areas (BTAs) for \$180 as part of the dissolution of GSMF.

As part of the original joint venture agreement, the Company and T-Mobile were each to receive 50% of the spectrum used in the operation of the joint venture following its dissolution. Spectrum licenses were not contributed to the joint venture upon its formation in 2001, but rather were subject to a separate agreement governing their use. In connection with the dissolution, the Company and T-Mobile are contractually required to exchange certain spectrum licenses. The Company expects the spectrum licenses to be exchanged on January 1, 2007. The Company will receive 10 MHz of spectrum in the New York BTA and 2.5 MHz of spectrum in the Las Vegas, Nevada BTA, and T-Mobile will receive 5 MHz of spectrum in each of nine BTAs in California, the largest of which is San Diego. T-Mobile also has the option to purchase an additional 10 MHz of spectrum in the Los Angeles and San Diego BTAs from the Company commencing January 2007. The Company expects to recognize a net gain on the dissolution of the joint venture upon the completion of the spectrum exchange in 2007, principally due to the value of the New York spectrum to be received in connection with the consummation of these transactions.



## CINGULAR WIRELESS LLC

PART II (Dollars in Millions)

### CINGULAR WIRELESS LLC NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

#### *Investment in Cincinnati Bell Wireless*

In connection with the acquisition of AT&T Wireless, the Company and Cincinnati Bell signed an agreement in August 2004 that allowed the Company the right to put to Cincinnati Bell, AT&T Wireless' 19.9% equity interest in Cincinnati Bell's wireless subsidiary, Cincinnati Bell Wireless LLC (CBW), for \$83. In February 2006, the Company exercised this put right and closed on the transfer of its investment to Cincinnati Bell. The Company accounted for its investment in CBW under the cost method. This investment, which had carrying amounts of \$81 and \$83 as of December 31, 2004 and 2005, respectively, is included in "Other assets" in the consolidated balance sheets. The gain on the sale was not material.

#### *Mobitex Data Business*

In September 2004, the Company sold Cingular Interactive, L.P. (Cingular Interactive), a data messaging business utilizing the proprietary "Mobitex" packet switched network. In connection with its agreement to sell Cingular Interactive, the Company evaluated the Cingular Interactive long-lived asset carrying values, including property, plant and equipment and FCC licenses, for recoverability. Based on the results of the recoverability test, the Company adjusted the carrying values of the Cingular Interactive long-lived assets to their fair value in September 2004, resulting in a loss of \$31. Fair value was determined using the agreed upon sale price for the Cingular Interactive assets, less costs to sell. The write-down of the long-lived assets is included in "Cost of services" in the consolidated statements of income and "Other, net" in the consolidated statements of cash flows for 2004. The loss recognized on sale of Cingular Interactive in October 2004 was not material.

#### *Sale of Bermuda and Caribbean Operations and Licenses*

In June 2005, the Company signed a stock purchase agreement with Digicel Limited (Digicel) to sell former AT&T Wireless operations and licenses in Bermuda and certain Caribbean markets to Digicel for \$61 in cash (subject to certain potential adjustments under the agreement). The majority of the transaction closed in the third and fourth quarters of 2005 for which the Company received approximately \$57 in cash. No gain or loss was recognized on the sales that closed. The two remaining markets are expected to close upon governmental and regulatory approvals in the respective markets. The Company does not expect to recognize a material gain or loss on these assets which are included in other current assets in the accompanying consolidated balance sheets as of December 31, 2005. The operating results of the Caribbean markets are not material for any period presented.

#### *Other Divestitures*

The Company has completed a series of transactions to dispose of certain domestic wireless assets, including those required to be divested by the FCC and the U.S. Department of Justice (DOJ) in connection with its acquisition of AT&T Wireless. These dispositions did not have a material impact on the Company's ability to provide services in any market or on its results of operations. The most significant of the required dispositions was the transaction completed in April 2005 with Alltel Corporation, in which the Company sold to Alltel, licenses, network assets and subscribers in several markets that the Company acquired as part of the AT&T Wireless acquisition. In exchange for the assets sold, the Company received cash and additional minority interests in partnerships that it already controlled. The Company also sold to Alltel 20 MHz of spectrum and network assets formerly held by AT&T Wireless in Wichita, Kansas, which it was not required to divest. The fair value of the assets exchanged in the transactions was approximately \$400. The gain recognized on the exchange was not material.

**CINGULAR WIRELESS LLC**

PART II (Dollars in Millions)

**CINGULAR WIRELESS LLC**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)****3. Property, Plant and Equipment**

Property, plant and equipment is summarized as follows:

	Estimated Useful Lives  (In years)	December 31,	
		2004	2005
Land	—	\$ 95	\$ 109
Buildings and building improvements	10-25	6,182	5,792
Operating and other equipment	2-15	25,388	29,217
Furniture and fixtures	3-10	450	427
Construction in progress	—	810	1,599
		32,925	37,144
Less accumulated depreciation and amortization		10,967	15,399
Property, plant and equipment, net		<u>\$ 21,958</u>	<u>\$ 21,745</u>

Depreciation expense and capitalized interest and network engineering costs incurred during the construction phase of the Company's wireless network are summarized as follows:

	Year Ended December 31,		
	2003	2004	2005
Depreciation expense	\$ 1,927	\$ 2,562	\$ 4,812
Capitalized interest costs	15	16	44
Capitalized network engineering costs	103	134	255

The net book value of assets recorded under capital leases was \$916 and \$897 at December 31, 2004 and 2005, respectively. These capital leases principally relate to communications towers and other operating equipment. Amortization of assets recorded under capital leases is included in depreciation expense. Capital lease additions for the years ended December 31, 2003, 2004 and 2005 were \$143, \$94 and \$79, respectively.

Previously, the Company's cellular/ PCS networks were equipped with GSM or TDMA digital transmission technologies. In the second quarter of 2004, the Company completed a two-year overlay of GSM equipment throughout its TDMA markets to provide a common voice standard. As a part of this project, the Company added high-speed technologies for data services known as General Packet Radio Service (GPRS) and Enhanced Data Rates for GSM Evolution (EDGE). Due to the accelerated migration of traffic to its GSM network experienced in 2004, the Company evaluated the estimated useful lives of its TDMA equipment. This review was completed in the fourth quarter of 2004 and, effective October 1, 2004, useful lives were further shortened to fully depreciate all TDMA equipment by December 31, 2007. This change in estimate increased depreciation expense in the fourth quarter of 2004 by \$61 and 2005 depreciation expense by approximately \$235.

**4. Intangible Assets**

A significant portion of the Company's intangible assets are FCC licenses that provide the Company with the exclusive right to utilize certain radio frequency spectrum to provide wireless communications services. While FCC licenses are issued for only a fixed time, renewals of FCC licenses have occurred routinely and

**CINGULAR WIRELESS LLC**

PART II (Dollars in Millions)

**CINGULAR WIRELESS LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

at nominal cost. Moreover, the Company has determined that there are currently no legal, regulatory, contractual, competitive, economic or other factors that limit the useful lives of its FCC licenses and therefore treats the FCC licenses as an indefinite-lived intangible asset under the provisions of SFAS 142.

In accordance with EITF No. 02-7, *Unit of Accounting for Testing Impairment of Indefinite-Lived Intangible Assets*, the Company tests its licenses for impairment on an aggregate basis, consistent with the Company's management of the business on a national scope. The Company utilizes a fair value approach, incorporating discounted cash flows, to complete the test. This approach determines the fair value of the FCC licenses and, accordingly, incorporates cash flow assumptions regarding the investment in a network, the development of distribution channels and other inputs for making the business operational. As these inputs are included in determining free cash flows of the business, the present value of the free cash flows is attributable to the licenses. The discount rate applied to the cash flows is consistent with the Company's weighted-average cost of capital.

During the fourth quarters of 2003, 2004 and 2005, the Company completed its annual impairment tests for goodwill and indefinite-lived FCC licenses. These annual impairment tests, prepared as of October 1, resulted in no impairment of the Company's goodwill or indefinite-lived FCC licenses.

Summarized below are the carrying values for the major classes of intangible assets that will continue to be amortized under SFAS 142, as well as the carrying values of those intangible assets deemed to have indefinite lives:

		<u>December 31, 2004</u>		<u>December 31, 2005</u>	
	<u>Estimated Useful Lives</u>	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>
	(In years)				
Intangible assets subject to amortization:					
Customer relationships	5	\$ 5,273	\$ (575)	\$ 5,316	\$ (2,318)
Other	1-18	326	(73)	306	(134)
Total		<u>\$ 5,599</u>	<u>\$ (648)</u>	<u>\$ 5,622</u>	<u>\$ (2,452)</u>
Intangible assets not subject to amortization:					
FCC licenses		<u>\$ 24,748</u>	<u>\$ —</u>	<u>\$ 25,242</u>	<u>\$ —</u>
Goodwill		<u>\$ 21,637</u>	<u>\$ —</u>	<u>\$ 22,359</u>	<u>\$ —</u>

The weighted average estimated useful lives of intangible assets subject to amortization was 5.0 years as of December 31, 2005, with remaining useful lives of approximately 3.8 years.

The changes in the carrying value of goodwill for the year ended December 31, 2005, which are largely attributable to adjustments to the purchase price allocation of AT&T Wireless assets and liabilities, are as follows:.

