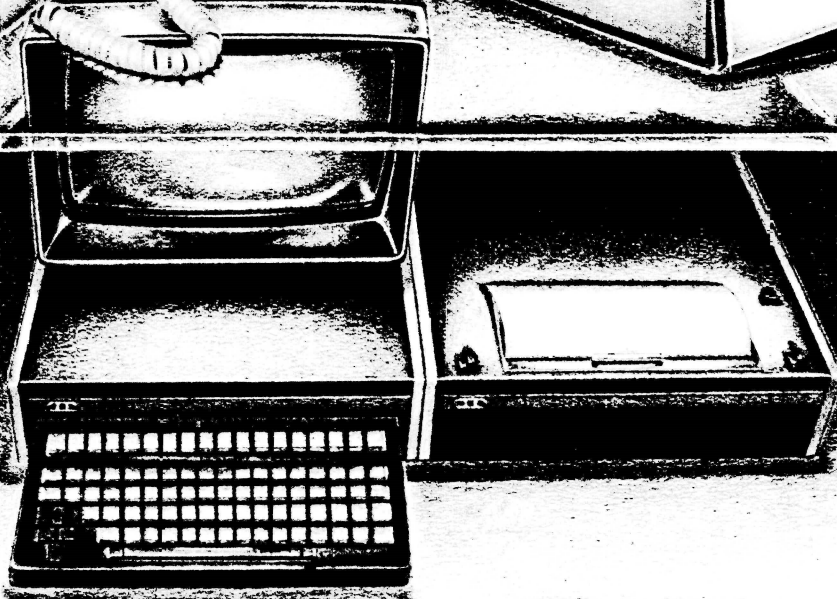
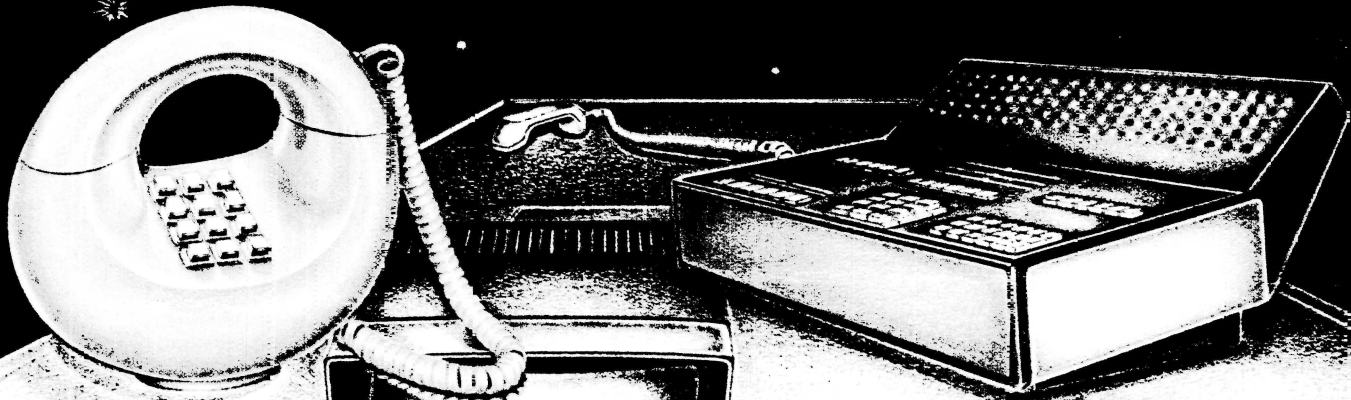
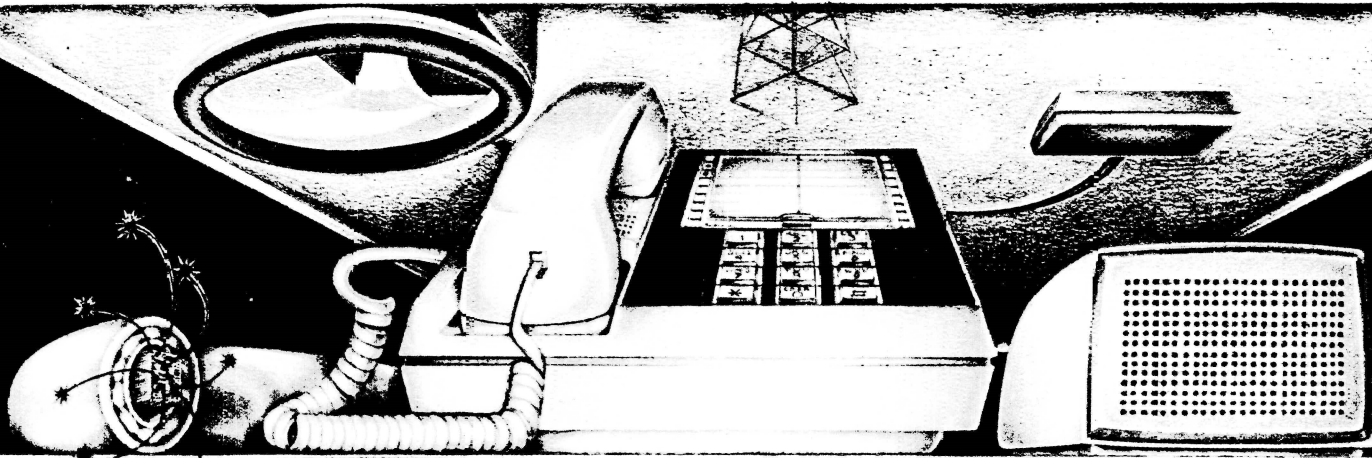
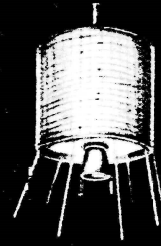
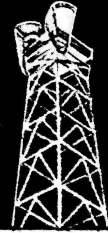
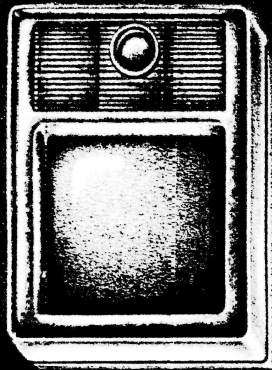




New England Telephone
1978 Annual Report

We help make things happen
through communications.



Results in Brief

	1978	1977	1976	1975	1974
Earnings per share	\$ 4.39	\$ 4.10	\$ 3.61	\$ 2.43	\$ 2.58
Based on average shares outstanding (thousands)	53,085	52,995	52,970	50,589	45,685
Dividends declared per share	\$ 2.95	\$ 2.67	\$ 2.42	\$ 2.36	\$ 2.36
Revenues	Thousands of Dollars				
Local service	\$ 995,861	\$ 928,171	\$ 848,063	\$ 716,226	\$ 670,882
Toll service	976,868	888,156	814,050	705,256	620,601
Other (including other income)	62,178	54,849	47,987	46,061	45,647
	<u>2,034,907</u>	<u>1,871,176</u>	<u>1,710,100</u>	<u>1,467,543</u>	<u>1,337,130</u>
Expenses					
Operating	1,310,311	1,183,089	1,083,745	996,036	888,577
Income taxes on operations	194,544	187,073	162,794	94,411	88,526
Other taxes on operations	185,310	176,666	160,132	140,953	130,724
Interest	111,545	107,099	112,217	112,968	111,372
	<u>1,801,710</u>	<u>1,653,927</u>	<u>1,518,888</u>	<u>1,344,368</u>	<u>1,219,199</u>
Net Income	<u>\$ 233,197</u>	<u>\$ 217,249</u>	<u>\$ 191,212</u>	<u>\$ 123,175</u>	<u>\$ 117,931</u>
Ratio of earnings to fixed charges—pre-income tax (Securities and Exchange Commission Basis)	4.48	4.43	3.90	2.77	2.72

Stock Transfer Offices

The Company maintains stock transfer offices at 185 Franklin Street, Boston, Massachusetts, 02107; and at 180 Fulton Street, New York, New York 10007.

Annual Meeting of Share Owners

The annual share owners' meeting will be held at the Company's headquarters building, 185 Franklin Street, Boston, at 10:30 a.m. on April 17, 1979.

New England Telephone

is engaged in the business of furnishing communications services, mainly local and toll telephone service, in Maine, Massachusetts, New Hampshire, Rhode Island and Vermont. The Company is an associated company of the Bell System. The annual report for the System as a whole is issued by the American Telephone and Telegraph Company. We shall be happy to

supply copies of that report, or additional copies of the New England Telephone report, upon request to any of our business offices. A copy of the Company's annual report on Form 10-K as filed with the Securities and Exchange Commission for the year 1978 will be furnished, without charge, on request directed to the Secretary of the Company, Room 100, 185 Franklin St., Boston, Mass. 02107.



New England Telephone and Telegraph Company

185 Franklin Street, Boston, Massachusetts 02107
Telephone 617 743-9800

The Cover: The theme of our 1978 Annual Report is "We Help Make Things Happen Through Communications." The cover drawing illustrates this theme and presents some of our new products, technologies and services. Sections of the

Report describe how we help make things happen through voice, data, image, and special needs communications, and describes what the future in telecommunications holds for the New England Telephone customer.

