

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-K ANNUAL REPORT

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

For the fiscal year ended December 31, 1986

Commission file number 1-1150

New England Telephone and Telegraph Company

A New York
Corporation

I.R.S. Employer
No. 04-1664340

185 Franklin Street, Boston, Massachusetts 02107

Telephone Number 617 743-9800

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

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

THE REGISTRANT, A WHOLLY-OWNED SUBSIDIARY OF NYNEX CORPORATION, MEETS THE CONDITIONS SET FORTH IN GENERAL INSTRUCTION J(1)(a) AND (b) OF FORM 10-K AND IS THEREFORE FILING THIS FORM WITH REDUCED DISCLOSURE FORMAT PURSUANT TO GENERAL INSTRUCTION J(2).

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 . . . X No

DOCUMENTS INCORPORATED BY REFERENCE:

None.

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PART I

Item 1. BUSINESS.

General

New England Telephone and Telegraph Company (the "Company") was incorporated in 1883 under the laws of the State of New York, has its principal executive offices at 185 Franklin Street, Boston, Massachusetts 02107 (telephone number 617 743-9800) and is engaged in providing telecommunications services in Maine, Massachusetts, New Hampshire, Rhode Island and Vermont. Prior to its divestiture by American Telephone and Telegraph Company ("AT&T") on January 1, 1984, the Company was an associated company of the Bell System and a wholly owned subsidiary of AT&T. Since January 1, 1984, the Company has been a wholly owned subsidiary of NYNEX Corporation ("NYNEX"), which is one of the seven regional holding companies ("RHCs") formed by AT&T in connection with the divestiture by AT&T of its 22 wholly owned Bell local exchange companies ("LECs"). On January 1, 1984, ownership of NYNEX and the other RHCs passed from AT&T directly to AT&T's shareholders. (See "Operations Under the Consent Decree" below.)

Telecommunications Services

The Company is engaged in providing two types of telecommunications services, exchange telecommunications and exchange access services in Maine, Massachusetts, New Hampshire, Rhode Island and Vermont. These telecommunications services include public and private line voice and data transmission, transmission of radio and television signals and teletypewriter services.

Exchange telecommunications service is the transportation of telecommunications traffic between telephones and other customer premises equipment ("CPE")* located within each of the 164 geographical areas (local access and transport areas or "LATAs") into which the former Bell System territory in the continental United States has been divided. These LATAs are generally centered on a city or other identifiable community of interest and, subject to certain exceptions, each LATA marks an area within which a LEC may provide telecommunications services. IntraLATA service may include toll service as well as local service.

Exchange access service refers to the link, provided by the LECs, between a customer's CPE and the transmission facilities of interexchange carriers which provide telecommunications services. In connection with divestiture, the Company is required to offer to all interexchange carriers and information

* Customer premises equipment ("CPE") is defined in the divestiture consent decree and generally refers to equipment, such as telephone sets and private branch exchanges, used by a customer at the customer's premises to originate, route or receive telecommunications. (See "Operations Under the Consent Decree" below.)

service providers exchange access and information access, at certain locations, which are equal in quality, type and price to that provided to AT&T and its affiliates ("Equal Access"). Certain billing and collection services are also performed by the Company for interexchange carriers that elect to subscribe to these services rather than perform such services themselves. In 1986, approximately 1.4% of operating revenues was derived from such billing and collection services. Effective January 1, 1987, such billing and collection services have been detariffed and are offered to interexchange carriers on a contractual basis. (See "Federal Regulation - Other Federal Matters" below.)

There are six LATAs served by the Company: Eastern Massachusetts, Western Massachusetts, Maine, New Hampshire, Rhode Island and Vermont.

Sizeable areas and many localities within the territories served by the Company are served by non-affiliated telephone companies which had approximately 156,000 network access lines in service in those territories on December 31, 1986. The Company does not furnish local service in the areas and localities served by such companies.

The following table sets forth for the Company the number of network access lines in service at the end of each year:

	<u>In Thousands</u>				
	<u>1986</u>	<u>1985</u>	<u>1984</u>	<u>1983</u>	<u>1982</u>
Network Access Lines in Service	4,975	4,804	4,651	4,479	4,347

For the year ending December 31, 1986, approximately 95% of the total operating revenues of the Company was derived from telecommunications services. The remaining 5% of total operating revenues was derived from other sources, principally publishing rights fees for telephone directories. In 1986, one customer, AT&T, accounted for approximately 27% of operating revenues, primarily in network access revenues.

Affiliated Business Operations

NYNEX Service Company. NYNEX Service Company ("NYNEX Service") was formed initially as a wholly owned subsidiary of NYNEX; as of January 1, 1985, ownership of NYNEX Service was transferred to the Company and New York Telephone Company ("New York Telephone"), also a wholly owned subsidiary of NYNEX. Voting rights are shared equally between the Company and New York Telephone, but the entitlement of the Company and New York Telephone to dividends and other distributions, including liquidation distributions, are in the proportion of one-third for the Company and two-thirds for New York Telephone. NYNEX Service provides staff and operational support services primarily for the Company and New York Telephone. Staff support services include marketing and technical planning, regulatory and legal services. Operational support services include the provision of data processing and other information services and the development of operational methods and procedures.

NYNEX Service owns a one-seventh interest in Bell Communications Research, Inc. ("Bellcore"); each of the other RHCs owns an equal interest. Bellcore furnishes the RHCs and certain of their subsidiaries, including the Company, technical and support services relating to exchange telecommunications and exchange access services (which include research and development) that can be provided more efficiently on a centralized basis. Bellcore is a central point of contact for coordinating the efforts of NYNEX and the other RHCs in meeting the national security and emergency preparedness requirements of the Federal government, as required under the divestiture consent decree.

NYNEX Information Resources Company. The Company entered into an agreement with NYNEX Information Resources Company ("NYNEX Information Resources"), a wholly owned subsidiary of NYNEX, pursuant to which NYNEX Information Resources pays a publishing rights fee to the Company for the right to produce, publish and distribute alphabetical (White Pages) and classified (Yellow Pages) directories for the Company.

NYNEX Mobile Communications Company. NYNEX Mobile Communications Company ("NYNEX Mobile") is a wholly owned subsidiary of NYNEX and, through its operating subsidiaries and partnerships, provides a variety of mobile telecommunications services and products, including services and products which incorporate cellular technology, throughout areas in the northeastern United States. Services provided by NYNEX Mobile, including cellular services and paging, are subject to regulation by the Federal Communications Commission ("FCC") and the regulatory authorities of some states.

NYNEX Materiel Enterprises Company. NYNEX Materiel Enterprises Company, a wholly owned subsidiary of NYNEX, undertakes various procurement support services for NYNEX and its subsidiaries, including the Company. Such support services include product evaluation, contracting, purchasing, materials management and disposition, warehousing, transportation and equipment repairs. The Company, however, performs certain procurement services on its own behalf.

NYNEX Credit Company. NYNEX Credit Company, a wholly owned subsidiary of NYNEX, provides a range of financial services, including leases and installment sales, to customers of the Company.

NYNEX Properties Company. NYNEX Properties Company, a wholly owned subsidiary of NYNEX, serves as a broker for acquisitions and dispositions of properties owned and leased by the Company.