**CINGULAR WIRELESS LLC**

PART II (Dollars in Millions)

**CINGULAR WIRELESS LLC**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Balance, December 31, 2004	\$ 21,637
Goodwill acquired	65
Goodwill disposed of	(150)
Other adjustments	807
Balance, December 31, 2005	<u>\$ 22,359</u>

The following table presents current and estimated amortization expense for each of the following periods:

Aggregate amortization expense for the year ended:	
2003	\$ 162
2004	515
2005	1,763
Estimated amortization expense for the year ending:	
2006	1,315
2007	955
2008	603
2009	237
2010 and thereafter	60

In addition to the SFAS 142 intangible assets noted above, the Company had \$2 of intangible assets in each of 2004 and 2005 in connection with the recognition of an additional minimum liability for its bargained pension plan and/or other unqualified benefit plans as required by SFAS No. 87, *Employers' Accounting for Pensions*, (SFAS 87) (see Note 14).

**5. Investments in and Advances to Equity Affiliates**

The Company had investments in affiliates and had made advances to entities that provided the Company access to additional U.S. and international wireless markets. The Company did not have a controlling interest in these investments, and all of these investments were accounted for under the equity method of accounting. The most significant of these investments was GSMF, a jointly controlled network infrastructure venture with T-Mobile for networks in the New York City metropolitan area, California and Nevada. GSMF was dissolved in January 2005, and the others were sold during 2005.

Investments in and advances to equity affiliates consisted of the following at December 31, 2004:

Investment in GSMF	\$ 2,108
Investment in Atlantic West B.V. (Netherlands)	349
Investment in IDEA Cellular Ltd. (India)	210
Other	9
	<u>\$ 2,676</u>

**GSMF**

In November 2001, the Company and T-Mobile formed GSMF and contributed to it portions of their existing network infrastructures in the California, Nevada and New York City metropolitan area markets.

**CINGULAR WIRELESS LLC**

PART II (Dollars in Millions)

**CINGULAR WIRELESS LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Management control of GSMF was vested in a four-member management committee. Both companies bought network services from GSMF but retained ownership and control of their own licenses in those markets. The Company and T-Mobile independently marketed their services to subscribers and utilized their own sales, marketing, billing and customer care operations. In July 2002, the Company began marketing its commercial service in the New York City market and T-Mobile began service in California and Nevada.

The Company and T-Mobile jointly funded capital expenditures of GSMF and procured services and network equipment on behalf of GSMF in the respective markets. Network equipment was contributed to GSMF at prices which approximated fair value. The Company deferred any resulting profits and recorded them as part of “Investments in and advances to equity affiliates” in the consolidated balance sheets. The Company recognized the intercompany profit over the estimated useful lives of the related assets as a reduction of equity in net loss of affiliates.

In January 2005, the Company and T-Mobile terminated their network infrastructure joint venture through a series of transactions. See Note 2 for additional information.

The Company incurred and charged to GSMF certain network operating costs. The monthly operating expenses of GSMF, including monthly cash payments made on tower capital lease obligations, were then charged back to the Company and T-Mobile based upon each party’s proportionate share of licensed spectrum in each market. Through a separate reciprocal home roaming agreement, the Company and T-Mobile charged each other for usage that was not in the same proportion as the spectrum-based allocations. This usage charge was primarily based upon the Company’s and T-Mobile’s share of the total minutes of use on the respective networks. These charges for network services are included in “Cost of services” in the consolidated statements of income. These transactions are summarized as follows:

	Year Ended December 31,	
	2003	2004
Network operating costs charged to GSMF	\$ 320	\$ 385
Network services received based on usage	254	253

At December 31, 2004, the “Due from affiliates, net” caption in the consolidated balance sheets included \$125 and \$13 related to transactions between the Company and GSMF for the settlement of capital obligations and settlement of operating expenses, respectively.

GSMF incurred net losses due to depreciation, deferred rent and interest expense, which were not reimbursed by the Company or T-Mobile. For the years ended December 31, 2003 and 2004, the Company recorded equity in the net loss of GSMF of \$335 and \$416, respectively.

***Atlantic West B.V.***

Atlantic West B.V. (AWBV), which was acquired through AT&T Wireless, was a joint venture between the Company and Verizon Communications, Inc. (Verizon). AWBV owned a 49% interest in Eurotel Bratislava a.s. (Bratislava), a wireless operating entity in Slovakia prior to its sale in December 2004. In December 2004, AWBV sold its interest in Bratislava to Slovak Telecom a.s. for cash proceeds of \$315. The Company’s share of proceeds from the sale totaled \$158. AWBV distributed \$280 of the proceeds upon completion of the sale, of which \$140 was distributed to the Company. The remaining cash proceeds, along with \$662 in cash from a prior sale, were distributed equally to the Company and Verizon in June

## CINGULAR WIRELESS LLC

PART II (Dollars in Millions)

### CINGULAR WIRELESS LLC

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

2005 upon completion of a repatriation plan which qualified under the American Jobs Creation Act of 2004 (see Note 13). The Company recognized no gain or loss on the sale transaction as the assumed fair value of the investment, in conjunction with its purchase of AT&T Wireless, equaled the transaction sale proceeds. AWBV is no longer operational as of December 31, 2005.

#### *IDEA Cellular Ltd.*

In September 2005, the Company sold its 32.9% interest in IDEA Cellular Ltd. (IDEA), a cellular telecommunications company in India, to the other principal shareholders in IDEA for \$300 in cash. The Company recognized no gain or loss on the transaction.

### 6. Variable Interest Entities

The Company has variable interests in several entities for which it is deemed to be the primary beneficiary and accordingly consolidates the statements of financial position, results of operations and cash flows for these entities pursuant to FASB Interpretation No. 46 (Revised December 2003), *Consolidation of Variable Interest Entities — an interpretation of ARB No. 51* (FIN 46R). These variable interests typically consist of a combination of some or all of voting equity interests, nonvoting equity interests, loans and put options that provide the other owners the right to require the Company, subject to prior governmental approvals to purchase their ownership interest if and when certain events occur. These entities were formed to enable individuals and businesses with limited assets and revenues to partner with, and receive financing from, large businesses, such as the Company or AT&T Wireless, to bid on licenses that were otherwise unavailable to large entities. To date, the activities of these entities have consisted primarily of acquiring licenses through acquisitions and FCC auctions and network construction. The Company has no significant variable interests for which it is not deemed to be the primary beneficiary.

#### *Salmon PCS LLC*

In November 2000, the Company and Crowley Digital Wireless, LLC (Crowley Digital) entered into an agreement, pursuant to which Salmon PCS LLC (Salmon) was formed to bid as a “very small business” for certain 1900 MHz band PCS licenses auctioned by the FCC.

Crowley Digital has the right to put its approximate 20% economic interest in Salmon to the Company at a cash price equal to Crowley Digital’s initial investment plus a specified rate of return. The put right can be exercised at certain times ending in April 2008. The Company’s maximum liability for the purchase of Crowley Digital’s interest in Salmon under this put right is \$225. The fair values of this put obligation, estimated at \$155 and \$172 as of December 31, 2004 and 2005, are included in “Other noncurrent liabilities” and “Accrued liabilities” in the consolidated balance sheets for the respective periods.

#### *Edge Mobile Wireless, LLC*

In November 2004, the Company and Edge Mobile Wireless, LLC (Edge Mobile Wireless) formed Edge Mobile, LLC (Edge) to bid as an “entrepreneur” for certain 1900 MHz band PCS licenses auctioned by the FCC. In February 2005, Edge’s total high bids for the 21 licenses it won at auction in November 2005 amounted to \$181, of which the Company was obligated to fund \$174. In December 2004, the Company contributed \$31 in equity to Edge, which was used to pay for a portion of the licenses. The Company contributed equity and made advances to Edge in March 2005 of \$7 and \$136, respectively, to cover its remaining obligation.

**CINGULAR WIRELESS LLC**

PART II (Dollars in Millions)

**CINGULAR WIRELESS LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Edge Mobile Wireless will have the right to put its economic interest in Edge to the Company at a cash price equal to Edge Mobile Wireless' investment plus a specified rate of return. The put right can be exercised at certain times, but, in no event, prior to the grant of the licenses. Upon grant of the licenses to Edge in November 2005, the Company recorded the estimated fair value of the put obligation, which is immaterial to the Company's financial condition.

***AT&T Wireless Variable Interest Entities***

As a result of the AT&T Wireless acquisition, the Company's consolidated financial statements include other variable interest entities, similar to Salmon and Edge Mobile Wireless. The Company's maximum liability related to these entities as of December 31, 2005 was approximately \$147, which represents the gross payment under the put options that provide the other owners the right to require the Company to purchase their ownership interests under certain circumstances. Also, through its acquisition of AT&T Wireless, the Company acquired a variable interest and was deemed to be the primary beneficiary in an entity engaged in leasing activities.