Management's Analysis of Results in Brief

Revenues—Revenues increased \$163.7 million in 1978 and \$161 million in 1977. Local and toll service revenues have increased primarily due to more telephones in service and growth in long distance calling volume (see "Selected Operating Data") and increased revenues of \$17.9 million in 1978 and \$58.6 million in 1977 resulting from intrastate rate increases. Directory advertising increased other revenues \$9.3 million in 1978 and \$7.5 million in 1977 due to higher volume of such sales and increases in rates.

Operating Expenses—Increases in operating expenses are due to the following, in millions of dollars:

	1978 versus 1977	1977 versus 1976
Changes in—		
Wages and salaries, including cost-of-living adjustments	\$ 47.3	\$ 43.4
Provision for pensions and other employee benefits	18.2	17.6
Depreciation due to increased: Rates (See Note (b) of Notes to Financial Statements)	24.3	—
Plant Investment	14.5	11.9
License Contract payments	6.0	4.4
Material, supplies and other payments	16.9	22.0
Total operating expenses	<u>\$127.2</u>	<u>\$ 99.3</u>

Income taxes—Total income taxes on operations increased \$7.5 million in 1978 and \$24.3 million in 1977 reflecting higher income before such taxes.

Other taxes—Other taxes on operations increased \$8.6 million in 1978 and \$16.5 million in 1977. Principal reasons for such increases are as follows: State gross receipts taxes rose \$3 million in 1978 and \$3.4 million in 1977 due to increased taxable revenues. Property taxes increased \$2.8 million in 1978 and \$10.2 million in 1977 due to increased tax rates and a higher tax base. The 1978 growth in property taxes was substantially less than in 1977 reflecting smaller increases in local tax rates. Social security taxes rose \$2.7 million in 1978 and \$3.2 million in 1977 due mainly to the statutory increases in taxable wage bases and also an increase in the statutory rate in 1978.

Interest—Interest expense increased \$4.4 million in 1978 due principally to the sale of \$100 million of three year 8¾% notes in June 1978. Interest expense decreased \$5.1 million in 1977 which was primarily the result of a redemption of long term debt in February 1977. This reduction was offset, in part, by amortization of expenses associated with that redemption and interest on private placement notes sold to finance a portion of that redemption.

Selected Operating Data	1978	1977	1976	1975	1974
	Thousands				
Main telephones	3,635	3,505	3,431	3,372	3,331
Extension telephones	3,146	3,022	2,833	2,723	2,555
Total telephones	6,781	6,527	6,264	6,095	5,886
Toll messages	714,122	662,265	631,945	610,370	599,829
WATS messages	252,354	215,108	172,522	131,196	104,238

Charges for main telephones and extension telephones currently account for about 24% and 4%, respectively, of Total operating revenues. Toll messages and WATS messages currently account for about 39% and 9%, respectively, of Total operating revenues.

Market and Dividend Information

The principal market where New England Telephone and Telegraph Company common shares are traded is the New York Stock Exchange. The composite high and low sales prices and the dividends paid on these securities during the most recent two fiscal years were:

Year	1978				1977			
	1st	2nd	3rd	4th	1st	2nd	3rd	4th
High	35½	34⅞	34⅞	35⅞	36⅞	34⅞	34¾	36⅞
Low	34	32½	33	31⅞	33	32¾	31¾	31¼
Dividends Paid	\$.72	\$.72	\$.72	\$.72	\$.65	\$.65	\$.65	\$.65

REPORT OF THE PRESIDENT

I am pleased to report that 1978 was an outstanding year for New England Telephone in several ways — all of them important to our customers, share owners and employees.

Our service capabilities were strengthened through new technology and new products brought on line. In four of our five states, basic charges for telephone service remained the same — in spite of continuing escalation of our costs due to inflation — and in the fifth state our rates increased only 5 per cent.

Our financial condition continued to improve as a result of more revenues generated from sales of our services and the increased volume of long distance messages, together with tight control of our expenses. As a consequence, we were able to raise the dividend to share owners for the third year in a row.

A reorganization of operating and marketing functions increased our opportunities to manage the changes that are necessary in a new era of competition in the telecommunications industry. The reorganization will make it possible for us to serve customers better.

A few comments about each of the above developments, and then I want to tell you about some general matters affecting the business.

Service Comments

On service, survey calls to customers consistently indicate that New England Telephone service is seen by them as reliable, technically proficient and a good buy in these days of rapid inflation. But customer requirements for telecommunications are changing constantly, and what is considered excellent for today will not be good enough for tomorrow. So we must always look ahead and build ahead to keep pace. For these reasons, during 1978 we invested \$449 million to add to, or modernize our facilities to handle growth demands, or to make our



services more useful to customers.

Customer Preference

More and more we find customers prefer "hands on" operation of their communications service, to individualize it and operate it themselves whenever feasible. Programming capabilities of our newer, computer-like central offices offer many such possibilities for personalized service. Custom calling features, which provide call transfer, three-way calling and speed calling to customers served by ESS offices, are just one example. Touch-a-matic®, automatic dialing telephones, and Dimension® PBX with memory capabilities, are others. The consumer interest in minimizing costs is also served when customers dial their own long distance calls. This type of long distance call, which is the least expensive, accounted for 96 per cent of all long distance calls completed during the latter part of 1978. Making our service as responsive as possible to the personal wishes of the individual customer is the direction we are taking as we plan and build for the future.

Growth of the Business

The gain in total telephones for the year was 254,000, 3 per cent below the comparable increase for 1977. This decrease was due to a drop in extension telephone sales. Orders for main

telephones, however, showed a very healthy gain of 130,000, or 79 per cent over the 1977 increase.

Revenues from all sources totaled slightly over \$2 billion, 9 per cent higher than 1977. Operating expenses were \$1.3 billion, up 11 per cent over the previous year. The result was that net income after taxes was \$233 million, or 7 per cent higher than for 1977.

Earnings per share grew from \$4.10 for the year 1977 to \$4.39 for 1978. As mentioned previously, the Board of Directors at the November meeting increased the quarterly dividend from 72 cents per share to 79 cents effective January 2, 1979.

Thus we are attempting to keep faith with those who have invested their savings in our business and to encourage future investors whose capital will be required to finance continued service improvements for our customers.

Reorganization

During the year this Company and other Bell System units began a major restructuring of operating and marketing departments. Two primary reasons are to better serve the diversified needs of our customers and to compete successfully in the new, competitive telecommunications markets.

When this reorganization is completed in early 1979, we will have moved from a Company that for over 95 years has been organized along functional lines (plant, traffic and commercial departments) to one organized according to the major markets we serve (business, residence, network, public coin service and directory).

In moving from a functional to a market-oriented organization, we will not in any respect de-emphasize our traditional commitment to service. In fact a principal purpose of this major restructuring is improved service to the customer; service that is responsive to the special needs of different categories of customers rather than merely a standardized service.

Competition

On another matter, Congressional examination of our national telecommunications policy continues with the end objective of enacting legislation that will resolve many of the questions that have arisen since the Federal Communications Commission decided to encourage wide-scale competition in our industry.

One of the major areas of controversy concerns the price of telecommunications service in this country. Up to now, it has been the objective of the telephone industry to hold the price of basic residence service as low as possible so that telephone service for everyone could be achieved. However, the more competition is introduced, the more our rates for toll services and for other services such as extensions, switchboards and key telephone sets must reflect market conditions. For some business services, this would mean reductions in price. The result, if this happens, is that the charge for basic residential service must be increased in order to offset the earnings lost from our competitive product line.

However the issues are finally resolved, the sooner Congress can come to a reasonable and fair decision the better it will be for all concerned. We in the Bell System are urging that this be a matter of top priority for Congressional attention in 1979.

Social Support

Coming now to a matter that I would like to discuss that can best be stated as a question: What, if anything, is New England Telephone's responsibility to the public, besides supplying the best possible telecommunications service at the lowest feasible rates and providing an adequate return to the owners of the business?

Our view is that the Company's responsibility does not end with these achievements. We have, as a corporation, taken a position that we have a responsibility to support cultural, educational, health, and civic organizations and programs that enable all citizens to enjoy an improving

quality of life.

We encourage our employees to work on various activities to help meet the needs of the communities in which they live and work. Such activities range from serving on town councils or school boards to helping train the unskilled, serving as volunteers with the United Way or Red Cross and working with the handicapped. The Company, for its part, supports minority enterprises, and a program to encourage minority youth to become engineers, and the Company is in partnership with a Boston high school, offering its experience in a number of programs for students. We also lend executives to serve on local, state and federal task forces studying ways to improve the administrative efficiency of government. All these efforts, we believe, are ways that we in business can lend our experience to solving some of society's problems. We do not believe any company should take the position that "these are not its problems; let someone else solve them."

Another measure of our response to societal obligations is our provision of opportunities for minorities and women within our own business. We continue to carry out programs that offer equal opportunity for all to be hired, trained and earn advancement in careers with New England Telephone.

Still another way that we are trying to be responsive to our social responsibility is through our continuing efforts to conserve our use of energy. We have had for four years a vigorous energy conservation program. As a result, in 1978 we used about 18 per cent less energy than we did at the time of the oil embargo even though we are handling 47 per cent more business.