NYNEX Business Information Systems Company. NYNEX Business Information Systems Company ("NYNEX Business Systems"), a wholly owned subsidiary of NYNEX, markets a wide range of telecommunications, information and other business products to large, medium and small business customers through 94 NYNEX Business Centers and a direct sales force. NYNEX Business Systems acts as a non-exclusive sales agent for the Company for the sale of network services.

Construction Expenditures

The Company makes large construction expenditures to meet the demand for telecommunications services and to further improve such services. Included in construction expenditures for 1984, 1985 and 1986 are costs incurred in connection with the requirement to provide Equal Access. (See "Telecommunications Services" above.) Construction expenditures for 1982 through 1986 are set forth below:

In Millions	
1986. \$743	1983. \$830
1985. \$843	1982. \$806
1984. \$765	

The Company's construction expenditures for 1987 are projected to be comparable to 1986 expenditures.

Operations Under the Consent Decree

On August 24, 1982, the United States District Court for the District of Columbia (the "Court") approved as in the public interest and entered a consent decree entitled the Modification of Final Judgment, which arose out of antitrust litigation brought by the Department of Justice (the "DOJ"), and was agreed to by AT&T and the DOJ, with certain modifications which the Court had required (the "Consent Decree"). On February 28, 1983, the United States Supreme Court affirmed the Consent Decree.

On December 16, 1982, AT&T, as required by the terms of the Consent Decree, filed with the Court the Plan of Reorganization outlining the method by which AT&T intended to comply with the Consent Decree. The Plan of Reorganization, with amendments agreed to by AT&T and the DOJ and modifications required by the Court, was approved by the Court on August 5, 1983 (the "Plan"). On December 12, 1983, the United States Supreme Court affirmed the August 5, 1983 order.

The Consent Decree restricts NYNEX and its subsidiaries, including the Company, to the provision of exchange telecommunications service, exchange access and information access services, the provision (but not manufacture) of CPE (subject to regulatory constraints), the publishing of printed directory advertising and the provision of any service which is a natural monopoly service actually regulated by tariff. NYNEX and its subsidiaries can seek Court approval to provide other services or engage in any other line of business upon a showing to the Court "that there is no substantial possibility that it could use its monopoly power to impede competition in the market it seeks to enter." The same standard applies to activities expressly barred by the Consent Decree, that is, providing interLATA telecommunications services, providing information services and manufacturing any product.

On July 26, 1984, the Court set forth the general guidelines and procedures under which it would consider requests by RHCs to engage in other business activities. The Court imposed the following conditions with respect to such requests: (1) competitive activities must be conducted through a separate subsidiary; (2) any such subsidiary must obtain its own debt

financing on its own credit, with arrangements to prevent recourse by a creditor to the assets of an operating telephone company; (3) for the present, the total estimated net revenues for the activities subject to a waiver may not exceed ten percent of an RHC's total estimated net revenues; and (4) the monitoring provisions of the Consent Decree will apply to the proposed new business activities.

The Court also established procedures for dealing with requests by RHCs to enter new businesses. Such requests must first be submitted to the DOJ for its review. The Court will then consider the recommendation of the DOJ in deciding whether a specific request should be granted. In the event that the DOJ does not recommend approval, the RHC may seek approval directly from the Court.

In 1986, the Court approved a NYNEX request to permit the Company to perform nontariff billing and collection services, and in 1987, the Court approved a NYNEX request to permit the Company to provide to the public the same types of training and educational services as it provides for its own use.

In February 1987, the DOJ filed with the Court its Triennial Report in which it recommended that certain restrictions imposed by the Consent Decree upon the RHCs, and their subsidiaries, including the Company, be removed. The Court will determine what restrictions, if any, are to be removed, and it is not possible to state when the Court might act on this matter.

Regulated Services

The Company is subject to the jurisdiction of the FCC with respect to interstate telecommunications services provided by the Company. In addition, the FCC prescribes a uniform system of accounts, depreciation rates and separations procedures. Separations procedures comprise the principles and standard methods used to separate property costs, revenues, expenses, taxes and reserves between those applicable to interstate services under the jurisdiction of the FCC and those applicable to intrastate services under the jurisdiction of the respective state regulatory authorities. (See "Federal Regulation" below.)

The Company is also subject to regulation by state commissions in all of the states in which it operates with respect to intrastate rates and services and other matters. (See "State Regulation" below.)

Federal Regulation

Interstate Access Charges

Interstate access charges are tariff charges filed with the FCC which compensate LECs for the use of their telephone plant to originate and terminate interstate telecommunications traffic, primarily between end users and interexchange carriers providing interstate service. Such charges recover the LECs' access-related costs allocated to the interstate jurisdiction ("Interstate Costs") under the FCC's jurisdictional cost allocation rules. (See also "State Regulation - Intrastate Access Charges" below.)

With respect to the provision of access to the switched network, separate charges are applied to end users ("End User Common Line Charges" or "EUCLCs") and to interexchange carriers. End User Common Line Charges recover, through a fixed charge, a portion of the interstate costs of the line connecting an end user's premises with the LEC's central office. Effective in June 1985, residence and single line business end users began paying a monthly EUCLC of \$1. This charge increased to \$2 in June 1986. A federal-state joint board has recommended to the FCC that the EUCLC be increased from the current \$2 to \$2.60 on June 1, 1987, to \$3.20 on September 1, 1988 and to \$3.50 on April 1, 1989. This matter is presently pending before the FCC for decision. Multi-line business end users began paying monthly EUCLCs of up to \$6 per line in May 1984. No increase is proposed for these EUCLCs. The LECs recover their remaining interstate costs of providing switched access service through mileage and usage sensitive charges to the interexchange carriers.

Special access refers to the provision of non-switched access for private line services. Between divestiture on January 1, 1984 and April 1985, the Company charged AT&T for special access pursuant to contractual agreements. Other interexchange carriers were charged pursuant to pre-existing tariffs based upon contracts executed in 1974. Effective November 13, 1984, pursuant to permission granted by the FCC, the Company increased the rates to other interexchange carriers (not including AT&T) for special access by approximately 20 percent. In April 1985, in accordance with an order of the FCC, special access tariffs applicable to all interexchange carriers, including AT&T, became effective. The validity of the increases to other interexchange carriers since November 1984, including the April 1985 and subsequent special access tariff increases, is subject to judicial review, and the additional revenues collected pursuant to such increases from November 1984 to date are subject to potential refund (with interest) upon the completion of pending court proceedings. The FCC has separately instituted an investigation, which is still pending, of special access rates with respect to all interexchange carriers, including AT&T, for the period from April 1985 through September 1985.

In July 1985, the Company filed revised switched and special access tariffs pursuant to FCC rules requiring annual access tariff updates. These revised tariffs took effect in October 1985. An FCC investigation of the October 1985 special access tariffs has been consolidated with the FCC's pending investigation of the special access tariffs which were effective from April 1985 through September 1985. An FCC investigation of the October 1985 switched access tariff rates in effect for the period from October 1985 through December 1986 is also pending.

On October 3, 1986, the Company again filed revised switched and special access tariffs to comply with the annual updating requirements of the FCC. These filings reflect the reduction in the authorized rate of return by the FCC from 12.75% to 12%, effective as of January 1, 1987. (See "Other Federal Matters" below.) The tariffs took effect on January 1, 1987.