**7. Accrued Liabilities**

Accrued liabilities are summarized as follows:

	December 31,	
	2004	2005
Accrued fixed asset purchases	\$ 822	\$ 1,369
Taxes, other than income	387	499
Payroll and other related liabilities	697	622
Agent commissions	329	289
Advertising	231	125
Accrued interest	232	219
Lease termination costs	—	291
Equipment removal costs	—	190
Other	1,016	1,448
Total accrued liabilities	\$ 3,714	\$ 5,052

**8. Debt*****Debt Maturing Within One Year******Revolving Credit Agreement***

Effective August 1, 2004, the Company entered into a revolving credit agreement with AT&T and BellSouth for them to provide unsubordinated short-term financing on a pro rata basis at an interest rate of LIBOR plus 0.05% for the Company's ordinary course operations based upon the Company's budget and forecasted cash needs. The revolving credit agreement provides that in the event that the Company has available cash (as defined) on any business day, such amount shall first be applied to the repayment of the revolving loans, and any remaining excess shall then be applied to the repayment of the Subordinated Notes (member loans) from AT&T and BellSouth at month end if the Company does not

**CINGULAR WIRELESS LLC**

PART II (Dollars in Millions)

**CINGULAR WIRELESS LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

then require a cash advance under the agreement. As of December 31, 2005, the Company had an outstanding balance of \$511 under the revolving credit agreement. The agreement was amended in June 2005 to extend expiration until July 31, 2007. The weighted average annual interest rate under this agreement for the period August 1, 2004 through December 31, 2004 and for the year ended December 31, 2005 was 2.3% and 2.9% respectively. Interest expense on the revolving credit agreement for the years ended December 31, 2004 and 2005 was \$4 and \$11, respectively.

***Long-term Debt***

Long-term debt is summarized as follows:

	<b>December 31,</b>	
	<b>2004</b>	<b>2005</b>
Due to members — Subordinated Notes due June 2008	\$ 9,628	\$ 6,717
Due to external parties — Cingular Wireless LLC, maker:		
5.625% Senior Notes, due December 2006	500	500
6.5% Senior Notes, due December 2011	750	750
7.125% Senior Notes, due December 2031	750	750
Due to external parties — AT&T Wireless Services, Inc., maker:		
6.875% Senior Notes, due April 2005	250	—
7.35% Senior Notes, due March 2006	1,000	1,000
7.5% Senior Notes, due May 2007	750	750
7.875% Senior Notes, due March 2011	3,000	3,000
8.125% Senior Notes, due May 2012	2,000	2,000
8.75% Senior Notes, due March 2031	2,500	2,500
Due to external parties — TeleCorp Wireless, Inc., maker:		
10.625% Senior Subordinated Notes	200	—
Capital leases, 5.72% to 9.6%	1,011	1,142
Other	52	38
Total long-term debt, including current maturities	22,391	19,147
Unamortized premium (discount) on noncurrent Senior Notes and Senior Subordinated Notes and other Notes, net	1,960	1,716
Current maturities of long-term debt	(491)	(1,523)
Interest rate swap fair value adjustment (see Note 9)	(3)	—
Total long-term debt	\$ 23,857	\$ 19,340

***Debt Due to Members***

The long-term debt due to members (member loans) represents borrowings from AT&T and BellSouth. Interest accrues at 6% and is payable monthly. Interest expense on the member loans for the years ended December 31, 2003, 2004 and 2005 was \$653, \$582 and \$510, respectively. The Company's member loans have a maturity date of June 30, 2008. The Company may prepay the member loans at any time, subject to the provisions described below, and is obligated to prepay the member loans to the extent of excess cash



## CINGULAR WIRELESS LLC

PART II (*Dollars in Millions*)

### CINGULAR WIRELESS LLC

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

from operations (as defined). See “Revolving Credit Agreement” above. For the years ended December 31, 2004 and December 31, 2005, the Company repaid \$50 and \$2,911, respectively, of its member loans. Funds generated from operations and proceeds from asset sales were used to make repayments on the member loans.

AT&T and BellSouth have agreed to subordinate their repayment rights applicable to the member loans to the repayment rights of the Company’s senior debt. Senior debt includes the Company’s Senior Notes, including Senior Notes of AT&T Wireless and other borrowings from external parties designated as senior debt to which AT&T and BellSouth have specifically agreed to be subordinate. The payment of principal and interest on the subordinated member loans by the Company is prohibited in the event of bankruptcy or an event of default in the payment or prepayment of any principal of or interest on any senior debt, or in the event of an acceleration of the subordinated debt upon its default, until the senior debt has been repaid in full.

#### *Senior Notes — Cingular Wireless LLC*

The Senior Notes are unsecured obligations and rank equally with all other unsecured and unsubordinated indebtedness. The Senior Notes are governed by an indenture with J.P. Morgan Trust Company, N.A., which acts as trustee. The indenture contains a “negative pledge” provision that the Company will not subject its property or assets to any mortgage or other encumbrance unless the Senior Notes are secured equally and ratably with other indebtedness that is secured by that property or assets, unless “secured debt” would not exceed 15% of “consolidated net tangible assets” (as such terms are defined in the indenture). There is no sinking fund or mandatory redemption applicable to the Senior Notes. The Senior Notes are redeemable, in whole or in part, at the Company’s option, at any time at a price equal to their principal amount plus any accrued interest and premium. CW II and AT&T Wireless became co-obligated on the Company’s Senior Notes following the Company’s acquisition of AT&T Wireless.

#### *Senior Notes — AT&T Wireless*

Following the Company’s acquisition of AT&T Wireless in October 2004, the Company, along with CW II, became co-obligated on \$9,500 of Senior Notes of AT&T Wireless. Included in the Senior Notes of AT&T Wireless are \$6,500 of unsecured and unsubordinated Senior Notes issued under a March 2001 private placement, with \$1,000 maturing on March 1, 2006; \$3,000 maturing on March 1, 2011; and \$2,500 maturing on March 1, 2031. Fixed interest rates range from 7.35% to 8.75% per annum, payable semi-annually. Also included in the Senior Notes are \$2,750 of unsecured and unsubordinated Senior Notes issued through an April 2002 registered public offering by AT&T Wireless, with \$750 maturing on May 1, 2007, and \$2,000 maturing on May 1, 2012. Fixed interest rates range from 7.5% to 8.125% per annum, payable semi-annually.

The \$9,250 outstanding Senior Notes of AT&T Wireless are governed under two separate indentures, with U.S. Bank N.A., successor to the Bank of New York, as trustee. The Senior Notes are unsecured unsubordinated obligations, ranking equally in right with all other unsecured and unsubordinated obligations of the Company. The Senior Notes are redeemable, as a whole or in part, at the Company’s option, at any time or from time to time, at a price equal to their principal amount plus any accrued interest and premium similar to that applicable to the Company’s Senior Notes. The Senior Notes are not subject to any sinking fund requirements. With respect to both indentures, covenants limit activity related to “sale and leaseback transactions” (as defined) under certain circumstances and contain a “negative pledge” provision similar to that applicable to the Company’s Senior Notes.

**CINGULAR WIRELESS LLC**

PART II (Dollars in Millions)

**CINGULAR WIRELESS LLC  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)***Fair Values of Long-term Debt*

At December 31, 2004 and 2005, the fair values of the Senior Notes and Senior Subordinated Notes were \$13,879 and \$13,153, respectively, based on their quoted market prices. The carrying value of the long-term debt due to members approximates fair value since the Company may prepay the debt at any time, as described above, without penalty. The above Senior Notes and Senior Subordinated Notes assumed in the Company's acquisition of AT&T Wireless were recorded at fair value on the acquisition date in accordance with the purchase accounting requirements of SFAS 141. The premium recorded at the acquisition date totaled \$2,045, of which \$1,731 remains outstanding as of December 31, 2005. The premium is being amortized under the effective interest method which reflects market interest rates on the date of the acquisition. Amortization of the premium is recorded in the Company's financial statements as a reduction to interest expense. For the year ended December 31, 2005, this amortization totaled \$231, which resulted in an effective annual interest rate of 4.7% for the acquired Senior Notes and Senior Subordinated Notes.

*Capital Leases*

The Company has entered into capital leases primarily for the use of communications towers.

*Maturities of Long-Term Debt*

Maturities of long-term debt outstanding, including capital lease obligations, at December 31, 2005 are summarized below:

	<u>Debt</u>	<u>Capital Leases</u>	<u>Total</u>
Maturities:			
2006	\$ 1,520	\$ 89	\$ 1,609
2007	755	94	849
2008	6,722	98	6,820
2009	3	103	106
2010	2	108	110
Thereafter	9,003	2,607	11,610
Total minimum payments	\$ 18,005	\$ 3,099	\$ 21,104
Less capital lease imputed interest	—	1,518	1,518
Less capital lease executory costs	—	439	439
Total obligations	\$ 18,005	\$ 1,142	\$ 19,147

*Cash Paid for Interest*

Cash paid for interest on debt for the years ended December 31, 2003, 2004 and 2005 was \$862, \$892 and \$1,503, respectively. These amounts include cash paid for interest on member loans and the revolving credit agreement with the members of \$665, \$582 and \$525 for the years ended December 31, 2003, 2004 and 2005, respectively.

**CINGULAR WIRELESS LLC**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)****9. Financial Instruments**

The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable, advanced billing and customer deposits and other current assets and liabilities are reasonable estimates of their fair value due to the short-term nature of these instruments.

The Company uses interest rate swaps to manage its interest rate exposure on certain of its debt obligations. The Company does not invest in derivative instruments for trading purposes. In March 2003, the Company entered into two interest rate swap contracts with banks to convert a portion of the fixed rate exposure on its five-year Senior Notes due December 15, 2006 to variable rates without an exchange of the underlying principal amount. Under the terms of the interest rate swap contracts, the Company receives interest at a fixed rate of 5.625% and pays interest at a variable rate equal to the six-month LIBOR plus a specified margin, based on an aggregate notional amount of \$250. The six-month LIBOR rate on each semi-annual reset date determines the variable portion of the interest rate swaps. For the years ended December 31, 2004 and 2005, the effective interest rate associated with this notional amount was 4.58% and 6.05%, respectively.