Consumer Concerns

Finally, I want to mention the recent steps we have taken to listen more closely to the comments of customers and consumer organizations regarding telephone service and the way we deliver that service. We have

established an officer-level consumer affairs committee to consider any procedure or operating method affecting customers, and where customer irritation or misinformation exists, to take action that ensures a reasonable response on our part from the customer's point of view. These same Company officers plan to hold a series of meetings during 1979 with a panel of representatives from consumer organizations to discuss consumer concerns and views of our business.

The Human Factor

I want to conclude my report by stressing the importance of the human effort that conceives, manufactures and operates modern telecommunications facilities, for in the end, our business depends on its people most of all. In 1978 the challenges they faced from demands for ever-higher service quality and efficiency, from a basic reorganization of our operating and marketing functions, and from competition were sizeable. The response of our employees was outstanding, and I want to take special notice of their accomplishments here. Particularly do I want to mention the superb way in which Telephone men and women maintained service during the devastating blizzard of February, 1978. Telephone lines literally became lifelines, and calling volumes rose 80 per cent higher than Christmas and Mother's Day records.

The future progress and continued success of the Company depend very much upon the determination of employees to do the best job possible, individually, and as a team member, in every undertaking. And whatever tomorrow's challenges or new directions, I have full faith in the abilities and the personal commitments of New England Telephone men and women to the tasks ahead.



W. C. Mercer
President

February 20, 1979

We Help Make Things Happen— THROUGH VOICE COMMUNICATIONS

The human voice, traveling successfully over a pair of wires, started our communications industry more than 100 years ago.

Today, the human voice is transmitted not only by wires and cables, but through the air from microwave tower to tower, via satellites in space and even over a tiny beam of pure light.

Thus the power of

the human voice is magnified in the distances it can be projected, and in its power to get things done in a modern world.

Although the transmission of numerical and other information has grown rapidly in recent years, conversations between people still produce more than 95 per cent of the revenues generated from the use of our services.

As the costs of transportation, postal services and labor have increased over the years, the relative costs of telephone calling have remained low. For this reason, many businesses are using our services in ever-increasing amounts—for example, to set up conference calls instead of holding meetings in one location, to contact customers by phone in-

stead of making time-consuming visits, and to conduct on-the-spot general business matters instead of writing letters.

Additionally, on the personal side, customers more and more find the relative cost of a long distance call, and its technological excellence, make it indeed "the next best thing to being there." No longer is a personal long distance



For this New England college coed, long distance is indeed "the next best thing to being there" as she keeps in touch with her family in Pennsylvania. Although data and image transmission have grown rapidly in recent years, conversation between people still produces most of our long distance revenue.



Geppeto's Toy Shop in Boston's historic Quincy Market has only a single telephone line, but subscribes to "call waiting" Custom Calling service that allows Geppeto's to answer a second incoming call by putting the first party on hold, thereby gaining the advantages of a second telephone line without the full costs.



Needham, Massachusetts police officers process a call received on the emergency report service or "911" line. There were "911" systems in 59 locations in the New England Telephone operating area at the end of 1978.

call used by most customers only in an emergency. It is a common, everyday means of communications for all.

In a real sense the modern telephone has become an extension of the user, helping to:

- cope with the complexity of modern life and the voluminous details of living,
- save time, an in-

creasingly vital asset,

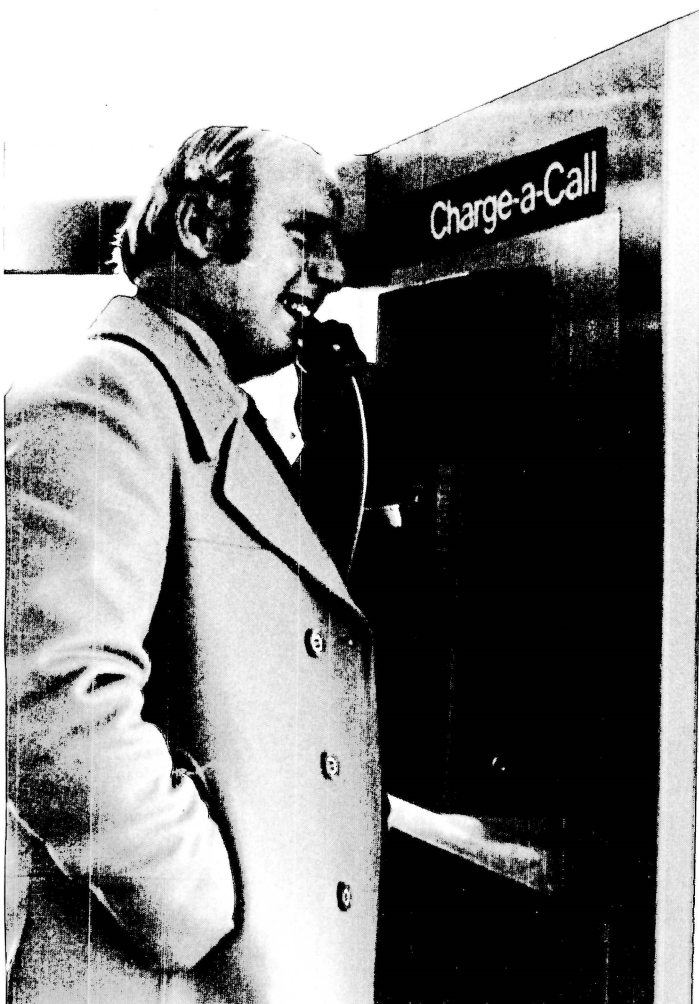
- secure or transmit necessary information,
- increase understanding, and
- at times, simply for enjoyment and the pleasure of conversation with someone we care about.

As the needs to communicate by voice

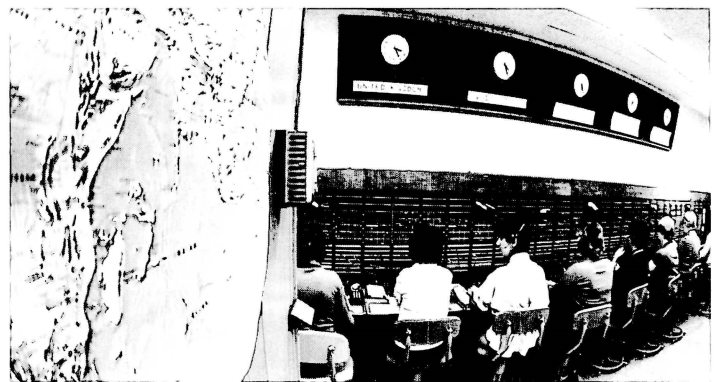
take new and different forms, we have the means through research (Bell Labs), manufacture (Western Electric Company) and operating companies (like New England Telephone) to answer the public need—putting the required resources all together in one unified system of communications service.

The following sections of our Annual Re-

port for 1978 are devoted to some of the other forms of communications that a modern New England society requires, and some of the services we supply in response to customer needs. These additional forms of communications include *data*, *image*, *special needs* of the handicapped and a look at what is coming in the *future* of communications.



Travelers at Logan Airport in Boston enjoy faster service and the convenience of dialing without coins on "Charge-a-Call" telephones. These special sets have been installed beside standard pay stations in areas with high volumes of credit card and collect calls.



About 28,000 overseas calls pass through this Raytheon Company switchboard each month, helping the company keep in touch with its expanding world-wide markets. Eight full-time operators at Raytheon's communication center in Waltham, Massachusetts, process calls for that facility, in addition to handling overseas calls for all 12 Raytheon plants in the New England Telephone operating area.



A laboratory facility in Wilmington, Massachusetts, chose the Dimension® 2000 PBX as the answer to its communication needs because it provided them with the flexibility needed to change and grow. The solid-state equipment can be programmed like a computer to perform specialized business functions.

We Help Make Things Happen— THROUGH DATA COMMUNICATIONS

Every advance in data communications opens more avenues for progress. In only two decades we have been able to increase dramatically the variety and speed of data communications services offered our customers.

Today, data accounts for an enormous

amount of the information traveling over our facilities, although it still produces but a small part of the Company's total revenues.

Significant new data products and services are being introduced at an accelerating rate, and in addition to vastly improved speeds, they offer

greater capabilities to perform customer-wanted functions and cost-saving features. Within the next two years alone, one-third of the 150 new products or features we now plan to introduce will be in the data field.

One especially exciting service for which we

are seeking Federal Communications Commission approval is called Advanced Communications Service. It could offer a nationwide data network that would allow dissimilar and diverse terminals and computers (which "speak different languages" at different speeds) to communicate with each



The Dataspeed® 40 communications terminal is used by a Rhode Island newspaper for faster, more accurate news gathering. A reporter at a bureau types the news story on a dataspeed keyboard. The story is displayed on a screen where it can be reviewed and edited before being transmitted over telephone lines to the paper's main office, where a hard copy is printed and the story is stored in a computer until used.

other.

A new family of data sets will have improved diagnostic capabilities to enable the customer to determine whether a trouble is occurring within his own system, his own terminal equipment or within our facilities, and thereby get to the source of the problem

and a remedy faster.

Higher speeds from new data products will mean lower costs for customers due to less network time used to send a given amount of information. Improved reliability will mean less "down time."

In the case of large users of communica-

tions, we are finding that data communications has become so crucial in the control of day-to-day business functions that its dependability and adequate capacity are equally as important as voice facilities for many customers.