An investigation of the special access tariffs that became effective on January 1, 1987 has been incorporated into the pending investigation of the special access tariffs that became effective in April 1985 and October 1985, and certain components of the special access rates that became effective in January 1987 are also subject to an accounting order of the FCC.

In addition to the investigations described above, any one of which could result in a refund order (with interest), if the FCC should find, pursuant to its interstate rate of return proceeding, that the Company's overall interstate access rate of return exceeded 13.1% during the period from October 1, 1985 to January 1, 1987, refunds could be automatically required in an amount sufficient to decrease the rate of return to the 13.1% level. If the FCC should find for that period that any one of the Company's access categories (switched access, special access or carrier common line) exceeded a 13.25% rate of return, automatic refunds for such categories could also be required.

Other Federal Matters

Effective February 15, 1985, the FCC allowed Equal Access Cost Recovery ("EACR") tariffs filed by the Company's to go into effect, subject to an investigation of the cost support for the rates filed and subject to refund pursuant to an accounting order. The EACR rates, to be filed annually, are intended to permit the Company to recover Equal Access costs from interexchange carriers. The EACR rates also provide a mechanism for the Company to obtain reimbursement from AT&T for those Equal Access costs, if any, not recovered through these tariffs by January 1, 1994.

In its interstate rate of return proceeding, on August 25, 1986, the FCC released an order prescribing 12% as the authorized interstate access rate of return for the Company for 1987 and 1988. The Company's interstate access tariffs which became effective on January 1, 1987 reflected the new rate of return. Under the FCC rate of return enforcement mechanism, which remains subject to judicial review, refunds will be required if the overall interstate access rate of return exceeds 12.25% during 1987 or 1988, or if earnings for any of three access categories (special access, switched access, or carrier common line) exceeds 12.4% during these years.

The FCC adopted two orders during 1986 with respect to the provision by the Company of enhanced telecommunications services ("enhanced services") and CPE. In May 1986, the FCC adopted an order in its Third Computer Inquiry proceeding that provides for the eventual elimination of mandatory structural separation for the provision of enhanced services by the Company and other

LECs upon the Company's fulfilling certain requirements, including compliance with the equal interconnection provisions of the order, and compliance with the regulations established in the FCC's Joint and Common Cost Proceeding (see below). (To the extent that a particular enhanced service is deemed to be an information service under the Consent Decree, NYNEX would continue to be prohibited by the Consent Decree from providing such a service. (See "Operations Under the Consent Decree" above.)) In November 1986, the FCC adopted an order providing for the withdrawal of its mandatory structural separation requirements with respect to the Company's provision of CPE, subject to compliance with certain requirements generally similar to those imposed in the Third Computer Inquiry order.

The FCC adopted an order in December 1986 in its Joint and Common Cost Proceeding. This proceeding concerns the accounting controls (in lieu of structural separation) to be applied to the provision of nonregulated services. The FCC has adopted rules for determining the costs to be attributed to nonregulated services and removed from regulated rates. The FCC has made compliance with these rules one of the preconditions for the Company's and other LECs' relief from structural separation requirements applicable to the provision of enhanced services and CPE. The Company must file cost apportionment manuals with the FCC no later than September 1, 1987.

Effective January 1, 1987, the Company's provision of billing and collection services to interexchange carriers was detariffed. The Company now provides these services on a contractual basis. A contract has been signed between the Company and AT&T for the provision of these services, and negotiations are ongoing between the Company and other interexchange carriers.

Effective January 1, 1987, the installation and maintenance of inside wire was deregulated and existing tariffs were withdrawn in the areas served by the Company. In their place, the Company is offering a variety of optional inside wire installation and maintenance plans.

State Regulation

Set forth below is a description of certain intrastate regulatory proceedings with respect to changes in rates and revenues. The Company is unable to state with certainty the amounts or effective dates of any changes that may be ordered or the actual revenues which may result from any such changes.

Intrastate Rates

Increases in annual intrastate revenues* authorized for the Company aggregated \$45 million in 1982, \$45.6 million in 1983, \$63.9 million in 1984 and \$49.2 million in 1985. The Company sought no rate increases in 1986.

*The term "revenues" refers to an estimated first year revenue amount, stated on an annual basis, which a rate change is intended to produce. In later years the annual effect of a revenue change may differ due to restriction or stimulation in demand caused by higher or lower rates, respectively.

As a result of divestiture, the Company was restructured and has new modes of operation and new tariff structures. The extent of the changes caused by restructuring generally does not permit meaningful comparisons of most post-divestiture and pre-divestiture intrastate revenue increases.

Maine. On September 27, 1985, the Company filed tariffs with the Maine Public Utilities Commission ("MPUC") for an increase in rates designed to produce additional annual revenues of approximately \$43.5 million. On December 20, 1985, the MPUC issued an order authorizing \$16.3 million in annual revenues. Increased rates for services other than exchange service became effective on January 1, 1986, and increased exchange service rates became effective on February 15, 1986.

On November 26, 1986, the MPUC issued a Notice of Investigation to evaluate the reasonableness of the Company's rates. On February 2, 1987, the Company filed materials in support of its revenue requirement.

On March 3, 1987, the Company, the MPUC Staff and the Office of the Public Advocate filed a Stipulation which resolved most of the revenue requirement issues raised in the investigation. The Stipulation provides for an annual rate decrease of approximately \$9.2 million as well as a one-time credit to customers of approximately \$1.0 million. The MPUC approved the Stipulation on March 25, 1987.

Massachusetts. On October 22, 1986, the Massachusetts Department of Public Utilities ("MDPU") ordered the Company to file testimony, evidence and all material concerning its revenue requirement. The Company complied with the order on January 5, 1987. This filing showed a \$76 million increase in intrastate revenue requirements. The MDPU is not expected to determine the total revenue requirements of the Company until June or July 1987.

New Hampshire. In December 1984, the New Hampshire Public Utilities Commission ("NHPUC") granted the Company's petition for a temporary increase of \$21.6 million in annual revenues. The NHPUC's final order in June 1985 authorized a permanent increase of \$21.5 million and required a refund to customers of the difference between the temporary rates and the permanent rates. The NHPUC also ordered that a proceeding be opened to examine the Company's capital structure. Hearings in that proceeding are scheduled for June 1987.

Rhode Island. There were no proceedings before the Rhode Island Public Utilities Commission which had a material effect on the level of Company revenues in 1986.

Vermont. The Vermont Public Service Board ("VPSB") issued an order authorizing a \$16.5 million increase in annual revenues which became effective on December 21, 1985.

In July 1986, the Company refunded a total of \$1.04 million to Vermont customers and Vermont independent telephone companies. This refund was in accordance with a Vermont Supreme Court ruling which found a prior VPSB rate award, which had been based solely upon increased depreciation expenses, to be improper.

On January 6, 1987, the Company announced a tentative five year agreement with the Vermont Department of Public Service ("VDPS"). This agreement generally provides for stabilization of basic exchange service rates for residence and small business customers. In return, the Company is afforded greater pricing flexibility for other services and freedom from rate of return regulation. Specifically, basic exchange service rates will not increase through 1988, and may only increase by approximately 1% per year between 1989 and 1991. Enabling legislation and VPSB approval, after hearings, are required before the agreement can be implemented.