In accordance with SFAS 133, the Company recorded a fair value adjustment to the portion of its fixed rate long-term debt that is hedged. This fair value adjustment is recorded as an increase or decrease to long-term debt, with the related value for the interest rate swaps' recorded in "Other assets" or "Other noncurrent liabilities" if noncurrent, and/or "Other current assets" or "Accrued liabilities" if current, in the consolidated balance sheets. At December 31, 2005, the portion of debt related to the interest rate swap is classified as current and is recorded net of \$5 related to the fair value of the interest rate swap. Interest rate differentials associated with these interest rate swaps are recorded as an adjustment to a current asset or liability, with the offset to interest expense over the life of the interest rate swaps.

The Company has designated the swaps as fair value hedges of its fixed rate debt. The terms of the interest rate swap contracts and hedged items are such that effectiveness can be measured using the short-cut method as defined in SFAS 133.

**10. Concentrations of Risk**

The Company relies on local and long-distance telephone companies and other companies to provide certain communications services. Additionally, the Company relies on one vendor to provide billing services for the postpaid subscribers acquired in conjunction with the Company's acquisition of AT&T Wireless (see Note 2). Although management believes alternative vendors could be found in a timely manner, any disruption of these services could potentially have an adverse impact on operating results.

The Company relies on roaming agreements with other wireless carriers to permit the Company's customers to use their GSM/GPRS/ EDGE and TDMA networks in areas not covered by the Company's networks. If these providers decide not to continue those agreements due to a change in ownership or other circumstance, this could cause a loss of service in certain areas and possible loss of subscribers.

Although the Company attempts to maintain multiple vendors to the extent practicable, its handset inventory and network infrastructure equipment, which are important components of its operations, are currently acquired from only a few sources. If the suppliers are unable to meet the Company's needs as it continues to build out and upgrade its network infrastructure and sell service and handsets, delays and increased costs in the expansion of the Company's network infrastructure or losses of potential customers could result, which would adversely affect operating results.

## CINGULAR WIRELESS LLC

PART II (Dollars in Millions)

### CINGULAR WIRELESS LLC

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Financial instruments that could potentially subject the Company to credit risks consist principally of trade accounts receivable. Concentrations of credit risk with respect to these receivables are limited due to the composition of the subscriber base, which includes a large number of individuals and businesses. No subscriber accounted for more than 10% of consolidated revenues in any year presented.

Approximately 35,000, or 55%, of the Company's employees are represented by the Communications Workers of America (CWA), with contracts expiring on various dates between March 2006 and February 2009. Approximately 9,700 of the Company's employees are covered by a contract that expires in March 2006. All of the contracts contain no-strike clauses. In most areas of the country and with most job titles, the Company is contractually required to maintain a position of neutrality and to allow card-check balloting with respect to unionization and support the determination of its employees.

The Company has approximately one million RIM BlackBerry users. In litigation against RIM by various patent holders, a court has held that BlackBerry services infringe several patents. If an injunction is issued and RIM cannot modify the way the service is provided so that it does not infringe the patents at issue, the Company may have to either migrate its BlackBerry users to another handheld device and service platform or separately seek licenses from the patent holders. While there could be some expense and disruption associated with implementing the modification, the expense and/or disruption to the Company's customers from having to migrate subscribers to another device and service platform or to negotiate licenses from the patent holders could be very expensive and disruptive to the Company's wireless data business.

#### 11. Related Party Transactions

In addition to the affiliate transactions described elsewhere in these financial statements, other significant transactions with related parties are summarized in the succeeding paragraphs.

In connection with the formation of Cingular, the Company entered into wireless agency agreements with subsidiaries of AT&T and BellSouth. Such subsidiaries, and any of their affiliates that make an election to do so may act as authorized agents exclusively on the Company's behalf for the sale of its wireless services to customers in AT&T's and BellSouth's respective incumbent service territories. The Company is free to contract with other agents, including retailers and other distributors, for the sale of its wireless services in these territories and elsewhere throughout the U.S. In addition to the unilateral rights of AT&T and BellSouth and their affiliates to terminate the agreements and to the Company's right to terminate in certain events, each wireless agency agreement terminates upon breach, mutual agreement of the parties or on December 31, 2050. Agent commissions and compensation charges are included in "Selling, general and administrative" in the consolidated statements of income.

The Company incurred local interconnect and long distance charges from AT&T and BellSouth and their affiliates related to the provision of wireless services to its subscribers, which are included in "Cost of services" in the consolidated statements of income, and telecommunication and other charges from AT&T and BellSouth and their affiliates in connection with its internal business operations, which are primarily included in "Selling, general and administrative" in the consolidated statements of income.

**CINGULAR WIRELESS LLC**

PART II (Dollars in Millions)

**CINGULAR WIRELESS LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Related party charges incurred by the Company are summarized as follows:

Type of Service:	Year Ended December 31,		
	2003	2004	2005
Agent commissions and compensation	\$ 103	\$ 67	\$ 74
Interconnect and long distance	815	927	1,297
Telecommunications and other charges	77	97	250

Additionally, the Company has purchase commitments to AT&T, BellSouth and their affiliates of approximately \$161 for dedicated leased lines used to provide interconnection services and \$109 for telecommunications and other services (see Note 15).

The Company had receivables from affiliates of \$247 and \$156 and payables to affiliates of \$109 and \$210 at December 31, 2004 and 2005, respectively, primarily with AT&T, BellSouth and GSMF.

In August 2005, the Company sold to AT&T and BellSouth certain ultra high frequency operating licenses that were acquired as part of the AT&T Wireless transaction for \$34 in cash. Sale proceeds were received from each member in proportion to their respective economic ownership interests. No gain or loss was recognized on the transaction.

In August 2000, Southwestern Bell Mobile Systems, Inc., which AT&T transferred to the Company on October 2, 2000, agreed to transfer approximately 3,900 of its communications towers (later reduced to 3,306), including those owned by consolidated partnerships, to another AT&T affiliate, in connection with an agreement whereby the AT&T affiliate would lease its rights to use and lease space on the towers to SpectraSite Inc. (SpectraSite). Under the arrangement, SpectraSite subleases back to the AT&T affiliate the space on the towers the Company uses. The AT&T affiliate further subleases that space to the Company or its affiliates. The annual rent escalates by 5% as of December 14 of every year. The term of the sublease is unique to each tower and ranges from 13 to 32 years. The Company (as lessee) has the right to withdraw from any lease on the tenth anniversary of the lease date and on each five-year anniversary thereafter. The Company accounts for its subleases of the tower space from the AT&T affiliate as capital leases.

In 2003 and 2004, the Company transferred to the AT&T affiliate 94 and 187 towers, respectively. No towers were transferred in 2005. Through December 31, 2005, a total of 3,265 towers were transferred having an aggregate net book value at transfer date of \$190.

**12. Acquisition-Related, Integration and Other Costs**

The Company is executing plans to exit certain activities and dispose of certain assets of AT&T Wireless, including redundant facilities and interests in certain foreign operations, and to fully integrate the acquired operations with those of the Company. These plans affect many areas of the combined company, including sales and marketing, network, information technology, customer care, supply chain and general and administrative functions. In connection therewith, the Company expects to continue to incur significant costs over the next several quarters associated with such integration activities. Plans affecting the Company's integration of retail stores, administrative space and the network have been completed and approved by management, resulting in adjustments to the purchase price allocation for the acquired assets and assumed liabilities of AT&T Wireless and the need to shorten the useful lives of certain network and other property, plant and equipment.

## CINGULAR WIRELESS LLC

PART II (Dollars in Millions)

### CINGULAR WIRELESS LLC

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

For the years ended December 31, 2004 and 2005, the Company expensed integration costs of \$288 and \$876, respectively, related to these exit plans. Total costs to date include \$601 for network integration, \$129 of costs to support the common customer service experience, \$116 to market the combined company, \$81 for billing and other IT systems conversions, \$59 to convert the branding of AT&T Wireless stores, agent locations and other signage to the Cingular brand, \$58 related to employee retention and involuntary terminations and \$120 of other integration planning and execution costs. These costs are primarily included in “Depreciation and amortization”, “Cost of services” and “Selling, general and administrative expenses” in the consolidated statements of income.

##### *Network Integration Plan — Phase I*

In June 2005, the Company finalized a portion of its plan to integrate certain acquired network assets of AT&T Wireless. The plan primarily addressed certain TDMA network equipment in locations where the Company and AT&T Wireless had overlapping TDMA network assets and AT&T Wireless’ UMTS (Universal Mobile Telephone Service) assets. The plan included decommissioning TDMA assets (approximately 85% former AT&T Wireless assets and 15% legacy Cingular assets) and replacing former AT&T Wireless UMTS assets by the end of 2005. The valuation of these former AT&T Wireless assets was reduced by approximately \$145 and was reflected as an adjustment to the original purchase price allocated to these assets as of the acquisition date.

The Company also determined to decommission and replace certain vendor-specific Cingular network assets in three markets as part of its overall network integration efforts, resulting in a net increase of \$257 in depreciation expense for 2005.