Communications begets communications,

especially in the data field, and the more economically feasible and technically excellent we can make our data services, the more uses customers will develop for them to solve their business problems. That is our marketing approach and our service intent.



The Transaction telephone enables customers of Cheshire County Savings Bank in Keene, New Hampshire, to bank and shop in the same place. Remote Service Units, such as the one pictured here, have been placed in area stores and restaurants, and allow customers to make deposits and withdrawals from their bank account even after banking hours. The transaction is carried over the telephone network to a computer located at the bank.

An employee of a Boston data processing center monitors telephone lines which carry bank account transaction information to the company's computer from some 2,000 teller terminals at 550 banks and branches throughout New England.

By dialing a series of numbers on a Touchtone® pad, tellers at a Rhode Island savings bank can get a visual readout of computer stored account information for customers in about 20 seconds on a VuSet§ data terminal. Customers' account transactions are recorded as they take place so that the figures are always current. A VuSet terminal, located in each branch office, eliminates the expense and delay of printing and distributing computer printouts.

§Registered Trademark of Plantronics, Inc.

We Help Make Things Happen— THROUGH IMAGE COMMUNICATIONS

Much of the work we do in image or visual communications centers on moving information in the form of pictures, charts, diagrams, etc. from one point to another, from one customer's terminal to that of another.

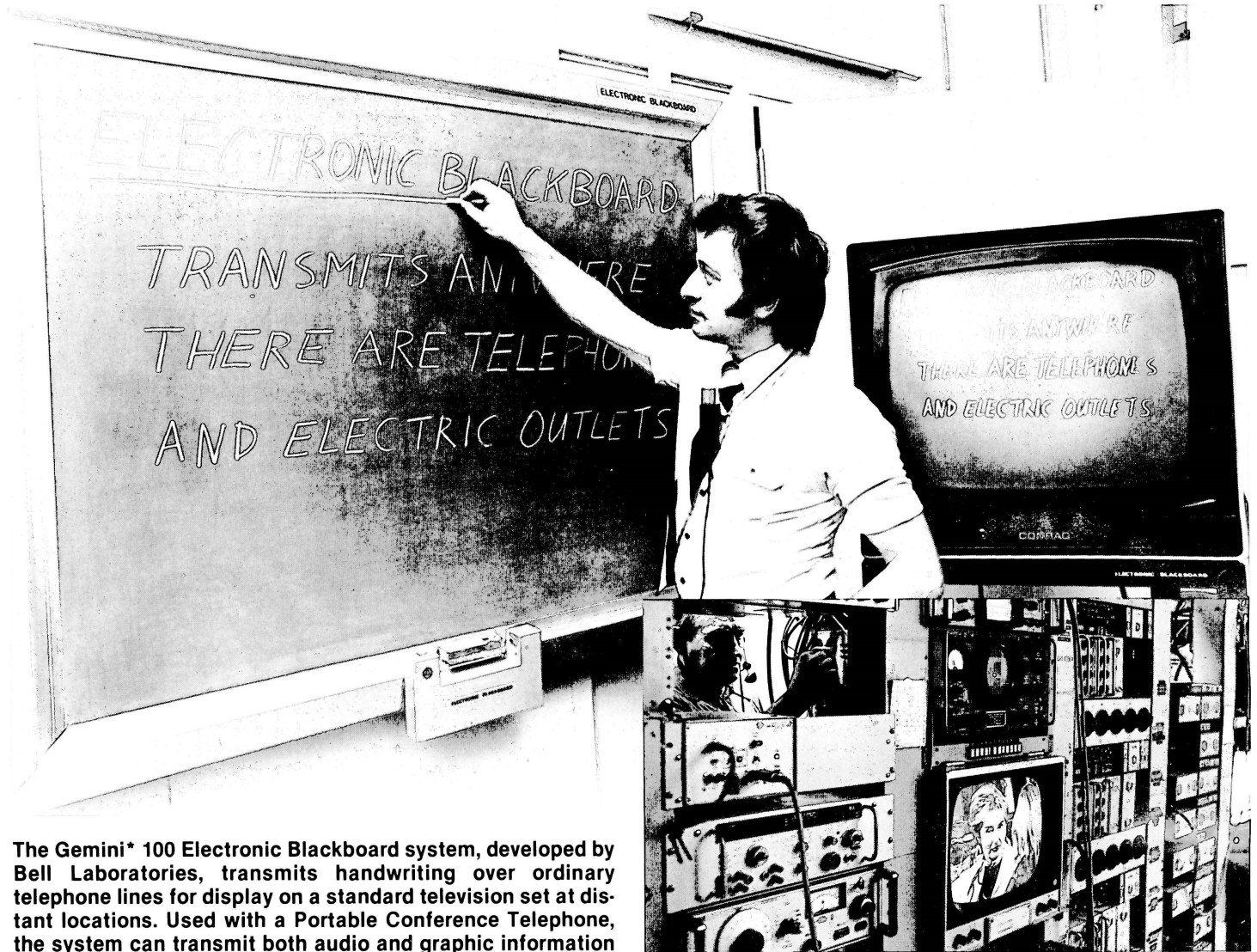
Customers send

some of their information over our high speed, private lines. But most use our regular voice-grade circuits which are available at the same rates as a standard phone call.

Over the years, the Bell System has been the primary carrier for tele-

vision networks because our own nationwide telecommunications network is in place, reliable and economically attractive. We are continuing to improve that network by installing digital, computer-aided switching and transmission systems with their cost advan-

tages and potential flexibility. Until recently in television transmission, the picture has been sent over one channel and the accompanying voice over another. Now we are able to carry both on the same channel. This of course reduces significantly the number of channels we



The Gemini* 100 Electronic Blackboard system, developed by Bell Laboratories, transmits handwriting over ordinary telephone lines for display on a standard television set at distant locations. Used with a Portable Conference Telephone, the system can transmit both audio and graphic information "live" to distant classrooms, lecture halls, conference rooms and offices.

*Trademark of AT&T Company.

The telephone company plays an important role in bringing television to viewers. Television signals are received by the microwave equipment on the roof of 185 Franklin Street, Boston, and carried by cable to this television operating center in the building. This center is the interface for AT&T Long Lines and all network video in Boston. The video signals are then transmitted to local TV stations over telephone cables. Short range video pick-up, such as transmissions from Schaefer Stadium, Boston Garden and Fenway Park are also monitored by this office.

need to install, and improves the quality of the service.

Two examples of our own products in the image communications field are the PICTUREPHONE® Meeting Service and the Gemini 100 Electronic Blackboard system.

Now being con-

structed in the Company's headquarters building in Boston is a PICTUREPHONE Meeting Center scheduled for operation in mid-1979. This telecommunications service will enable customers to save time and travel expense by holding visual conferences with

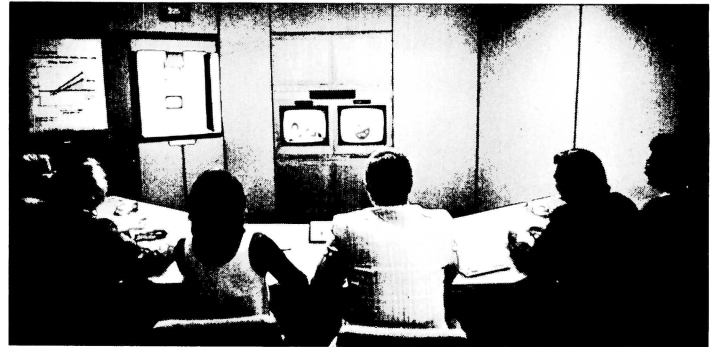
persons in similar centers in five other major cities.

The Gemini 100 has a 4 foot by 6 foot pressure-sensitive chalkboard that senses and transmits the writing made upon it. Transmission of the writing and the speaker's voice is over regular telephone circuits, local or

long distance, to a standard television set on the other end. Costs to the customer are low because only normal telephone circuits are used in transmitting the voice and written material.



An employee at an accounting firm in Boston uses facsimile for transmitting a wide variety of record information to its branch offices and customers throughout the country. Transmitted signals are carried by the telephone network from one machine to another for the price of a regular phone call.



Business associates can conduct face-to-face meetings with colleagues in other cities with the aid of PICTUREPHONE Meeting Service. This audio-visual communication system offers savings of time and money by eliminating the need for travel. There were PICTUREPHONE Meeting Center locations in five cities at the end of 1978 with several more, including Boston, to open in 1979.



A Boston hospital offers a service to patients who have a pacemaker device implanted in their hearts — *surveillance by telephone*. Impulses from a small, hand-held appliance are transmitted over regular telephone lines to this machine at the hospital which produces a printout. Technicians can monitor the patients' pulse and heartbeat, plus check the pacemaker batteries.

We Help Make Things Happen— THROUGH SPECIAL NEEDS COMMUNICATIONS

Communications is often more important for the disabled person than for the able-bodied.

The ability to communicate in another form can substitute in part for lost eyesight, hearing or mobility problems or loss

of speech—permitting social, professional and community relationships to continue.

The ability to communicate increases the independence of the handicapped person and can be an essential part of

rehabilitation. Actually, Alexander Graham Bell's invention of the telephone owes much to his earlier work with the deaf and his research in hearing problems.