The Company also agreed to provide Vermont customers with a one-time refund totaling \$5.4 million to be reflected in their 1987 bills. In return, the VDPS agreed to dismiss its appeal before the Vermont Supreme Court of the VPSB's decision in the Company's most recent rate case.

Intrastate Access Charges.

Massachusetts. Intrastate intraLATA access charges and revised intrastate interLATA access charges became effective in Massachusetts on December 1, 1986. It is estimated that the intrastate access charges, as filed, will reduce the Company's annual intrastate revenue by approximately \$2.7 million.

Vermont. An interim access charge tariff became effective in Vermont in May 1986. The VPSB has initiated a proceeding in which it is investigating the appropriate access services, tariff structure and rates, and is also investigating whether presubscription of customers should be offered.

The outcome of the refund matters described above under "Regulated Services" is not presently determinable, but, in the opinion of management based on the advice of counsel, the ultimate resolution of such matters will not have a material adverse impact on the Company's financial position and results of operation.

Competition

Advances in technology, as well as regulatory and court decisions, have expanded the types of communications products and services available in the market, as well as the number of alternatives to telecommunications services provided by the Company. New technology may provide a means for both residence and business customers to reduce or avoid use of the local network for exchange access and exchange telecommunications. Interexchange carriers and end users increasingly are seeking competitive alternatives to the use of the local exchange network of the Company in order to originate and complete both interstate and intrastate communications.

With respect to interstate communications, the extent of the FCC's actions to permit the recovery of an increasing proportion of the Interstate Costs directly from end users through EUCLCs will necessarily determine the amount of residual costs to be recovered from interexchange carriers. (See "Federal Regulation - Interstate Access Charges" above.) To the extent that EUCLCs fail to recover an increasing proportion of such Interstate Costs, and absent other tariff alternatives, the rates paid by interexchange carriers will be higher. Delays or changes in the scheduled implementation of EUCLCs will further encourage interexchange carriers and end users to seek alternative means of originating and completing interstate communications. An increasing number of large companies with substantial capital, technological and marketing resources presently are able to provide such telecommunications services for themselves and for other companies.

With respect to intrastate communications, interexchange carriers and resellers are also required to pay access charges for intrastate interLATA access, and similar efforts to avoid use of the local network will occur unless such access charges are properly priced in relation to the actual cost of providing access.

State regulators determine whether interexchange and other carriers are permitted to provide intraLATA services. Pursuant to commitments filed with the Court, where intraLATA competition has been authorized, the Company must provide access service which is technically equivalent in quality to that which it provides to itself. The MDPU and VPSB have authorized intrastate intraLATA competition in Massachusetts and Vermont, respectively. In Massachusetts, the MDPU has authorized nine carriers to provide intrastate intraLATA service. In Vermont, the VPSB has authorized two carriers to provide such service.

The ultimate impact of competition on the provision of telecommunications services and equipment will depend, to a considerable degree, on future Federal and state regulatory actions to permit flexible pricing of competitive services, court decisions, possible Federal and state legislation and the Company's ability to incorporate the latest technology in the products and services it markets. The Company is unable to predict the effect of such competition on its future revenues, expenses, rate of return, profit or growth.

Employee Relations

The Company has approximately 26,900 employees. Approximately 17,300 employees are represented by unions. Of those so represented, approximately 99% are represented by the International Brotherhood of Electrical Workers ("IBEW") and 1% by the Communications Workers of America ("CWA"), both of which are affiliated with the AFL-CIO.

In August 1986, new three-year collective bargaining contracts for represented employees were executed between the Company and the IBEW and the CWA. These contracts provide for wage increases of 2.5% in the first year and 1.0% in each of the second and third years together with capped cost-of-living adjustments in the second and third years and improvements in pensions, medical and health care, income protection and employment security.

Item 2. PROPERTIES.

The properties of the Company do not lend themselves to simple description by character and location of principal units.

At December 31, 1986, the gross book value of telephone plant and equipment was \$8.5 billion, consisting principally of: central office equipment (39%); outside aerial and underground facilities (37%); other telephone equipment, mainly station connections (12%); land and buildings (7%); and the remaining (5%) principally plant under construction and furniture and office equipment.

Substantially all of the Company's central office equipment is located in buildings owned by the Company situated on land which it owns in fee. Many administrative offices, garages and business offices are in rented quarters.

Item 3. LEGAL PROCEEDINGS

Contingent Liabilities Agreement

The Plan provides for the recognition and payment of liabilities that are attributable to pre-divestiture events (including transactions to implement divestiture), but that do not become certain until after divestiture. These contingent liabilities relate principally to litigation and other claims against AT&T, its affiliates and the LECs with respect to rates, taxes, contracts and torts (including business torts, such as alleged violations of the antitrust laws).

With respect to such liabilities, AT&T and the LECs will share the costs of any judgment or other determination of liability entered by a court or administrative agency against any of them, whether or not a given entity is a party to the proceeding and regardless of whether an entity is dismissed from the proceeding by virtue of settlement or otherwise. Other costs to be shared would include the costs of defending the claim (including attorneys' fees and court costs) and the cost of interest or penalties with respect to any such judgment or determination.* Except as described below, responsibility for such contingent liabilities will generally be divided among AT&T and the LECs on the basis of their relative net investment as of the effective date of divestiture. Under this general rule of allocation, the Company will pay approximately 3.5% of any judgment or determination of liability.

Where all or part of a liability relates exclusively to pre-divestiture interstate operations, responsibility will be allocated among AT&T and the LECs in proportion to their relative net investment devoted to interstate services as of the effective date of divestiture. Under this rule of allocation, the Company will pay approximately 3.6% of any judgment or determination of liability.

* To simplify the administration of relatively small proceedings (other than claims relating to Federal income taxes or to tax-timing and investment tax credit adjustments attributable to state and local income taxes), the responsibility is shared only for amounts exceeding \$1 million for each judgment or determination of liability. The responsibility for judgments or determinations of \$1 million or less, and the first \$1 million of other judgments or determinations, remains with the entities that are actually parties to the particular proceeding.

Where all or part of a liability relates exclusively to pre-divestiture intrastate operations, responsibility will be allocated among AT&T and the LECs in proportion to their operations in that state. The allocation will be in proportion to the companies' relative net investment devoted to intrastate services as of the effective date of divestiture. Under this rule of allocation, the Company will pay the following approximate percentages of any judgment or determination of liability: 99.5% in Massachusetts and 100% in Maine, New Hampshire, Rhode Island and Vermont. AT&T will be liable for the remainder of any judgment or determination of liability.

Where there is a liability relating to Federal income tax deficiencies or overpayments for the former Bell System's pre-divestiture consolidated tax return years, the amount initially will be divided between AT&T and the individual LECs in accordance with pre-divestiture tax allocation agreements. To the extent that any portion of an amount thus allocated relates to tax-timing adjustments, that portion of the liability will be further allocated to the entity that will receive the benefit or detriment of such tax-timing adjustment. To the extent that any portion of an amount relates to investment tax credits, that portion of the liability will be assigned between AT&T and a LEC on the basis of the Plan's assignment of the assets that gave rise to the investment tax credits. All other amounts allocated to that LEC under the tax allocation agreements will be assigned between AT&T and that LEC on the basis of the relative net investment held, as of the effective date of divestiture, by that LEC and by the AT&T owned subsidiaries created to receive that LEC's interLATA facilities and CPE.