##### *Network Integration Plan — Phase II*

In October 2005, the Company approved the second and final phase of its network integration plan. This plan complemented the activities undertaken in June 2005 to eliminate redundant network facilities that arose upon the purchase of AT&T Wireless. In connection with the second phase of the network integration plan, the Company is integrating its GSM (Global System for Mobile Communication) networks, decommissioning redundant cell sites and core network elements and swapping vendor equipment in various markets to have like equipment in each operating market. The plan is anticipated to result in decommissioning approximately 7,600 cell sites, of which approximately 5,700 were acquired from AT&T Wireless. The valuation of the former AT&T Wireless assets affected by the second phase of the network integration plan was reduced by approximately \$1,319 and is reflected as an adjustment to the original purchase price allocated to these assets. Certain legacy Cingular assets that will be decommissioned as a result of the second phase of the network rationalization plan were depreciated on an accelerated basis beginning in the fourth quarter of 2005. The incremental depreciation associated with those legacy assets amounted to \$165 for the year ended December 31, 2005. The Company expects to complete activities associated with its network integration plans by December 31, 2006.

##### *Retail Stores and Administrative Space Integration Plans*

The Company also finalized plans to integrate the retail stores and administrative space requirements for the sales/distribution and corporate real estate functions in June 2005. The valuation of former AT&T Wireless non-network assets affected by these integration plans was reduced by \$74 and was reflected as an adjustment to the original purchase price allocated to these assets as of the acquisition date. Legacy

**CINGULAR WIRELESS LLC**

PART II (Dollars in Millions)

**CINGULAR WIRELESS LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Cingular assets affected by the integration plans will be depreciated on an accelerated basis through their estimated remaining lives. The impact on depreciation expense is not material.

*Exit Costs Recorded under Integration Plans*

In addition to the revaluation of assets, the Company incurred and recorded certain costs and accruals associated with the integration plans in accordance with the requirements of EITF 95-3 and Statement of Financial Accounting Standards No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* (SFAS 146). The costs presented in the table immediately following were recorded under EITF 95-3 during 2005, to exit certain AT&T Wireless activities and resulted in adjustments to the purchase price allocation for assets acquired and liabilities assumed in the acquisition of AT&T Wireless. The majority of the costs recognized related to termination fees associated with leases and other contractual arrangements. Costs recorded under SFAS 146 as presented in the second table below are recognized in the income statement when those costs have been incurred.

The following table displays the activity and balances recorded under EITF 95-3 and are reflected in “Accrued liabilities” in the consolidated balance sheets:

**EITF 95-3 Summary**

	<u>December 31, 2004</u>	<u>Accruals</u>	<u>Payments</u>	<u>December 31, 2005</u>
Lease terminations	\$ —	\$ 293	\$ (31)	\$ 262
Severance	27	85	(97)	15
Equipment removal costs	—	194	(9)	185
Other	—	4	(1)	3
Total	<u>\$ 27</u>	<u>\$ 576</u>	<u>\$ (138)</u>	<u>\$ 465</u>

A summary of total expected costs to be incurred under SFAS 146 for the integration plans, and the amounts incurred for the year ended December 31, 2005, is presented in the table below:

**Summary of SFAS 146 Costs**

	<u>Estimate of Costs Expected to be Incurred</u>	<u>Costs incurred during 2005</u>	<u>Cumulative Costs Incurred through December 31, 2005</u>
Contract termination costs:			
Lease terminations	\$ 138	\$ 36	\$ 36
Agent terminations	10	—	—
Other contract terminations	6	—	—
Equipment removal costs	126	15	15
Other	4	3	3
Total	<u>\$ 284</u>	<u>\$ 54</u>	<u>\$ 54</u>

Costs recorded under SFAS 146 were classified in “Cost of services” and “Selling, general and administrative” in the consolidated statements of income.



**CINGULAR WIRELESS LLC**

PART II (Dollars in Millions)

**CINGULAR WIRELESS LLC  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)***Employee Termination Costs*

In connection with the integration of AT&T Wireless, the Company recognized \$42 of termination costs in the year ended December 31, 2005, for approximately 2,400 Cingular employees who were identified to be terminated during 2005 and 2006. Approximately 1,900 of these employees left their positions by December 31, 2005. Employee termination benefits to be paid to former Cingular employees are recorded in accordance with SFAS No. 112, *Employers' Accounting for Postemployment Benefits* (SFAS 112). Additional liabilities for termination benefits to be provided to former Cingular employees will be recognized when such costs are probable and estimable.

Additionally, employee termination benefits of \$35 and \$85, including involuntary severance and related benefits, were recorded in the years ended December 31, 2004 and 2005, respectively, for approximately 2,200 former AT&T Wireless employees. These costs were recognized under EITF 95-3 as liabilities assumed in the purchase business combination, which increased goodwill and did not affect net income, and are reflected in the EITF 95-3 Summary table above. As of December 31, 2005, approximately 1,800 of the identified employees had left their positions.

The following table displays the SFAS 112 and SFAS 146 activity and balances of the restructuring liabilities associated with the integration plans which are reflected in accrued liabilities on the consolidated balance sheet:

	<u>SFAS 112</u>	<u>SFAS 146</u>
Balance at December 31, 2004	\$ 4	\$ —
Additions	42	54
Payments	(35) <sup>(1)</sup>	(17)
Balance at December 31, 2005	<u>\$ 11</u>	<u>\$ 37</u>

<sup>(1)</sup> Includes cash payments and adjustments for changes in employment status.

*Hurricane Costs*

In August and September 2005, hurricanes Katrina and Rita caused significant damage to coastal areas served by the Company in Louisiana, Mississippi, Alabama and Texas. The Company consequently experienced disruptions to its service and operations, and incurred losses to its network equipment, retail locations and other property. The extent of these asset losses caused by the storms, and costs incurred for service restoration efforts, totaled \$116. In addition, the Company recorded \$32 in revenue losses related to subscribers residing in geographic areas affected by hurricane Katrina.

**13. Income Taxes**

The Company is not a taxable entity for federal income tax purposes. Federal taxable income or loss is included in the respective member's federal income tax return. The majority of states follow this treatment. Certain states, however, impose taxes at the Company level and such taxes are the responsibility of the Company and are included in the Company's income tax provision (benefit). The consolidated financial statements also include income tax provisions (benefits) for federal and state income taxes for all corporate subsidiaries of the Company.



**CINGULAR WIRELESS LLC**

PART II (Dollars in Millions)

**CINGULAR WIRELESS LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Following the Company's acquisition of AT&T Wireless and related restructuring, AT&T Wireless became a direct wholly-owned subsidiary of the Company. The Company and AT&T Wireless transferred significant portions of their respective assets and liabilities to CW II. Earnings or losses from CW II flow to its owners in accordance with their respective ownership interests. The structure retains AT&T Wireless as a tax-paying corporation that is a 43% owner of CW II. The Company owns the remaining 57% of CW II. The Company and CW II are generally both considered partnerships for federal and state income tax purposes. For partnerships, income tax items generally flow through to their partners and are taxed at the partner level pursuant to federal and state income tax laws.

Deferred income taxes are recorded using enacted tax law and rates for the years in which the taxes are expected to be paid or refunds received. Deferred income taxes are provided for items when there is a temporary difference in recording such items for financial reporting and income tax reporting. A majority of these deferred taxes were recorded through the required application of the purchase method of accounting for the Company's acquisition of AT&T Wireless. As part of purchase accounting, the assets and liabilities acquired were recorded by the Company at fair value. The difference between the fair values recorded for these acquired assets (other than goodwill) and liabilities and the tax basis of those assets and liabilities generated the related deferred income taxes that have been recorded in the Company's financial statements. Additionally, the Company assumed significant tax net operating losses (NOLs) with its acquisition of AT&T Wireless.

The provision (benefit) for income taxes consists of the following:

	<b>Year Ended December 31,</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
<b>Current:</b>			
Federal	\$ 26	\$ 14	\$ 73
State and local	3	2	35
Total current	29	16	108
<b>Deferred:</b>			
Federal	(3)	(67)	72
State and local	2	(7)	18
Total deferred	(1)	(74)	90
<b>Provision (benefit) for income taxes</b>	<b>\$ 28</b>	<b>\$ (58)</b>	<b>\$ 198</b>

**CINGULAR WIRELESS LLC**

PART II (Dollars in Millions)

**CINGULAR WIRELESS LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

A reconciliation of the income tax provision (benefit) computed at the statutory tax rate to the Company's effective tax rate is as follows:

	Year Ended December 31,		
	2003	2004	2005
Income tax provision at federal statutory rate of 35%	\$ 352	\$ 50	\$ 186
State income taxes, net of federal U.S. tax benefit	40	6	19
LLC income not subject to federal or state income taxes	(364)	(114)	(17)
State law changes, net	—	—	29
Reversal of valuation allowance	—	—	(13)
Other	—	—	(6)
Provision (benefit) for income taxes	\$ 28	\$ (58)	\$ 198

The significant components of the Company's deferred tax assets and liabilities are as follows:

	December 31,	
	2004	2005
Current deferred tax assets:		
Net operating loss carryforwards	\$ —	\$ 753
Other	2	14
Total current deferred tax assets	2	767
Noncurrent deferred tax assets:		
Net operating loss/credit carryforwards	3,078	2,246
Valuation allowances	(147)	(131)
Total net noncurrent deferred tax assets	2,931	2,115
Noncurrent deferred tax liabilities:		
Investment in Cingular Wireless II	6,655	4,962
FCC licenses and goodwill	216	201
Investments in and advances to unconsolidated subsidiaries	41	—
Other	16	38
Total noncurrent deferred tax liabilities	6,928	5,201
Total noncurrent net deferred tax liabilities	\$ 3,997	\$ 3,086

The Company, through AT&T Wireless, has federal and state NOL carryforwards of approximately \$6,979 and \$9,858, respectively, which expire at various dates principally from December 31, 2007 through December 31, 2024. The Company also has federal tax credit carryforwards of \$42 which expire between 2007 and 2024. Internal Revenue Code Section 382 places certain limitations on the annual amount of NOL carryforwards that can be utilized if certain changes to a company's ownership occur. The Company believes its purchase of AT&T Wireless was a change in ownership pursuant to Section 382 of the Code, and the NOL carryforwards of AT&T Wireless are limited but more likely than not will be used in future periods. As of December 31, 2005, the Company has valuation allowances of \$119 for NOLs and \$12 for tax credits which were more likely than not to expire unused. The majority of the Company's deferred tax

## CINGULAR WIRELESS LLC

PART II (Dollars in Millions)

### CINGULAR WIRELESS LLC

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

asset valuation allowance would be applied to reduce goodwill in the event that the tax benefits for the items are recognized.