As a company in the communications busi-

ness, we believe we have a responsibility to adapt our products and services to the particular needs of handicapped customers.

We provide facilities for impaired hearing or vision, for speech loss, for motion difficulties and for



The Speakerphone makes telephone communication easier for this handicapped person by allowing hands-free use of the telephone set. His telephone is also equipped with a special, pressure sensitive tape switch for activating the phone.

A deaf teletype operator at a large New England insurance company uses a Bell System Code-Com*, which signals her that a computer message is about to be received on the teletypewriter. The Code-Com converts sound into sight signals, replacing an audible ring with a flashing light, and into touch signals for the blind and deaf by vibrations on a half-dollar size disc.

*Trademark of AT&T Company.

homebound students. Many of the facilities we supply make it possible for handicapped persons to perform jobs that provide their economic independence. Should custom-made arrangements be required, these

can be produced by engineers in our special designs group.

Hands free phones, amplifiers, conduction receivers, signaling lights, automatic dialers and an electronic larynx are only a few of the services we

offer the handicapped. Telephone service representatives in local telephone business offices have specific information on these and many more.

New England Telephone not only hires the handicapped, but we at-

tempt to assist them as well by developing ways for the disabled to take a more active part in the economic and social life of their communities through the communications facilities we can provide.



A blind operator at the Massachusetts Commission for the Blind can tell which telephone lines are ringing or in use with the aid of a light-sensitive probe which buzzes in response to lighted signal lamps on her Call Director® set.



The artificial larynx provides a voice for people who have lost their ability to speak by substituting electronic vibrations for vibrating vocal cords. Speech is produced by forming words with the lips and tongue just as in normal conversation.

We Help Make Things Happen— THROUGH FUTURE COMMUNICATIONS

What will distinguish tomorrow's telecommunications service?

Certainly it will be technically superior, and it will be more personalized—responding to individual wishes because of its computer-like memory capabilities.

But beyond the expected scientific break-

throughs, perhaps the most significant characteristics of future telecommunications will be its diversity and abundance. Telecommunications is going to grow enormously as an extension of man in a complex and global society.

Even the immediate future holds exciting new

advances for our customers that point the way to the world of tomorrow in telecommunications.

To mention a few:

Communication by lightwave—transmitting up to 672 telephone conversations, or a full video channel, by light through a pair of transparent, hair-thin glass fibers.

A new high capacity mobile communication system (under trial in Chicago) theoretically can serve an almost unlimited number of subscribers. Calls in progress are automatically switched from closely spaced base station to base station as vehicles move about, thus freeing



Advanced Mobile Phone Service (AMPS) is currently on trial in Chicago. While most mobile radio systems now use a transmitter for large area coverage and can accommodate only about 500 users, the AMPS system will be able to serve up to a half million customers by dividing a given area into "cells" and employing many low-powered radio transmitters. The trial is expected to run through December 1979.



The Horizon® Communication System, the Bell System's newest offering to business customers, was introduced by AT&T in October. Combining key telephone capabilities with calling features previously associated with larger PBX, the Horizon System is designed to serve business customers who require no more than 79 stations. This new system is now available in Maine, New Hampshire and Vermont. Subject to regulatory approval, it will be offered to Massachusetts and Rhode Island customers in 1979.

channels for more calls.

Bell Labs researchers are now operating electronic circuits at picosecond (trillionth of a second) speeds using a laser beam to turn the circuit switches on and off.

Circuit chips, the size of a postage stamp, today have the equivalent

of 15,000 transistors on a single silicon slice. Even smaller chips, one-tenth the size of a stamp, with the equivalence of 7,000 transistors, have been perfected at Bell Labs. These chips may cost about \$10 when produced in quantity and yet they have more computing power than the

central processor of a large computer costing \$100,000 in the early 1960's.

Continued lowering of the cost of transmission due to ever-improving devices for storing and switching calls—Bell System average investment per circuit mile of interstate

transmission facilities has dropped from \$42 in 1955 to \$14 today.

New phones for the home, data sets and PBX consoles for business plus new calling services—all promise a new tomorrow in communications from New England Telephone.



Bell Laboratories scientists are working to increase the information handling capacity of silicon chips to provide smaller, more economical equipment for telephone customers. This silicon wafer being tested at Bell Labs has over one hundred 16,000-bit memory circuits. It will replace lower capacity devices in electronic switching and other systems used by the telephone companies.

Glass fibers, similar to those displayed here, have high capacity transmission capabilities, and may serve as "wires" for future telecommunications transmission systems. A lightwave communication system utilizing these fibers is now on trial in Chicago. The trial is the result of nearly 20 years of Bell System research and development, and is one of the steps being taken to analyze the design, manufacturing, operational and economic feasibility of this type of system.

Statements of Income and Reinvested Earnings

	Thousands of Dollars	
	Year 1978	Year 1977
OPERATING REVENUES		
Local service	\$ 995,861	\$ 928,171
Toll service	976,868	888,156
Directory advertising and other	72,900	61,862
Less: Provision for uncollectibles	16,135	12,387
Total operating revenues	<u>2,029,494</u>	<u>1,865,802</u>
OPERATING EXPENSES		
Maintenance	408,724	383,251
Depreciation (b)	275,345	236,574
Traffic—primarily costs of handling messages	122,808	122,228
Commercial—primarily costs of local business		
office operations	79,585	65,213
Marketing	90,952	78,958
Accounting	49,586	45,199
Provision for pensions and other employee benefits (c)	197,007	178,812
Services received from parent under License		
Contract	38,226	32,193
Other operating expenses	48,078	40,661
Total operating expenses	<u>1,310,311</u>	<u>1,183,089</u>
Net operating revenues	<u>719,183</u>	<u>682,713</u>
OPERATING TAXES		
Federal income taxes (a)	170,769	164,599
State income taxes (a)	23,775	22,474
Property taxes	112,962	110,138
Gross receipts, payroll-related and other taxes	72,348	66,528
Total operating taxes	<u>379,854</u>	<u>363,739</u>
Operating income (carried forward)	\$ 339,329	\$ 318,974

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

We hereby certify that the condensed return of its business and financial condition contained on pages 14 to 22 inclusive of this Annual Report is full, just and true.


Treasurer.



Vice President — Finance and Comptroller.

THE COMMONWEALTH OF MASSACHUSETTS

Suffolk ss. Boston, March 1, 1979. Then personally appeared the above-named J.F. Crain, Treasurer, and H.H. Fellows, Jr., Vice President — Finance and Comptroller, and severally made oath that the foregoing certificate by them subscribed is true to the best of their knowledge, information and belief.

Before me,


Notary Public.

My Commission expires November 27, 1981.

	Thousands of Dollars	
	Year 1978	Year 1977
Operating Income (brought forward)	\$ 339,329	\$ 318,974
OTHER INCOME		
Interest charged construction (d)	6,552	6,277
Miscellaneous income and deductions—net (a)	(1,139)	(903)
Total other income	5,413	5,374
Income before interest deductions	344,742	324,348
INTEREST DEDUCTIONS	111,545	107,099
NET INCOME	\$ 233,197	\$ 217,249
EARNINGS PER SHARE based on average shares out- standing, 53,084,708 in 1978 and 52,995,221 in 1977	\$ 4.39	\$ 4.10
REINVESTED EARNINGS		
At beginning of year	\$ 376,639	\$ 300,885
Add: Net income	233,197	217,249
	609,836	518,134
Deduct—Dividends declared per share:		
\$2.95 in 1978, \$2.67 in 1977	156,592	141,492
Miscellaneous—net	10	3
	156,602	141,495
REINVESTED EARNINGS AT END OF YEAR	\$ 453,234	\$ 376,639

Balance Sheets

ASSETS

	Thousands of Dollars	
	December 31, 1978	December 31, 1977*
TELEPHONE PLANT—at cost		
In service (e)	\$5,116,634	\$4,863,847
Under construction	80,061	63,310
Held for future use	<u>136</u>	<u>1,454</u>
	5,196,831	4,928,611
Less: Accumulated depreciation	<u>1,245,034</u>	<u>1,141,209</u>
	3,951,797	3,787,402
INVESTMENTS—at cost	<u>6,471</u>	<u>4,571</u>
	<u>3,958,268</u>	<u>3,791,973</u>
CURRENT ASSETS		
Cash (f)	8,660	9,239
Receivables—less allowance for uncollectibles:		
1978, \$3,893,000; 1977, \$2,302,000	325,745	274,001
Material and supplies	22,625	19,210
Prepaid expenses	<u>16,339</u>	<u>15,264</u>
	<u>373,369</u>	<u>317,714</u>
DEFERRED CHARGES	<u>61,171</u>	<u>58,418</u>
TOTAL ASSETS	<u>\$4,392,808</u>	<u>\$4,168,105</u>

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

*Reclassified to conform to 1978 format.