Antitrust Actions

The Company will be responsible for sharing in any judgment rendered, subject to the allocation rules described above, in a number of pending private antitrust actions of varying magnitudes, which allege, among other things, violations of Federal and state antitrust laws and claim substantial monetary damages and a variety of equitable relief. One case challenges the validity of Bell System tariffs that had required protective connecting arrangements for the interconnection of customer-provided terminal equipment to the network. This case also includes allegations relating to predatory pricing of terminal equipment and procurement practices. Another case challenges the Bell System's procurement practices with respect to particular items of equipment. In addition, there are a few miscellaneous private actions which challenge a variety of conduct on the part of former Bell System companies that allegedly violated the antitrust laws.

In November 1986, a settlement was reached in a private antitrust case that had alleged that the Bell System's interconnection practices for competitive intercity services violated the antitrust laws. The amount of the settlement was shared by AT&T and other former Bell System operating companies pursuant to the allocation rules described above. The aggregate amount of the Company's share of this settlement, as recorded in the Company's financial statements, was not material.

The outcome of the antitrust and other litigation described above and other pending litigation is not presently determinable, but, in the opinion of management based on the advice of counsel, the ultimate resolution of such matters will not have a material adverse impact on the Company's financial position.

We hereby certify that the condensed return of its business and financial condition contained on pages 17 to 38 inclusive of this Form 10-K Annual Return is full, just and true.



Treasurer



Vice President - Finance and Comptroller

THE COMMONWEALTH OF MASSACHUSETTS Suffolk s.s.
Boston, March 30, 1987. Then personally appeared the above-named J.H. Cogswell, Treasurer and P.C. Manus, 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 June 4, 1993

PART II

Item 6. SELECTED FINANCIAL DATA

SELECTED FINANCIAL DATA*

Dollars in Millions	<u>1986</u>	<u>1985</u>	<u>1984</u>	<u>1983</u>	<u>1982</u>
Operating revenues.	\$3,259	\$3,086	\$2,844	\$3,088	\$2,976
Operating expenses.	\$2,234	\$2,121	\$1,945	\$2,174	\$2,068
Interest expense.	\$ 166	\$ 164	\$ 179	\$ 181	\$ 163
Net income.	\$ 410	\$ 380	\$ 325	\$ 327	\$ 321
Telephone plant - net	\$5,867	\$5,733	\$5,448	\$5,669	\$5,316
Total assets.	\$6,812	\$6,595	\$6,321	\$6,511	\$6,046
Long-term debt.	\$1,771	\$1,774	\$1,726	\$1,718	\$1,715
Share owner's equity.	\$2,718	\$2,625	\$2,532	\$2,580	\$2,515
Total construction.	\$ 743	\$ 843	\$ 765	\$ 830	\$ 806
Return to equity.	15.22%	14.51%	13.55%	12.75%	12.85%
Ratio of earnings to fixed charges+.	4.98	4.59	3.78	3.84	3.91

SELECTED OPERATING DATA

In thousands

Network access lines in service

at December 31.	4,975	4,804	4,651	4,479	4,347
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* Financial data for 1986, 1985 and 1984 reflect post-divestiture results of New England Telephone and Telegraph Company (the "Company"), a restructured entity with new modes of operation and new tariff structures. Financial data for 1983 and 1982 reflect the historical financial data of the Company as a wholly owned subsidiary of American Telephone and Telegraph Company ("AT&T"). The extent of the changes required as a result of divestiture generally does not permit meaningful comparisons of post-divestiture and pre-divestiture financial data.

+ For the purpose of this ratio: (i) earnings have been calculated by adding to Income before interest expense the amount of related taxes on income and the estimated portion of rentals representative of the interest factor; and (ii) fixed charges are comprised of Interest expense and the estimated interest portion of rentals.

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

For the year ended December 31, 1986 as compared to December 31, 1985

Operating Revenues

Total 1986 operating revenues increased \$172.4 million, a 5.6% increase over 1985.

Local service revenues increased \$82.8 million, or 6.8%, due to rate awards in 1985 in various jurisdictions which generated \$30.0 million and increased demand for telecommunications services which accounted for \$52.8 million.

Network access revenues increased \$71.6 million, or 8.1%, due primarily to an increase in interstate access revenues of \$58.0 million. Of this increase, \$80.4 million was a result of additional switched access and special access revenues due to higher rates and usage. This increase in interstate access revenues was partially offset by reduced Carrier Common Line pool revenues of \$22.7 million. Intrastate access revenues increased \$13.6 million due primarily to greater volume.

Toll service revenues increased \$88.7 million, or 11.5%, due principally to increased usage of \$79.4 million and rate awards in various jurisdictions which generated \$9.3 million.

Directory and other operating revenues decreased \$63.7 million, or 27.1%, primarily due to reduced revenues of \$40.9 million from reduced charges for billing and collection services provided to interexchange carriers and reduced shared network facilities revenues of \$19.9 million.

Operating Expenses

Total operating expenses increased by \$113.5 million, or 5.4%, from 1985.

Maintenance expense increased \$42.0 million, or 6.4%, primarily as a result of increases in computer related expenses and contracted services. There were also increases in Company labor and material expenses. These increases were partially offset by insurance reimbursements in 1986 for expenses incurred during 1985 associated with Hurricane Gloria.

Depreciation expense increased \$50.6 million, or 9.0%, due primarily to increased plant investment.

Provisions for pensions and other employee benefits decreased \$27.6 million, or 13.3%, due principally to a \$9.9 million reduction in pension costs due to actuarial experience and the transfer of employees to affiliated companies whose costs are now included in contracted services.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS. (continued)

The remaining operating expenses increased \$48.5 million, or 7.0%, due to increased costs for contracted and centralized services. These increases were partially offset by decreases in rental expense for network facilities shared with AT&T Communications and by reduced accident and damage expense.

Operating Taxes

Total operating taxes increased \$28.4 million, or 6.4%, reflecting an increase in Federal and State income taxes resulting from higher pre-tax income.

Anticipated Effects of Inflation

In recent years there has been a sharp decline in the rate of inflation nationwide. This trend continued in 1986 when inflation had an insignificant effect on the Company's results of operations. The Company has a substantial portion of assets in the form of property, plant and equipment. The generation of replacement capital for these assets through depreciation charges can be impeded by high levels of inflation. Under the rate-making process prescribed by the regulatory commissions to which the Company is subject, only the historical cost of telephone plant is recoverable in revenues as depreciation. Therefore, the cost of net telephone plant, stated in terms of replacement cost over the average historical cost of net telephone plant, is not presently recoverable in rates as depreciation. Although the rate-making process gives no recognition to the replacement cost of telephone plant, based on past practices, the Company believes that it will be allowed to earn a return on the increased cost of net investment when replacement of facilities actually occurs.