On December 21, 2004, the FASB issued FSP FAS 109-2, *Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004* (the Act), to provide accounting and disclosure guidance for the repatriation provision of the Act. The Act created a temporary incentive for U.S. corporations to repatriate accumulated income earned abroad by providing an 85 percent dividends received deduction for certain dividends from controlled foreign corporations. Such repatriations must occur in either an enterprise's last tax year that began before the enactment date, or the first tax year that begins during the one-year period beginning on the date of enactment. The Company and the Board of Directors approved a plan to repatriate approximately \$310 in previously unremitted foreign earnings under the Act, which were remitted in the third quarter of 2005. Amounts to be repatriated under the Act do not have an effect on the Company's income tax expense. Changes in deferred taxes related to the Act directly resulted in adjustments to the purchase price allocations that were recorded in connection with the Company's acquisition of AT&T Wireless.

At December 31, 2004 and 2005, the Company's recorded net assets at entities that are not taxpayers exceed their tax bases by approximately \$14,000 and \$14,900, respectively. The Company does not record deferred taxes for their differences due to its structure. For the year ended December 31, 2004 and 2005, this basis difference principally relates to the Company's investment in CW II. Cash paid for income taxes for the years ended December 31, 2003, 2004 and 2005 was \$23, \$22 and \$138, respectively.

The Company's income tax returns are regularly audited and reviewed by the Internal Revenue Service (IRS) and state taxing authorities. During the fourth quarter of 2005, the IRS completed field examinations for tax years 1997 through 2003 for the legacy AT&T Wireless operations. During 1997 through July 9, 2001 (the effective date of its split off from Old AT&T), AT&T Wireless was included in the consolidated federal income tax return of Old AT&T. After the spin-off, AT&T Wireless filed as a separate taxpayer. The IRS has issued assessments challenging the timing and amounts of various deductions for both the January 1, 1997 through July 9, 2001 and the July 10, 2001 through December 31, 2003 periods. The proposed assessment for these years is currently under review by the Congressional Joint Committee on Taxation (JCT). The Company expects completion of the JCT review and final resolution of these audits during 2006. Since the audit periods predate the Company's acquisition of AT&T Wireless, any adjustments that result from the assessment will increase or decrease goodwill pursuant to the rules of purchase accounting.

#### 14. Employee Benefits

##### *Pensions and Post-Retirement Benefits*

As of December 31, 2005, approximately 41,000 of the Company's employees are covered by one of two noncontributory qualified pension plans. Participation in the Company's plans commenced November 1, 2001, following the initial contribution of employees and related obligations and liabilities by AT&T and BellSouth to the Company. In connection with this contribution, AT&T and BellSouth transferred pension assets from their qualified trusts to the trusts established for the Company's pension plans. Approximately 24,000 current employees of the Company who were formerly employed by AT&T Wireless became eligible to participate in the pension plans on January 1, 2006.

Nonbargained employees commencing service on or before December 31, 2005, and some bargained employees, participate in a cash balance plan, under which they can elect to receive their pensions in a

**CINGULAR WIRELESS LLC**

PART II (Dollars in Millions)

**CINGULAR WIRELESS LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

lump sum. The pension benefit formula for many bargained employees is based on a flat dollar amount per year of service according to job classification, and these benefits are typically paid as an annuity. Nonbargained employees commencing service on or after January 1, 2006 do not participate in any defined benefit pension plan.

The projected benefit obligation of the Company's pension plans is the actuarial present value of all benefits attributed by the pension benefit formula to previously rendered employee service. It is measured based on assumptions concerning future interest rates, employee compensation levels, retirement date and mortality. Actual experience may differ from the actuarial assumptions, and the benefit obligation will be affected. The Company uses a December 31 measurement date for its plans.

For a closed group of nonbargained and bargained transitional employees, the Company provides certain retiree medical, dental and life insurance benefits under various plans and accrues actuarially determined post-retirement benefit costs as active employees earn these benefits. These post-retirement plans are not funded. Other nonbargained employees and their covered dependents who meet certain eligibility requirements are provided access to post-retirement medical and dental benefits at no cost to the Company. Current employees formerly employed by AT&T Wireless who meet certain eligibility requirements are eligible only for access to post-retirement medical and dental benefits at no cost to the Company.

In accordance with FASB Staff Position No. FAS 106-2, *Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003*, the obligation under the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (Medicare Modernization Act) has been reflected effective January 1, 2004. Due to expected future receipt of subsidies available under the Act for plans that are determined to be actuarially equivalent, the plans' combined accumulated postretirement benefit obligation was reduced by approximately \$8 and \$10 as of the beginning of 2004 and 2005, respectively, and the 2004 and 2005 net periodic benefit cost were each reduced by approximately \$2.

*Obligations and Funded Status*

The funded status of the pension plan and post-retirement benefit plan and amounts recognized in the consolidated balance sheets at December 31, 2004 and 2005 are as follows:

	Pension December 31,		Post- Retirement December 31,	
	2004	2005	2004	2005
Change in Benefit Obligation:				
Benefit obligation at beginning of year	\$ 456	\$ 536	\$ 114	\$ 117
Service cost	65	71	10	11
Interest cost	26	30	6	7
Amendments	2	—	(12)	—
Impact of Medicare Modernization Act	—	—	(8)	—
Actuarial loss (gain)	18	(12)	7	22
Benefits paid	(31)	(47)	—	—
Benefit obligation at end of year	<u>\$ 536</u>	<u>\$ 578</u>	<u>\$ 117</u>	<u>\$ 157</u>

**CINGULAR WIRELESS LLC**
**PART II** (Dollars in Millions)

**CINGULAR WIRELESS LLC**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

	Pension December 31,		Post- Retirement December 31,	
	2004	2005	2004	2005
Change in Plan Assets:				
Fair value of plan assets at beginning of year	\$ 510	\$ 526	\$ —	\$ —
Actual return on plan assets	47	37	—	—
Employer contribution	—	—	—	—
Benefits paid	(31)	(47)	—	—
Fair value of plan assets at end of year	\$ 526	\$ 516	\$ —	\$ —

	Pension December 31,		Post- Retirement December 31,	
	2004	2005	2004	2005
Funded status	\$ (10)	\$ (62)	\$ (117)	\$ (157)
Unrecognized prior service cost	14	11	(7)	(6)
Unrecognized net actuarial loss	12	3	29	50
Prepaid (accrued) pension cost and post-retirement benefit obligation	\$ 16	\$ (48)	\$ (95)	\$ (113)

The accumulated benefit obligation for the pension plans was \$511 and \$554 at December 31, 2004 and 2005, respectively. As of December 31, 2005, the bargained pension plan had an accumulated benefit obligation that exceeded the fair value of plan assets, and an additional minimum liability of \$10 was recorded in accordance with the provisions of SFAS No. 87, “Employers’ Accounting for Pensions”. Additional information for this plan is as follows:

	December 31,	
	2004	2005
Projected benefit obligation	\$ 26	\$ 38
Accumulated benefit obligation	22	32
Fair value of plan assets	17	15
Increase in minimum liability included in other comprehensive income	4	5

**CINGULAR WIRELESS LLC**

**PART II** (Dollars in Millions)

**CINGULAR WIRELESS LLC**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

*Components of Net Periodic Pension Cost*

Net pension expense and post-retirement benefit expense recognized is comprised of the following:

	<b>Pension</b>			<b>Post-Retirement</b>		
	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Service cost	\$ 61	\$ 65	\$ 71	\$ 9	\$ 10	\$ 11
Interest cost	24	26	30	6	6	7
Expected return on plan assets	(36)	(38)	(41)	—	—	—
Amortization of prior service cost	3	3	3	1	1	(1)
Recognized actuarial loss	—	—	1	1	1	1
Net expense	<u>\$ 52</u>	<u>\$ 56</u>	<u>\$ 64</u>	<u>\$ 17</u>	<u>\$ 18</u>	<u>\$ 18</u>

*Assumptions*

Significant weighted-average assumptions used in developing pension and post-retirement benefit obligations at December 31 include:

	<b>Pension</b>		<b>Post-Retirement</b>	
	<u>2004</u>	<u>2005</u>	<u>2004</u>	<u>2005</u>
Discount rate	5.75%	5.50%	5.75%	5.50%
Composite rate of compensation increase	6.00%	5.00%	6.00%	5.00%

Significant weighted-average assumptions used to determine net periodic pension and post-retirement cost for the years ended December 31 include:

	<b>Pension 2003</b>			<b>Post-Retirement</b>		
	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Discount rate	6.75%	6.25%	5.75%	6.75%	6.25%	5.75%
Expected long-term return on plan assets	8.50%	8.50%	8.50%	—	—	—
Composite rate of compensation increase	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%

Discount rates are selected considering yields available on high-quality debt instruments at the measurement date. At December 31, 2005, in addition to reviewing standard bond market indices, we specifically considered the timing and amounts of expected future benefit payments and compared that with a yield curve developed to reflect yields available on high-quality bonds. The discount rate selected as of December 31, 2005 reflects the results of this yield curve analysis, with appropriate consideration given to plan demographics and benefit design, as well as comparisons to other published indices of long-maturity corporate bond rates.