Statements of Sources of Funds Supporting Construction Activity

	Thousands of Dollars	
	Year 1978	Year 1977*
FUNDS FROM OPERATIONS		
Net income	\$ 233,197	\$ 217,249
Add—Expenses not requiring funds currently:		
Depreciation	275,345	236,574
Deferred income taxes—net	69,381	84,414
Investment tax credits—net	19,936	20,023
Deduct—Income not providing funds currently:		
Interest charged construction	6,552	6,277
Total funds from operations	591,307	551,983
Less—Dividends	156,592	141,492
	434,715	410,491
FUNDS FROM EXTERNAL FINANCING		
Issuance of shares	3,290	2,867
Issuance of long and intermediate term debt	100,000	—
Retirement of long and intermediate term debt	—	(140,481)
Increase (decrease) in short term borrowings (h)	(62,700)	128,300
	40,590	(9,314)
CHANGES IN WORKING CAPITAL (excluding debt maturing within one year)†		
Cash	579	46,790
Receivables	(51,744)	(29,021)
Material and supplies	(3,415)	(1,282)
Prepaid expenses	(1,075)	(338)
Accounts payable	8,414	5,035
Taxes accrued	8,123	(19,797)
Dividend payable	3,790	3,771
Interest accrued	204	(990)
Advance billing and customers' deposits	(3,055)	1,818
	(38,179)	5,986
OTHER CHANGES†		
Investments	(1,900)	(2,145)
Deferred charges	(2,753)	(17,771)
Other—net	10,175	2,918
	5,522	(16,998)
FUNDS SUPPORTING CONSTRUCTION ACTIVITY		
Add—Interest charged construction	442,648	390,165
	6,552	6,277
TOTAL CONSTRUCTION	\$ 449,200	\$ 396,442

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

*Reclassified to conform to 1978 format.

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

Notes to Financial Statements

(a) ACCOUNTING POLICIES—The financial statements of the New England Telephone and Telegraph Company ("Company"), which is a subsidiary of American Telephone and Telegraph Company ("American Company"), reflect the application of the accounting policies described in this note. These statements have been prepared in conformity with generally accepted accounting principles applicable to rate-regulated public utilities. Such accounting principles are consistent in all material respects with accounting prescribed by the Federal Communications Commission ("FCC"), except as to the accounting for revenue refunds described in this note. Other policies and practices are covered in Notes (c), (d), (f), and (i).

REVENUE REFUNDS—The FCC's Uniform System of Accounts provides that refunds of prior years' revenues, less related income tax adjustments, be charged against current income. However, in conformity with generally accepted accounting principles applicable to rate-regulated public utilities, the Company, in its financial statements, treats material revenue refunds applicable to prior years as adjustments of the respective years' income and, within a year, as adjustments of the applicable interim periods' income.

PURCHASES FROM WESTERN ELECTRIC—Most of the telephone equipment, apparatus and materials used by the Company have been manufactured or procured for it by Western Electric Company, Incorporated ("Western Electric"), a wholly-owned subsidiary of the American Company. A contract with the Company provides that Western Electric's prices shall be as low as to its most favored customers for like materials and services under comparable conditions. The financial statements reflect items purchased from Western Electric at cost to the Company, which cost includes the return realized by Western Electric on its investment devoted to this business.

DEPRECIATION—Provision in the accounts for depreciation (5.71% in 1978 and 5.17% in 1977 of the cost of depreciable plant in service) is based on straight-line composite rates determined on the basis of the average expected lives of categories of plant acquired in a given year. The Company has requested the FCC to permit such straight-line composite rates to be determined on the basis of equal life groups of certain categories of telephone plant acquired in a given year which, if granted, will increase depreciation expense above the levels that

otherwise would be computed. Such increased depreciation should be allowable in determining revenue requirements in future rate-making proceedings. Depreciation for income tax purposes is provided using different lives, bases and methods as explained under "Income Taxes" below.

INCOME TAXES:

(1) The use of accelerated depreciation methods and shorter lives, permitted by income tax laws and regulations, causes depreciation charges used for tax purposes to be higher during the early years of plant life than the depreciation charges for such plant reflected in these financial statements. Appropriate charges and their subsequent reversal, reflected as deferred income taxes-net, are made to prevent the tax effects of these timing differences from distorting Net Income. The components of operating tax expense, in thousands of dollars, were:

	1978	1977
Federal:		
Current	\$ 85,665	\$ 66,446
Deferred-net	61,591	75,110
Investment tax credit-net ..	<u>23,513</u>	<u>23,043</u>
	170,769	164,599
State:		
Current	15,985	13,170
Deferred-net	<u>7,790</u>	<u>9,304</u>
	23,775	22,474
Total	<u>\$194,544</u>	<u>\$187,073</u>

Current income tax benefits related to non-operating deductions, included as credits in Miscellaneous income and deductions-net, in thousands of dollars, were:

	1978	1977
Federal	\$ 890	\$ 872
State	109	105
Total	<u>\$ 999</u>	<u>\$ 977</u>

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

(3) The Company's effective federal income tax rate, as determined by dividing Federal income taxes (see section (1) above) by the sum of Federal income taxes and Net Income, was 42.1% in 1978 and 43.0% in 1977. The differences of 5.9% and 5.0% in 1978 and 1977, respectively, between the effective rate and the 48% federal income tax statutory rate are attributable to the following factors:

	<u>1978</u>	<u>1977</u>
a. Certain taxes and payroll-related construction costs capitalized for financial statement purposes, but deducted for income tax purposes, net of applicable depreciation	2.9%	2.8%
b. Interest charged construction, which is excluded from taxable income, net of applicable depreciation3%	.3%
c. Amortization of investment tax credits over the life of the plant which gave rise to the credits. Such amortization reduced income tax expense for the years 1978 and 1977 by about \$12,426,000 and \$8,561,000, respectively	3.1%	2.2%
d. Other differences	<u>(.4%)</u>	<u>(.3%)</u>
Total	<u>5.9%</u>	<u>5.0%</u>

(b) REVISED DEPRECIATION RATES—Results reflect revised depreciation rates prescribed by the FCC, effective January 1, 1978, which decreased Net Income in 1978 by about \$8,834,000 (\$.17 per share).

(c) PROVISION FOR PENSIONS AND DEATH BENEFITS—The Company has a noncontributory plan which covers all employees and provides for service pensions and certain death benefits. The Company has an accrual program under which actuarially determined regular payments are made to trust funds that are irrevocably devoted to service pension and death benefit purposes. The total provision for these service pensions and death benefits, including amounts charged to construction, was \$128,116,000 in 1978 and \$114,843,000 in 1977, which represented 16.9% in 1978 and 16.4% in 1977 of salaries and wages. Amendments to the plan, adopted pursuant to 1977 union contracts, provided for improved benefits for all employees and increased 1978 pension accruals by approximately \$5,240,000. Based on the latest actuarial valuation, the Company estimates that the actuarially computed value of vested benefits exceeded the cost of trust fund assets by about \$14,801,000. The accrual program contemplates that there will be available in the funds amounts sufficient to provide benefits as stated in the plan.

(d) INTEREST CHARGED CONSTRUCTION—Regulatory authorities allow the Company to provide for a return on capital invested in new telephone plant while under construction by accruing interest charged construction as an item of income during the construction period and as an addition to the cost of the plant constructed. Such income is not realized in cash currently but will be realized over the service life of plant as the resulting higher depreciation expense is recovered in the form of increased revenues.

As a result of a change in the FCC's Uniform System of Accounts, effective January 1, 1979 interest charged construction will no longer be accrued on the Company's books for telephone construction projects expected to be completed within one year from the time construction starts ("short term projects"). The interstate portion of the cost of short term projects will be included in the rate base upon which interstate revenue requirements are determined. The Company will need approval from the state regulatory commissions for similar rate base treatment for intrastate rate-making. Approximately \$5,600,000 and \$5,400,000 of interest charged construction was accrued on the combined intrastate and interstate costs of such projects in 1978 and 1977, respectively. (It previously was reported that the 1978 and 1977 interstate portion of these amounts were subject to possible reversal; in December 1978 the FCC ruled that such reversal would not be required.)

(e) ACCOUNTING FOR STATION CONNECTION COSTS—In August 1977, pursuant to an FCC order, the American Company filed a proposal to change the accounting treatment provided in the FCC's Uniform System of Accounts for station connection costs so that a significant portion of these costs which are now being capitalized would be expensed when incurred in the future. Station connection costs of the type proposed to be expensed amount currently to about \$80,000,000 per year. Under the proposal, this accounting change would be implemented prospectively over a four-year period in approximately equal amounts with provision for straight-line amortization of that portion of the current investment in station connection costs of the type proposed to be expensed in the future; at December 31, 1978 this amounted to approximately \$270,000,000.

This change will result in an increase in annual expenses; however, such increased expenses should be included in the determination of revenue requirements in future rate-making proceedings. If the FCC adopts these proposed changes during 1979, the Company may begin implementation retroactively to January 1, 1979.

(f) CASH—The Company follows the practice of making certain payments by draft and recording such drafts as accounts payable until such time as the banks honoring the drafts have presented them for payment. The American Company maintains cash and temporary cash investments upon which the Company may draw on a day-to-day basis to meet its obligations, including coverage for outstanding drafts. Outstanding drafts included in Accounts payable amounted to \$17,639,000 at December 31, 1978 and \$11,674,000 at December 31, 1977.