Anticipated Effects of the Tax Reform Act of 1986

In October 1986, Congress enacted the Tax Reform Act of 1986 (the "Act"). Since substantially all of the Company's operations are subject to either federal or state regulation, the projected impact of the Act on the results of operations and financial position of the Company is dependent upon actions to be taken by such regulatory bodies. Therefore, quantification of the effect of such actions cannot be determined. There are, however, two principal areas in which the Act will affect the Company: (1) reduction in the tax rate and (2) elimination of the investment tax credit ("ITC").

Provisions of the Act will cause the statutory rate used in computing Federal tax expense to decrease from 46% in 1986 to a blended rate of 39.95% in 1987 and to 34% in 1988 and thereafter. However, the tax expense decreases of the Company may be offset, in whole or in part, by reductions in current or future utility rates or accelerated cost allowances for other items.

The elimination of the ITC is expected to increase the current tax liability for the Company as well as to reduce an available source of capital. The loss of the ITC as a capital source is not expected to have a significant effect on the Company's capital spending program. Management expects to finance such capital expenditures through other internal or external financing sources.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS. (continued)

Additionally, the final 1986 estimated tax payment of the Company in March 1987 will reflect the repeal of ITC which results in an increased tax payment of approximately \$44 million. Although this payment affects the Company's cash requirements in 1987, management expects to provide the funds for this additional tax liability through various sources of internal or external financing.

Any remaining changes under the Act, including changes relating to depreciation tax accounting methods, bad debt expense deductions and reinstatement of the research and development credit, are not expected to have a significant effect on the Company.

Anticipated Effect of Statement of Financial Accounting Standards No. 87 "Employers' Accounting for Pensions"

Effective January 1, 1987, the Company will implement, for financial reporting purposes, the provisions of Statement of Financial Accounting Standards No. 87 "Employers' Accounting for Pensions" ("Statement No. 87") for both of the defined benefit pension plans maintained for the Company's employees. Preliminary actuarial evaluations indicate that pension costs as calculated under Statement No. 87 for 1987 will not, in the aggregate, be significantly different than pension costs as calculated under the Aggregate Cost Method, which the Company currently uses for financial reporting as well as rate-making purposes. There are anticipated reductions in 1987 pension costs, primarily due to actuarial experience.

Depending on regulatory decisions, the pension costs of the Company allowed for rate-making purposes could be less than costs determined under Statement No. 87. Based upon regulatory actions, the Company may report these lower costs for financial reporting purposes if the difference between amounts reported and Statement No. 87 pension cost is to be allowed for future rate-making purposes.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Report of Management

The financial statements on the following pages have been prepared in conformity with generally accepted accounting principles and, in the judgment of management, present fairly the Company's financial position and results of operations.

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 on Form 10-K unless indicated otherwise. Accordingly, management maintains a system of internal accounting controls which is reviewed and evaluated on an ongoing basis. Our internal auditors monitor compliance with the system of internal accounting controls in connection with the annual plan of internal audits. However, there are inherent limitations that should be recognized in considering the assurances provided by any system of internal accounting controls. The concept of reasonable assurance recognizes that the costs of a system of internal accounting controls should not exceed, in management's judgment, the benefits to be derived from the system. Management believes that the Company's system does provide reasonable assurance that transactions are executed in accordance with management's general or specific authorizations and are recorded properly to maintain accountability for assets and to permit the preparation of financial statements in conformity with generally accepted accounting principles. Management also believes that this system provides reasonable assurance that access to assets is permitted only in accordance with management's authorizations, that the recorded assets are compared with the existing assets at reasonable intervals and that appropriate action is taken with respect to any differences. Management also seeks to assure the objectivity and integrity of its financial data by careful selection of its managers, by organizational arrangements that provide an appropriate division of responsibility and by communications programs aimed at assuring that its policies, standards and managerial authorities are understood throughout the organization.

These financial statements have been examined by Coopers & Lybrand, Independent Certified Public Accountants.

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

P. C. Manus
Vice President - Finance and Comptroller

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Board of Directors
and the Share Owner of
New England Telephone and
Telegraph Company

We have examined the financial statements and the financial statement schedules of New England Telephone and Telegraph Company as listed in Item 14(a) of this Form 10-K. 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 referred to above present fairly the financial position of New England Telephone and Telegraph Company as of December 31, 1986 and 1985, and the results of their operations and changes in their financial position for each of the three years in the period ended December 31, 1986, in conformity with generally accepted accounting principles applied on a consistent basis. In addition, the financial statement schedules referred to above, when considered in relation to the basic financial statements taken as a whole, present fairly the information required to be included therein.

COOPERS & LYBRAND

Boston, Massachusetts
February 6, 1987

NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY
STATEMENTS OF INCOME AND RETAINED EARNINGS

Dollars in Millions

	For the Year Ended December 31,		
	1986	1985	1984
OPERATING REVENUES			
Local service			
Service and equipment charges	\$1,023.7	\$ 966.5	\$ 902.1
Message charges	187.8	168.6	155.6
Public telephones and other	93.2	86.8	78.8
Network access [Note (I)]	956.4	884.8	770.7
Toll service			
Message charges	534.2	487.2	440.9
WATS, private lines and other	322.5	280.8	226.2
Directory and other [Notes (I) and (J)]	171.5	235.2	293.3
Provision for uncollectibles	(30.5)	(23.5)	(23.6)
Total operating revenues	3,258.8	3,086.4	2,844.0
OPERATING EXPENSES			
Maintenance	693.2	651.2	644.3
Depreciation	614.4	563.8	410.7
Marketing and customer services	250.6	220.3	207.7
Provisions for pensions and other employee benefits [Note (C)]	180.5	208.1	219.6
Network and operator services	145.6	138.8	144.8
Financial operations	126.1	104.1	95.7
Centralized services [Note (J)]	119.3	96.7	79.8
Other	104.6	137.8	142.7
Total operating expenses	2,234.3	2,120.8	1,945.3
Net operating revenues	1,024.5	965.6	898.7
OPERATING TAXES			
Federal income [Note (B)]	261.5	237.8	193.8
State income [Note (B)]	46.0	42.1	33.2
Property	46.7	44.9	64.5
Other [Note (K)]	117.6	118.6	122.5
Total operating taxes	471.8	443.4	414.0
Operating income	552.7	522.2	484.7
OTHER INCOME AND DEDUCTIONS - NET [NOTE(B)]			
Income before interest expense	23.3	21.3	19.2
Income before interest expense	576.0	543.5	503.9
INTEREST EXPENSE			
	165.7	164.0	179.1
NET INCOME			
	\$ 410.3	\$ 379.5	\$ 324.8
RETAINED EARNINGS			
Beginning of year	\$ 833.8	\$ 755.7	\$ 704.8
Net income	410.3	379.5	324.8
Dividends	(316.8)	(301.4)	(273.9)
End of year	\$ 927.3	\$ 833.8	\$ 755.7

See notes to financial statements.

NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY
BALANCE SHEETS
 Dollars in Millions

	December 31,	
<u>ASSETS</u>	1986	1985
Telephone plant		
In service	\$8,301.5	\$7,868.9
Under construction	<u>178.4</u>	<u>170.1</u>
	8,479.9	8,039.0
Less: accumulated depreciation.	<u>2,613.3</u>	<u>2,306.3</u>
	<u>5,866.6</u>	<u>5,732.7</u>
Current assets		
Cash [Note (D)].	16.2	15.7
Receivables		
Customers (net of allowance of \$16.8 and \$11.8, respectively) [Note (I)].	612.6	578.0
Affiliates [Note (J)].	7.2	4.9
Other.	42.4	46.1
Material and supplies.	56.9	53.6
Charges deferred for one year.	72.7	70.7
Prepaid expenses and other current assets. . .	<u>15.5</u>	<u>15.7</u>
	<u>823.5</u>	<u>784.7</u>
Other assets and deferred charges [Note (J)] . .	<u>122.3</u>	<u>77.6</u>
TOTAL ASSETS	<u>\$6,812.4</u>	<u>\$6,595.0</u>

See notes to financial statements.

NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY

BALANCE SHEETS

Dollars in Millions

	December 31,	
	<u>1986</u>	<u>1985</u>
<u>SHARE OWNER'S EQUITY, LIABILITIES AND DEFERRED CREDITS</u>		
Share owner's equity		
Common stock - one share, without par value [Note (E)]	\$1,791.1	\$1,791.1
Retained earnings	927.3	833.8
	<u>2,718.4</u>	<u>2,624.9</u>
Long-term debt [Note (F)]	<u>1,770.7</u>	<u>1,773.7</u>
Current liabilities		
Accounts payable [Note (D)]		
AT&T [Note (I)]	136.5	146.4
Affiliates [Note (J)]	92.2	76.4
Compensated absences	72.7	76.4
Trade and other	185.3	221.8
Taxes accrued	138.4	40.7
Dividends payable	79.2	76.8
Debt maturing within one year [Note (G)]	40.7	117.4
Interest accrued	40.7	35.0
Advance billing and customers' deposits	31.6	31.5
Income taxes deferred for one year	14.5	7.0
	<u>831.8</u>	<u>829.4</u>
Deferred credits		
Accumulated deferred income taxes	1,118.3	991.7
Unamortized investment tax credits	347.9	363.8
Other	25.3	11.5
	<u>1,491.5</u>	<u>1,367.0</u>
Commitments and contingencies [Notes (H) and (L)]		
TOTAL SHARE OWNER'S EQUITY, LIABILITIES AND DEFERRED CREDITS	<u>\$6,812.4</u>	<u>\$6,595.0</u>

See notes to financial statements.

NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY
STATEMENTS OF SOURCES OF FUNDS
SUPPORTING CONSTRUCTION ACTIVITY
Dollars in Millions

	<u>For the Year Ended December 31,</u>		
	<u>1986</u>	<u>1985</u>	<u>1984</u>
Funds from operations:			
Net Income	\$ 410.3	\$ 379.5	\$324.8
Add expenses not requiring funds currently:			
Depreciation	614.4	563.8	410.7
Deferred income taxes - net	133.7	96.9	107.3
Deferred tax credits - net.	(10.9)	34.2	46.9
Deduct income not providing funds currently:			
Interest charged construction . . .	14.2	12.9	17.9
Total funds from operations. . . .	<u>1,133.3</u>	<u>1,061.5</u>	<u>871.8</u>
Less: dividends	<u>316.8</u>	<u>301.4</u>	<u>273.9</u>
	<u>816.5</u>	<u>760.1</u>	<u>597.9</u>
Funds from external financing:			
Equity investment by parent.	-	14.6	151.9
Issuance of long-term debt	344.0	197.0	-
Change in short-term borrowings - net.	<u>(76.7)</u>	<u>(69.0)</u>	<u>(92.4)</u>
	267.3	142.6	59.5
Less: retirement of long-term debt. .	<u>351.5</u>	<u>154.6</u>	<u>-</u>
	<u>(84.2)</u>	<u>(12.0)</u>	<u>59.5</u>
Changes in working capital (excluding debt maturing within one year and income taxes deferred for one year):			
Cash.	(5)	6.5	(7.0)
Receivables	(33.2)	38.0	(100.1)
Material and supplies	(3.3)	(3.7)	.7
Charges deferred for one year	(2.0)	5.3	(2.6)
Prepaid expenses and other current assets. . . . .	.2	(4.5)	40.2
Accounts payable.	(34.3)	9.4	117.8
Taxes accrued	97.7	(8.5)	(13.2)
Dividends payable	2.4	76.8	-
Interest accrued.	5.7	8.7	.2
Advance billing and customers' deposits.	<u>.1</u>	<u>1.4</u>	<u>1.1</u>
	<u>32.8</u>	<u>129.4</u>	<u>37.1</u>
Other changes:			
Other assets and deferred charges . .	(44.7)	(30.6)	23.5
Other - net	8.7	(16.4)	29.6
	<u>(36.0)</u>	<u>(47.0)</u>	<u>53.1</u>
Funds supporting construction activity. .	729.1	830.5	747.6
Add: interest charged construction. .	<u>14.2</u>	<u>12.9</u>	<u>17.9</u>
Total Construction.	<u>\$ 743.3</u>	<u>\$ 843.4</u>	<u>\$765.5</u>

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

(A) Accounting Policies

Basis of Presentation

New England Telephone and Telegraph Company (the "Company") is a wholly owned subsidiary of NYNEX Corporation ("NYNEX") and provides exchange telecommunications and exchange access services within Local Access and Transport Areas ("LATAs").

On January 1, 1985, NYNEX transferred a 33 1/3% ownership interest in NYNEX Service Company ("NYNEX Service") to the Company. The remaining ownership interest was transferred to New York Telephone Company, a wholly owned subsidiary of NYNEX. The share owners' voting rights are divided equally between the Company and New York Telephone Company. The Company uses the equity method of accounting for its investment in NYNEX Service.

The financial statements have been prepared in conformity with generally accepted accounting principles applicable to regulated utilities. Such accounting principles are consistent in all material respects with accounting rules prescribed by the Federal Communications Commission (the "FCC"), except for certain intrastate items accorded a different accounting treatment by state regulatory commissions.

The 1985 and 1984 financial statements have been reclassified to conform to the current year's format.

Telephone Plant

Telephone plant is stated at its original cost.

When depreciable plant is disposed of, the amount at which such plant has been carried in telephone plant in service, as well as salvage and the cost to remove such plant, is charged to accumulated depreciation.

Material and Supplies

Material and supplies are carried principally at average cost.

Depreciation

Depreciation rates used by the Company are prescribed by the FCC. All rates are calculated using the "remaining life" method. Most new plant is depreciated using the equal life group method, which approximates a straight-line unit depreciation method. Older plant is depreciated using the vintage group method, which provides depreciation at lesser amounts per year than would be provided under a straight-line unit depreciation method.

NOTES TO FINANCIAL STATEMENTS (continued)

Station Connections

Certain costs of installing telephone service on a customer's premises have been expensed since January 1981, as prescribed by the FCC. The balance of the investment in installation costs capitalized prior to 1981 is being amortized to expense over a period of up to ten years.

Interest Charged Construction

Regulatory authorities in Maine, Massachusetts, New Hampshire and Rhode Island allow the Company to accrue interest, including an allowance on share owner's equity, as a cost of constructing certain plant and as an item of income, which is included in Other Income and Deductions - Net. Such income is not realized in cash currently, but will be realized over the service life of the plant as the resulting higher depreciation expense is recovered through the rate-making process. As a result of regulatory action in Vermont, interest during construction is not treated as an item of income for that state as of January 1, 1986.