The expected long-term rate of return on assets was derived using data from investment managers and 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. The Company considers many factors, which include 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.

**CINGULAR WIRELESS LLC**

**PART II** (Dollars in Millions)

**CINGULAR WIRELESS LLC**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Assumed health care cost trend rates at December 31 are as follows:

	<u>2004</u>		<u>2005</u>	
	<u>Pre- Age 65</u>	<u>Post- Age 65</u>	<u>Pre- Age 65</u>	<u>Post- Age 65</u>
Health care cost trend rate assumed for next year	9.25%	10.00%	9.25%	10.00%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.00%	5.00%	5.00%	5.00%
Year the rate reaches the ultimate trend rate	2011	2011	2012	2012

The assumed dental cost trend rate is 5.0% in 2005 and future years. A one percentage-point change in the assumed health care cost trend rate would have the following effects:

	<u>One Percentage- Point Increase</u>	<u>One Percentage- Point Decrease</u>
Effect on total of service and interest cost components	\$ 5	\$ (4)
Effect on post-retirement benefit obligation	23	(18)

*Plan Assets*

The Company's pension plans asset allocations at December 31, by asset category are as follows:

	<u>Plan Assets at December 31,</u>	
	<u>2004</u>	<u>2005</u>
<b>Asset Category</b>		
Equity securities	62%	63%
Debt securities	28	27
Cash	—	—
Other	10	10
Total	<u>100%</u>	<u>100%</u>

The investment goal of the plans is to ensure the availability of funds for the liabilities as they become due and to meet the objectives with a prudent risk profile, diversification and diligent management in accordance with applicable statutory and regulatory constraints. Target allocations for the pension plans are 35% large cap equity (range of 30 — 40%), 10% small/mid cap equity (range of 5 — 15%), 15% international equity (range of 10 — 20%), 30% domestic fixed income (range of 25 — 30%), 10% alternative investments (range 5 — 15%) and 0% cash (0 — 2%) range. The alternative investment allocation is comprised of absolute return strategies. Absolute return strategies are designed to return cash plus a premium regardless of market direction and are included in the portfolio for diversification purposes. Prohibited investments are outlined in each individual manager's agreement, and derivatives are allowed if in compliance with the Company's internal derivative policy. Derivatives may be used as a substitute for physical investing or to manage duration and currency risk. Performance is reviewed on a monthly basis.

**CINGULAR WIRELESS LLC**

PART II (Dollars in Millions)

**CINGULAR WIRELESS LLC**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)***Contributions*

The Company estimates it will have a minimum funding requirement of \$10 for its bargained pension plan in 2006. No contributions are expected for the nonbargained pension plan or post-retirement benefit plans in 2006.

*Estimated Future Benefit Payments*

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid. Post-retirement benefit payments shown reflect estimated payment amounts, without the Medicare subsidy. The Medicare subsidy for all years shown below totals less than \$2 in aggregate.

	<u>Pension Benefits</u>	<u>Post- retirement Benefits</u>
2006	\$ 47	\$ 1
2007	43	2
2008	46	2
2009	47	3
2010	52	4
2011-2015	294	30

*Defined Contribution Plans*

The Company maintains several contributory savings plans that cover substantially all employees. Contributions made by the Company and the related costs are determined as a percentage of covered employees' eligible contributions to the plans and totaled \$46 in 2003, \$46 in 2004 and \$48 in 2005.

Current employees who were formerly employed by AT&T Wireless participated in a legacy savings plan until December 31, 2005, at which time that plan was merged into the Company's existing savings plan. The plan matched a percentage of employee contributions up to certain limits and provided for a fixed percentage contribution and a discretionary profit sharing contribution. A final fixed percentage contribution and discretionary profit sharing contribution will be made in 2006 for the 2005 plan year for certain eligible employees formerly employed by AT&T Wireless. Contributions under the plan totaled \$13 from the acquisition date of October 26, 2004 through December 31, 2004, and \$79 for the year ended December 31, 2005.

*Supplemental Retirement Plans*

The Company also assumed the liabilities related to nonqualified, unfunded supplemental retirement plans for senior managers previously employed by AT&T affiliates that were contributed to the Company. Expenses related to these plans were less than \$2 in each year presented. Liabilities of \$8 and \$10 related to these plans, which include an additional minimum pension liability of \$3 and \$4, have been included in "Other noncurrent liabilities" in the consolidated balance sheets at December 31, 2004 and 2005, respectively. The consolidated balance sheets also include \$1 in "Other intangible assets, net" at December 31, 2004 and 2005 related to these plans.



**CINGULAR WIRELESS LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)*****Deferred Compensation Plan***

The Company provides certain management employees with a nonqualified, unfunded deferred compensation plan. The plan allows eligible participants to defer some of their compensation on a pre-tax basis and receive pre-determined market-based interest rates of return. In addition, the plan provides for a stated matching contribution by the Company based on a percentage of the compensation deferred. Deferred compensation expenses for all years presented was not significant. Certain management employees who previously were employees of AT&T Wireless are participants in a nonqualified, unfunded deferred compensation plan, which allows participants to defer a portion of their compensation on a pre-tax basis, with earnings calculated based on valuation funds selected by the participants. In addition, the plan provides for contributions by the Company to participants whose matching and profit sharing contributions to the qualified 401(k) plan were capped by operation of the limitations imposed by tax laws. The liability of the deferred compensation plans totaled \$81 as of December 31, 2005, of which \$14 and \$67 have been recorded as "Accrued liabilities" and "Other noncurrent liabilities", respectively, in the consolidated balance sheets.

The liabilities associated with the AT&T Wireless deferred compensation plan, along with other benefit obligations, have been funded and are held in a grantor trust, subject to the claims of the Company's creditors in the event of the Company's insolvency. Upon the acquisition of AT&T Wireless by the Company, the trust became irrevocable, and the Company was required to contribute an amount to the grantor trust equal to the present value of the total amount owed to participants in the deferred compensation plan and other benefit obligations. As of December 31, 2005, the grantor trust held \$46 in assets, of which \$31 was invested in cash equivalents and short term investments. The remaining \$15 represented the cash surrender value of Company owned life insurance policies. The assets held by the grantor trust were included in "Other assets" in the consolidated balance sheets. Effective January 1, 2006, former employees of AT&T Wireless commenced participation in the Company's deferred compensation plan. After December 31, 2005, no future deferrals will be made into the AT&T Wireless deferred compensation plan.

***Long-Term Compensation Plan***

The Cingular Wireless Long-Term Compensation Plan, as amended (the Plan), provides for incentive compensation to eligible participants over periods that are two years or longer in the form of performance units, stock appreciation units, restricted stock units and performance stock units. Awards granted in any particular year may be comprised of any combination of award type provided for under the Plan, as approved by the plan administrator. All awards are ultimately settled in cash. Grants are made in April of the award year.

Performance units granted prior to 2005 are tied to the achievement of specified financial objectives over a three-year performance period. The units have a stated value of \$50 (whole dollars). Performance units granted at inception of a three-year performance period are payable in the first quarter following the performance period, with payouts ranging from 0% to 200% of the stated value of the performance units for years prior to 2004 and 0% to 150% for 2004 grants. The number of performance units granted under the Plan total approximately 540,000 units in 2003 and 732,000 units in 2004. As of December 31, 2005, the Company has approximately 1.1 million outstanding performance units issued prior to 2005. Expense is accrued ratably throughout the performance period based upon management's estimate of the compensation that will ultimately be earned under the Plan. As performance is monitored against the financial objectives that have been established throughout the respective three-year performance periods,

## CINGULAR WIRELESS LLC

PART II (*Dollars in Millions*)

### CINGULAR WIRELESS LLC

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

management may revise its estimate of the compensation that will ultimately be earned under the Plan and adjust its accrual accordingly. For the year ended December 31, 2005, 822,000 performance units that were granted in connection with the 2002-2004 performance period were paid in the amount of \$16.

Stock appreciation units granted under the Plan, which approximate 3.3 million in total, are indexed to an underlying share of BellSouth or AT&T common stock. Each stock appreciation unit has a grant price equal to the closing price of BellSouth or AT&T common stock, as the case may be, based on the closing New York Stock Exchange price on the grant date. Stock appreciation units were granted to eligible employees on April 1, 2003, 50% of which vest two years after the grant date and the remaining 50% of which vest three years following the grant date. Exercised units are paid out based on the appreciation of the stock price underlying the units to the exercise date. As of December 31, 2005, the Company had approximately 2.5 million outstanding stock appreciation units. The units expire 10 years from the grant date. Compensation cost is recognized over the period such units remain outstanding based upon the change in the fair value of the stock appreciation units at the end of each reporting period.