- (g) LONG AND INTERMEDIATE TERM DEBT—Interest rates and maturities on long and intermediate term debt outstanding at December 31, 1978 were as follows:

Maturities	Thousands of Dollars			Total
	3% to 4 $\frac{5}{8}$ %	6 $\frac{1}{8}$ % to 7 $\frac{3}{8}$ %	8% to 9 $\frac{1}{2}$ %	
1981	\$ —	\$ —	\$100,000	\$ 100,000
1982	40,000	—	—	40,000
1984-1993	105,000	—	—	105,000
1994-2003	95,000	—	170,000	265,000
2004-2010	60,000	425,000	429,965	914,965
Total	<u>\$300,000</u>	<u>\$425,000</u>	<u>\$699,965</u>	<u>\$1,424,965</u>

- (h) DEBT MATURING WITHIN ONE YEAR—The Company follows the practice of financing construction of telephone plant partially through advances from the American Company, bank loans, commercial paper and other notes payable in twelve months or less after issuance, pending long term financing. In the Company's computation of ratios of debt to combined debt and equity (usually referred to as "debt ratios"), debt maturing within one year is included with Long and Intermediate Term Debt.

Debt maturing within one year consists of the following:

	Thousands of Dollars	
	1978	1977
Notes Payable:		
Bank loans	\$ —	\$ 180
Commercial paper	65,600	128,120
Seven Year 6 $\frac{1}{2}$ % Notes due March 15, 1979	100,000	—
Total	<u>\$165,600</u>	<u>\$128,300</u>

The weighted average annual interest rate for commercial paper outstanding at December 31, 1978 was 10.16% and for bank loans and commercial paper outstanding at December 31, 1977 were 6.65% and 7.75%, respectively. The maximum amount of notes payable at any month-end during the years 1978 and 1977 were \$150,500,000 and \$128,300,000, respectively, and the average amounts outstanding during those years were approximately \$73,341,000 and \$77,600,000 at weighted average interest rates of 7.19% and 5.63%, respectively, computed by dividing the daily face amount of notes payable into the aggregate related interest expense.

- (i) LEASE COMMITMENTS—The Company leases certain facilities and equipment used in its operations and reflects lease payments as rental expense of the period to which they relate. Total rental expense amounted to \$34,481,000 and \$30,974,000 in 1978 and 1977, respectively. At December 31, 1978 the aggregate minimum rental commitments under noncancellable leases for the periods shown were as follows:

Years	Thousands of Dollars
1979	\$ 24,149
1980	21,157
1981	19,282
1982	16,501
1983	15,384
Thereafter	123,556
Total	<u>\$220,029</u>

These leases include some which would be leases under criteria established by the Financial Accounting Standards Board as "capital leases". However, for regulatory accounting and rate-making purposes, such leases are not capitalized. Had such leases been capitalized, additional assets of \$50,427,000 and \$56,227,000 (net of \$30,012,000 and \$24,888,000 accumulated amortization) and obligations of \$61,622,000 and \$66,096,000 would have been included on the balance sheets as of December 31, 1978 and 1977, respectively; the effect on Net Income would have been insignificant. Under regulatory rate-making procedures, any expense effect would not be recognized currently but would be recognized over the life of the respective lease.

- (j) DEPARTMENT OF JUSTICE ANTITRUST ACTION—In 1974 the Department of Justice brought a civil antitrust action naming the American Company, Western Electric and Bell Telephone Laboratories, Incorporated as defendants, and the 23 Bell System Telephone companies (including the Company) as co-conspirators but not defendants. This matter is not likely to be resolved for several years. The American Company has stated that it believes that the relief sought, which includes dismemberment of the Bell System, is adverse to the public interest and that it is confident that it has not been in violation of the antitrust laws and that the structure of the Bell System will remain basically unchanged. In the opinion of the Company, dismemberment of the Bell System would have adverse effects on its business, could affect its ability to raise capital, its credit standing and the market value of its securities and could require an immediate payment by the Company of federal income taxes previously deferred on intercompany profits. A lump sum payment of such deferred taxes, which are being credited to the plant accounts, would have no direct effect on Net Income but would materially increase the Company's needs for cash and revenues.
- (k) QUARTERLY FINANCIAL INFORMATION (UNAUDITED)—All adjustments necessary for a fair statement of income for each period have been included.

Calendar Quarter	Thousands of Dollars			Earnings per Share
	Total Operating Revenues	Operating Income	Net Income	
<u>1977</u>				
1st	\$ 445,236	\$ 73,203	\$ 47,796	\$.90
2nd	463,624	80,357	54,933	1.04
3rd	478,877	84,754	59,325	1.12
4th	478,065	80,660	55,195	1.04
Total	<u>\$1,865,802</u>	<u>\$318,974</u>	<u>\$217,249</u>	<u>\$4.10</u>
<u>1978</u>				
1st	\$ 487,985	\$ 76,428	\$ 49,319	\$.93
2nd	504,464	84,987	58,068	1.09
3rd	517,583	91,898	65,924	1.25
4th	519,462	86,016	59,886	1.12
Total	<u>\$2,029,494</u>	<u>\$339,329</u>	<u>\$233,197</u>	<u>\$4.39</u>

Results for the first quarter of 1978 have been restated to reflect the use of revised depreciation rates prescribed by the FCC retroactively to January 1, 1978 which reduced Net Income for this period by \$2,246,000 (\$.04 per share).

- (l) REPLACEMENT COST (UNAUDITED)—The following information required by the Securities and Exchange Commission compares telephone plant investment as shown on the balance sheets at December 31, 1978 and 1977 with the approximate cost of replacing the Company's productive capacity at those dates. It also compares accumulated depreciation at those dates with the amounts that would have been provided had past depreciation accruals contemplated such replacement costs. Additionally, the depreciation expense for the years ended December 31, 1978 and 1977 is compared with depreciation expense computed (using historic depreciation assumptions) on these estimates of replacement costs.

Thousands of Dollars

Year 1977	As Stated	At Replace- ment Cost	Difference
Telephone plant investment: For which replacement costs have been determined	\$4,835,558	\$7,647,952	\$2,812,394
Included at historic cost	93,053	93,053	—
Total	4,928,611	7,741,005	2,812,394
Accumulated depreciation	1,141,209	2,240,150	1,098,941
Net telephone plant investment	<u>\$3,787,402</u>	<u>\$5,500,855</u>	<u>\$1,713,453</u>
Depreciation expense	<u>\$ 236,574</u>	<u>\$ 340,955</u>	<u>\$ 104,381</u>
Year 1978			
Telephone plant investment: For which replacement costs have been determined	\$5,088,241	\$8,291,971	\$3,203,730
Included at historic cost	108,590	108,590	—
Total	5,196,831	8,400,561	3,203,730
Accumulated depreciation	1,245,034	2,505,018	1,259,984
Net telephone plant investment	<u>\$3,951,797</u>	<u>\$5,895,543</u>	<u>\$1,943,746</u>
Depreciation expense	<u>\$ 275,345</u>	<u>\$ 388,718</u>	<u>\$ 113,373</u>

These replacement costs are theoretical, based on the assumptions that, as of December 31, 1978 and 1977, electronic switching systems would replace all electromechanical switching systems, most other telephone plant would be replaced in accordance with present replacement practices and building space would be reduced because of the use of electronic switching systems. Certain telephone plant categories are included at historic cost: principally land and telephone plant under construction.

The difference between historic and estimated replacement cost of net telephone plant investment does not represent additional book value for the Company's stock. The above replacement costs are approximations of the amount of capital that could have been required were the Company to have replaced the entire productive capacity of such plant on December 31, 1978 and 1977. Replacement actually will take place over many years and the funds needed will be derived from sources similar to those available during 1978 and 1977.

Depreciation expense based on an estimate of replacement cost also is theoretical and not deductible in determining income tax expense. The excess of depreciation on replacement cost over that determined on historic cost is a measure of the extent to which current operations have not been making provision for the higher replacement cost of present plant capacity. Such provision, if made, would provide funds which would be used in lieu of funds from other sources for plant construction.

It would be unrealistic to impute a reduced net income by the difference between depreciation based on historic cost and that based on estimates of replacement cost. New plant is likely to provide largely-offsetting additional revenue-generating services and operating efficiencies. Additionally, replacement of plant will take place over many years. It is true, however, that the earnings of the Company must be high enough to provide some equity capital from reinvested earnings and to attract additional debt and equity to provide funds for any replacement cost in excess of depreciation accruals based on the historic cost of the plant.

Report of Independent Certified Public Accountants

To the Share Owners of
New England Telephone and Telegraph Company:

We have examined the balance sheets of New England Telephone and Telegraph Company as of December 31, 1978 and 1977, and the related statements of income and reinvested earnings and sources of funds supporting construction activity for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements (pages 14 to 22) present fairly the financial position of New England Telephone and Telegraph Company at December 31, 1978 and 1977, and the results of its operations and the sources of funds supporting its construction activity for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Coopers & Lybrand

Boston, Massachusetts
February 2, 1979

Report of Management

The Financial Statements which appear on pages 14 to 22 have been prepared in conformity with generally accepted accounting principles applicable to rate-regulated public utilities. Such accounting principles are consistent in all material respects with accounting prescribed by the Federal Communications Commission for telephone companies, except as to revenue refunds, as discussed in Notes to Financial Statements.

The integrity and objectivity of data in these financial statements, including estimates and judgments relating to matters not concluded by year end, are the responsibility of management as is all other information included in the Annual Report unless indicated otherwise. To this end, management maintains a highly developed system of internal controls and supports an extensive program of internal audits to give it reasonable assurance at reasonable cost that the Company's assets are protected and that transactions and events are recorded properly. The Company also seeks to assure this objectivity and integrity by careful selection of its managers, by organizational arrangements that provide an appropriate division of responsibility and by communications programs aimed at assuring that its policies, standards and managerial authorities are understood throughout the organization.

These financial statements have been examined by Coopers & Lybrand, Certified Public Accountants. The auditors' report, which appears on page 22, expresses an informed judgment as to whether management's financial statements, considered in their entirety, present fairly in conformity with generally accepted accounting principles the Company's financial condition and operating results. This judgment is based on procedures described in the first paragraph of their report, which include studying and evaluating the Company's systems, procedures and internal controls, and performing tests and other auditing procedures sufficient to provide reasonable assurance that the financial statements neither are materially misleading nor contain material errors. While the auditors make extensive tests of Company procedures and controls, it is neither practicable nor necessary for them to scrutinize a large portion of the Company's transactions.

The Board of Directors pursues its responsibility for reported financial information through its Audit Committee, composed of Directors (see page 25) who are not employees. The Audit Committee meets periodically with management, the internal auditors and the independent auditors to assure that each is carrying out their responsibilities and to discuss auditing, internal control and financial reporting matters. Both the internal auditors and the independent auditors periodically meet alone with the Audit Committee, and have free access to the Audit Committee at any time.



Vice President-Finance
and Comptroller

Company Statistics

AT DECEMBER 31	1978	1977	1976	1975	1974
NUMBER OF SHARES					
OUTSTANDING	53,152,551	53,056,395	52,969,692	52,969,692	45,685,080
Book Value Per Share	\$ 36.03	\$ 34.59	\$ 33.16	\$ 31.97	\$ 33.39
Number of Share Owners	44,410	44,746	45,117	45,708	44,221
TOTAL PLANT INVESTMENTS§	\$5,196,831,000	\$4,928,611,000	\$4,691,309,000	\$4,501,951,000	\$4,260,015,000
Depreciation Reserve	1,245,034,000	1,141,209,000	1,060,768,000	980,353,000	900,702,000
Net Plant Investment§	<u>\$3,951,797,000</u>	<u>\$3,787,402,000</u>	<u>\$3,630,541,000</u>	<u>\$3,521,598,000</u>	<u>\$3,359,313,000</u>
% RESIDENCE EXTENSIONS TO					
RESIDENCE MAIN	62%	61%	57%	53%	48%
EMPLOYEES	40,489	40,299	40,779	42,378	46,739
YEAR					
CONSTRUCTION EXPENDITURES†	\$ 449,200,000	\$ 396,442,000	\$ 330,977,000	\$ 360,622,000	\$ 482,651,000
ORIGINATING CALLS—AVERAGE					
BUSINESS DAY	35,946,000	34,188,000	32,575,000	31,531,000	31,001,000
LONG DISTANCE MESSAGES*	966,476,000	877,373,000	804,467,000	741,566,000	704,067,000
Customer Dialed*	96%	94%	92%	89%	88%
TOTAL TAXES	\$ 455,889,000	\$ 448,153,000	\$ 412,434,000	\$ 322,411,000	\$ 308,991,000
Federal Income and					
Social Security	203,772,000	194,627,000	170,630,000	107,656,000	101,890,000
State and Local	175,750,000	169,112,000	152,296,000	127,708,000	117,360,000
Federal Excise	65,436,000	74,397,000	80,748,000	79,544,000	82,956,000
State Sales	10,931,000	10,017,000	8,760,000	7,503,000	6,785,000
Total Taxes per Customer					
per month	\$ 10.52	\$ 10.72	\$ 10.07	\$ 8.01	\$ 7.77

§Reclassified to conform to 1978 format.

†Excludes Intra-Company Reused Material.

*Includes Wide Area Telephone messages.

Board of Directors

JAMES S. BARKER

Chairman of the Board, Incian Head National Bank of Concord, Concord, New Hampshire

RANDOLPH W. BROMERY

Chancellor, University of Massachusetts, Amherst, Mass.

LOUIS W. CABOT

Chairman of the Board, Cabot Corporation, Boston, Mass.

ABRAM T. COLLIER

Former Chairman of the Board, New England Mutual Life Insurance Company, Boston, Mass.

HAYNES H. FELLOWS, JR.

Vice President, New England Telephone and Telegraph Company

RICHARD D. HILL

Chairman of the Board and Chief Executive Officer, First National Boston Corporation, Boston, Mass.

WALTER B. KELLEY

Vice President-Tariffs and Costs American Telephone and Telegraph Company, New York, N.Y.

MAURICE LAZARUS

Chairman of the Finance Committee, Federated Department Stores, Inc. Boston, Mass.

WILLIAM C. MERCER

President, New England Telephone and Telegraph Company

JOHN S. NORTH

Executive Vice President, New England Telephone and Telegraph Company

DONALD A. ROACH

President, Brown & Sharpe Manufacturing Company, North Kingstown, Rhode Island

MRS. GEORGE L. SARGENT

Vice Chairman of Board of Trustees, New England Medical Center Hospital, Inc., Boston, Mass.

HUGH C. SAUNDERS

Chairman of the Board and Chief Executive Officer, Saunders Brothers, Inc., Westbrook, Maine

FREDERICK P. SMITH

Chairman of the Board and Chief Executive Officer, Burlington Savings Bank, Burlington, Vermont

H. BRADFORD WASHBURN, JR.

Director, Museum of Science, Boston, Mass.

Executive Committee

WILLIAM C. MERCER

CHAIRMAN

ABRAM T. COLLIER

RICHARD D. HILL

MAURICE LAZARUS

JOHN S. NORTH

H. BRADFORD WASHBURN, JR.

Officers

PRESIDENT

WILLIAM C. MERCER

EXECUTIVE VICE PRESIDENT

JOHN S. NORTH

VICE PRESIDENTS

C. DUANE ALDRICH

GENERAL COUNSEL

PETER W. BERTSCHMANN

HAROLD R. DANN

LINCOLN A. DIVOLL

DELBERT L. EMERY

HAYNES H. FELLOWS, JR.

FINANCE AND COMPTROLLER

PETER L. HAYNES

ROBERT F. LANDRY

PETER C. MANUS

GEORGE D. NOBLE, JR.

THOMAS J. NORRIS

JOHN F. PRENDIVILLE, JR.

RODNEY M. TORRES

JOSEPH J. URBAN

TREASURER

JAMES F. CRAIN

SECRETARY

WILLIAM H. P. SMITH

General Managers

PERRY M. HUDSON

Maine

W. RUSSELL SCOTT

Massachusetts

JOHN J. COLEMAN

New Hampshire

BRUCE W. BALDWIN

Rhode Island

DEIGHTON K. EMMONS

Vermont

Audit Committee

FREDERICK P. SMITH

CHAIRMAN

LOUIS W. CABOT

MRS. GEORGE L. SARGENT

Pension Committee

MAURICE LAZARUS

CHAIRMAN

JAMES S. BARKER

HUGH C. SAUNDERS

Organization Changes

Walter B. Kelley and Donald A. Roach were elected Directors of the Company at the annual meeting on April 18, 1978.

Mr. Kelley is a Vice President of American Telephone and Telegraph Company, New York, with responsibility for tariffs and costs.

Mr. Roach is President and Chief Operating Officer of Brown & Sharpe Manufacturing Company in Rhode Island, designers and manufacturers of machine tools, precision measuring equipment and industrial hydraulic components.

Robert H. I. Goddard, a partner of Brown & Ives, Providence, Rhode Island, retired from the Board on April 18, 1978. He had served for 16 years.

Thomas S. Nurnberger, Executive Vice President, American Telephone and Telegraph Company, New York, also retired as a Director on April 18, 1978, after 18 months of service to the Company.

John S. North, Vice President-Operations, was elected Executive Vice President and Chief Operating Officer of the Company effective December 1, 1978.

Also on that date, Peter L. Haynes and Thomas J. Norris were elected Vice Presidents of the Company.

Liability Insurance

The Business Corporation Law of the State of New York, in which state the Company is incorporated, provides that the Company may indemnify its directors and officers against certain liabilities arising out of the performance of their duties and may purchase insurance for that purpose; and to protect directors and officers against liabilities for which they cannot be so indemnified. Accordingly, the Company has purchased liability insurance policies insuring it and the directors and officers for any such liabilities which it or they may incur. The cost of the policies for the three-year period commencing June 30, 1978 is estimated to be \$57,000. The primary insurance carriers are Lloyd's of London and National Union Fire Insurance Company.

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CAMBRIDGE, MASS.



**New England
Telephone**

185 Franklin Street
Boston, Mass. 02107
Phone (617) 743-4207

Joseph R. Plati
Division Staff Manager-Taxes

March 30, 1979

Dear Sir:

Enclosed is a copy of Annual Report to the Share Owners of
New England Telephone and Telegraph Company for the year 1978 filed
in accordance with Massachusetts General Laws (Ter. Ed.), Chapter 166,
Section 12A.

Very truly yours,

JR Plati

Division Staff Manager-Taxes

Encl.

1.

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Annual Report of the New England Telephone &
Telegraph Company for the year 1978.

In City Council,

April 9, 1979

Placed on File -