Restricted stock units granted under the Plan are indexed to an underlying share of BellSouth or AT&T common stock. The value of the restricted stock units granted in 2004 and 2005 will be paid in cash to holders in March 2007 and March 2008, respectively, based on the average of the closing stock prices of BellSouth and AT&T common stock for the last ten trading days of February 2007 and February 2008. Dividend equivalents will be paid annually at the same rate as the dividend received by all BellSouth and AT&T shareholders, respectively. The number of BellSouth restricted stock units and AT&T restricted stock units granted in 2004 totaled 339,000 and 378,000, respectively, with an aggregate value on the grant date of approximately \$19. During the year ended December 31, 2005, the Company granted approximately 730,000 BellSouth restricted stock units and 797,000 AT&T restricted stock units with an aggregate value on the grant date of approximately \$37. As of December 31, 2005, the Company had approximately 2.1 million outstanding restricted stock units. The value of the restricted stock units, adjusted for changes in the value of the underlying BellSouth and AT&T common stock as the case may be, is recognized as compensation expense over the respective three-year vesting periods.

Performance stock units granted in 2005 under the Plan, which approximate 4.4 million in total, are indexed to an underlying share of BellSouth or AT&T common stock, based on the closing New York Stock Exchange price of each stock for the 10 trading days preceding the grant date. The value of the units is also based upon the Company's performance relative to pre-established performance objectives over the performance period. For the 2005 grant, the performance objectives are based upon return on capital objectives. Performance stock units were granted to eligible employees on April 1, 2005, and vest and become payable on March 1, 2008, with the final payment based upon the average closing stock prices for the last 10 trading days in February 2008 applied to a payout percentage ranging from between 0% to 150% as determined by the Company's performance against the objectives. Dividend equivalents will be paid annually on each performance stock unit at the same rate as the dividend received by all BellSouth and AT&T shareholders, respectively. A portion of the 2005 grants of BellSouth and AT&T performance stock units is tied to the Company's achievement of a ranking of first or second in several critical industry measures by the end of 2007. The number of performance units paid at the end of the performance period will range from 0% to 150% based upon attainment of those predetermined objectives, with the value of each unit based upon the average closing stock prices for the last 10 trading days of February 2008. Dividend equivalents on these units will be paid at the end of the performance period based on the same payout percentage that applies to the performance stock units. As of December 31, 2005, the Company had approximately 3.8 million outstanding 2005 performance stock units. Compensation cost is recognized

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over the period such units remain outstanding based upon the change in the fair value of the stock appreciation units at the end of each reporting period.

For the years ended December 31, 2004 and 2005, the Company recognized compensation expense of \$26 and \$68, respectively, associated with the Plan. Former AT&T Wireless employees who remain in the employment of the Company and meet certain eligibility requirements were eligible to participate in the Plan beginning in 2005.

**15. Commitments and Contingencies*****Leases***

The Company enters into capital leases primarily for the use of communications towers. Capital lease obligations are included in Note 8.

The Company also enters into operating leases for facilities and equipment used in operations. These leases typically include renewal options and escalation clauses. In general, ground and collocation leases have five or ten year initial terms with three to five renewal terms of five years each. Rental expense under operating leases for the years ended December 31, 2003, 2004 and 2005 was \$512, \$699 and \$1,646, respectively.

The following table summarizes the approximate future minimum rentals under noncancelable operating leases, including renewals that are reasonably assured, in effect at December 31, 2005:

2006	\$ 1,263
2007	1,121
2008	1,000
2009	912
2010	838
Thereafter	4,955
Total	<u>\$ 10,089</u>

***Commitments***

The Company has unconditional purchase commitments for advertising and marketing, computer equipment and services, roaming, long distance services, network equipment and related maintenance and software development and related maintenance. These commitments totaled approximately \$1,845 at December 31, 2005. Included in this amount are commitments of \$109 to AT&T, BellSouth and their affiliates for telecommunications and other services.

The Company has commitments with local exchange carriers for dedicated leased lines. The original terms of these commitments vary from month-to-month to up to five years. The Company's related commitment to its primary carriers as of December 31, 2005, was approximately \$347, with remaining payments due in succeeding fiscal years as follows: \$171 in 2006, \$108 in 2007, \$60 in 2008, and \$8 in 2009. Included in these amounts are commitments of approximately \$161 to AT&T, BellSouth and their affiliates.

The Company has commitments to Crown Castle International for monitoring and maintenance services related to its communication towers. The Company's commitment at December 31, 2005 was

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#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

approximately \$421, with payments due in succeeding fiscal years as follows: \$59 in 2006, \$61 in 2007, \$65 in 2008, \$68 in 2009 and \$23 in 2010.

In connection with the termination of the Company's GSMF network infrastructure joint venture with T-Mobile (see Note 2), the Company made a \$1,200 commitment to purchase a minimum number of minutes from T-Mobile. This commitment became effective in January 2005, and approximately \$520 of the purchase commitment remained outstanding as of December 31, 2005.

#### *Contingencies*

In a jury trial, Freedom Wireless, Inc. (Freedom) was awarded damages jointly against the Company and Boston Communications Group, Inc. (BCGI) in the aggregate amount, including prejudgment interest, of approximately \$165 for alleged past infringement of two patents allegedly owned by Freedom and used by BCGI to provide to the Company and other carriers a prepaid wireless telephone service technology platform. The court also enjoined the Company's continued use of the BCGI platform, but the U.S. Court of Appeals for the Federal Circuit issued a stay of the injunction, and the Company and BCGI are appealing the entire case. BCGI has agreed to indemnify the Company with respect to the claims asserted in this litigation and has escrowed \$41 for that purpose.

However, if BCGI were to commence a bankruptcy proceeding, which is possible, the \$41 may not be available to cover any of the Company's liability. As a result of this arrangement and based upon the Company's anticipated prospects on appeal, the Company does not believe the ultimate disposition of this case will have a material impact on its operations, cash flows or financial position beyond the \$20 accrued in its consolidated financial statements.

Several class-action lawsuits have been filed against Old AT&T asserting claims under the federal securities laws. The complaints assert claims that Old AT&T made material misstatements concerning earnings and financial condition, while omitting other material information, allegedly to maximize proceeds from the offering of AT&T Wireless Group tracking stock in April 2000 and/or to avoid paying a cash guarantee in connection with its MediaOne acquisition. The plaintiffs have demanded damages in excess of \$2,100 related to the offering of AT&T Wireless Group tracking stock. In connection with the split-off of AT&T Wireless from Old AT&T, the Separation Agreement between AT&T Wireless and Old AT&T provides for the allocation to AT&T Wireless of 70% of any liabilities arising out of these actions. Management's estimation of the potential loss from this and other preacquisition liabilities from AT&T Wireless is reflected in the purchase price allocation to AT&T Wireless' assets acquired and liabilities assumed.

The Company is subject to claims arising in the ordinary course of business involving allegations of personal injury, breach of contract, anti-competitive conduct, employment law issues, regulatory matters and other actions. To the extent that management believes that a loss arising from litigation or regulatory proceedings is probable and can reasonably be estimated, an amount is accrued on the financial statements for the estimated loss. As additional information becomes available, the potential liability related to the matter is reassessed and the accruals are revised, if necessary. While complete assurance cannot be given as to the outcome of any legal claims, the Company believes that any financial impact would not be material to its business, financial position or cash flows.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)****16. Selected Quarterly Financial Data (Unaudited)**

The table below sets forth summarized quarterly financial data for the years ended December 31, 2004 and 2005.

<u>2004</u>	<u>First Quarter</u>	<u>Second Quarter</u>	<u>Third Quarter</u>	<u>Fourth Quarter(a)</u>
Total operating revenues	\$ 3,967(b)	\$ 4,187(b)	\$ 4,292(b)	\$ 7,119(b)
Operating income (loss)	550	671	460(c)	(153)(d)
Income (loss) before provision for income taxes	221	337	142(c)	(557)(d)
Net income (loss)	215	339	142(c)	(495)(d)
<u>2005</u>	<u>First Quarter</u>	<u>Second Quarter</u>	<u>Third Quarter</u>	<u>Fourth Quarter</u>
Total operating revenues	\$ 8,229	\$ 8,609	\$ 8,746	\$ 8,849
Operating income	114(e)	504(f)	657(g)	549(h)
Income (loss) before provision for income taxes	(218)(e)	171(f)	326(g)	252(h)
Net income (loss)	(240)(e)	147(f)	222(g)	204(h)

- (a) On October 26, 2004, the Company completed its acquisition of AT&T Wireless. Operating results for AT&T Wireless have been included in the consolidated financial statements subsequent to that date.
- (b) In order to conform with the current year presentation, amounts reflect reclassifications related to the presentation of gross receipts taxes in the amount of \$25, \$32, \$35 and \$37 for first, second, third and fourth quarter, respectively. The amounts presented are greater than those previously reported. The reclassifications did not have an impact on previously reported Operating income, Income (loss) before provision for income taxes or net income (loss).
- (c) Includes a reduction of \$43 for integration planning costs and \$31 loss on the writedown of the carrying value of the Company's Mobitex business.
- (d) Includes an increase in customer list intangible amortization associated with purchase accounting adjustments (see Notes 2 and 4) and \$245 of acquisition-related and integration costs (see Note 12).
- (e) Includes a reduction of \$105 for integration planning costs.
- (f) Includes a reduction of \$204 for integration planning costs.
- (g) Includes a reduction of \$241 for integration planning costs, \$96 in hurricane related costs.
- (h) Includes a reduction of \$326 for integration planning costs, \$20 in hurricane related costs.