Compensated Absences

The Company accrues a liability for employees' rights to receive compensation for future absences. In accordance with Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation" ("Statement No. 71"), the Company defers such costs in the balance sheets until the compensation is paid and recovered through rates.

Income Taxes

The Company's provision for Federal income taxes currently payable is allocated in accordance with its contribution to the consolidated group's taxable income and tax credits.

Income tax regulations allow recognition of certain transactions for tax purposes in time periods other than the period during which the transactions will be recognized in the determination of net income for financial reporting purposes. Appropriate income tax charges and their subsequent reversal, reflected as Federal income taxes deferred - net [See Note (B)], prevent the tax effect of these timing differences from distorting net income.

NOTES TO FINANCIAL STATEMENTS (continued)

Income Taxes (continued)

Deferred income tax provisions are recorded for timing differences when recognized currently by regulators in the rate-making process.

The principal timing difference relates to depreciation. Depreciation for income tax purposes is determined based on accelerated methods and shortened lives which cause such depreciation to be higher during the early years of plant life and lower in later years than the corresponding depreciation charges for such plant reflected in the financial statements. The accumulated tax effects of these timing differences are shown in the accompanying balance sheets as Deferred credits - Accumulated deferred income taxes. [See Note (B).]

Investment tax credits resulted from provisions of Federal tax law which allowed for a reduction in tax liability based on certain capital expenditures. Corresponding reductions in tax expense were deferred and are amortized as reductions in tax expense over the life of the plant which gave rise to the credits. The Tax Reform Act of 1986 repealed the investment tax credit effective January 1, 1986, but provided transition rules which allow the Company certain investment tax credits in 1986 and in later years.

(B) Income Taxes

The components of operating income tax expense are as follows:

Dollars in Millions	1986	1985	1984
Federal:			
Current.	\$149.6	\$123.5	\$ 54.3
Deferred - net	122.8	80.1	92.6
Deferred tax credits - net	(10.9)	34.2	46.9
	<u>261.5</u>	<u>237.8</u>	<u>193.8</u>
State:			
Current.	35.1	25.3	18.5
Deferred - net	10.9	16.8	14.7
	<u>46.0</u>	<u>42.1</u>	<u>33.2</u>
Total.	<u>\$307.5</u>	<u>\$279.9</u>	<u>\$227.0</u>

NOTES TO FINANCIAL STATEMENTS (continued)

Income tax expense included in Other Income and Deductions - Net was \$7.0, \$6.4 and \$3.2 million in 1986, 1985 and 1984, respectively.

Federal income tax expense for each of the years ended December 31, 1986, 1985 and 1984 was less than the amounts computed by applying the statutory Federal income tax rate to pre-tax income. The reasons for the differences are as follows:

	1986	1985	1984
Statutory rate	46.0%	46.0%	46.0%
a. Amortization of investment tax credits over the life of the plant which gave rise to the credits.	(6.3)	(6.3)	(5.7)
b. Certain taxes and payroll-related construction costs capitalized for financial statement purposes, but deducted currently for income tax purposes, net of applicable depreciation . .	.7	(.2)	(1.2)
c. Interest charged construction, which is excluded from taxable income, net of applicable depreciation	(.3)	(.2)	(.9)
d. Other differences.	<u>(.6)</u>	<u>(.2)</u>	<u>(.5)</u>
Effective tax rate	<u>39.5%</u>	<u>39.1%</u>	<u>37.7%</u>

The amortization of investment tax credits was \$42.5, \$39.5 and \$29.5 million in 1986, 1985 and 1984, respectively.

The cumulative net amount of income tax timing differences for which deferred income taxes are not provided are represented principally by (b), (c) and (d) above. The tax effects of these amounts are not recorded currently because regulatory commission procedures result in such costs being charged to customers when the timing differences reverse and the taxes are paid. As of December 31, 1986, the cumulative net amount of these items was \$480.7 million.

NOTES TO FINANCIAL STATEMENTS (continued)

(C) Pension and Employee Benefits

NYNEX has two noncontributory defined benefit pension plans (the "Plans"), one for management and another for nonmanagement employees. Contributions, made to an irrevocable trust, are equal to the current year cost of the Plans determined using the Aggregate Cost Method. Total costs for the Company were \$54.5 million in 1986. This amount was developed using an assumed investment earnings rate of 8 1/4% for 1986, followed by a graduated decline to 5 1/2% for 1998 and for all years thereafter. Total costs were \$74.2 million in 1985. This amount was developed using an assumed investment earnings rate of 8 1/4% for 1985, followed by a graduated decline to 5 1/4% for 1998 and for all years thereafter. Total costs were \$81.6 million in 1984. These amounts were developed using an assumed investment earnings rate of 8% for 1984 and 1985, followed by a graduated decline to 5% for 1998 and for all years thereafter.

During 1986, there were amendments to both Plans, designed primarily to comply with revisions to applicable laws and reflect benefit changes. The effect of these amendments was to increase 1986 costs by approximately \$3.2 million. Changes in the assumed earnings rate, mentioned above, had the effect of decreasing 1986 costs by approximately \$9.2 million. The remaining decrease in 1986 costs was principally the result of recognition of 1985 actuarial experience, the use of an updated mortality table, the charging of investment costs to the Plan's trust and the transfer of employees to NYNEX Service.

During 1985, there were amendments to both Plans designed primarily to comply with revisions to applicable laws, to increase benefits and to grant special increases to previously retired employees. The effect of these amendments was to increase 1985 costs by approximately \$8.5 million. Changes in the assumed earnings rate, mentioned above, had the effect of decreasing 1985 costs by approximately \$10.2 million. The remaining decrease in 1985 costs was principally the result of recognition of 1984 actuarial experience. There were no plan amendments in 1984.

The actuarial present value of accumulated plan benefits and the fair value of net assets available for plan benefits are required disclosures. However, such disclosures are not presented for the Company as the structure of the Plans does not readily permit the Plans' assets and the accumulated benefits data to be disaggregated. Based on the actuarial valuation of the Plans as of January 1, 1986 and 1985 utilizing assumed rates of return averaging 8.2% and 9.6%, respectively, the fair value of the net assets available for plan benefits exceeded the actuarial present value of vested and nonvested accumulated plan benefits.

NOTES TO FINANCIAL STATEMENTS (continued)

The Company also provides certain health care and life insurance benefits for retired employees and their families. Substantially all of the Company's employees may become eligible for these benefits if they reach normal retirement age while working for the Company. Most of these benefits are provided through an insurance company whose premiums are based principally on the amount of benefits paid during the year. Total costs of providing benefits for active and retired employees and their families were \$85.6, \$92.1 and \$94.8 million in 1986, 1985 and 1984, respectively. The major portion of the costs of providing these benefits for the approximately 14,500 retirees is not separable from the costs of providing these benefits for the approximately 26,800 active employees.

(D) Cash

It is the practice of the Company to make certain payments by draft and to record such drafts as accounts payable until such time as the banks honoring the drafts have presented them for payment. Accordingly, outstanding drafts of \$56.2 and \$78.2 million at December 31, 1986 and 1985, respectively, are reflected in Accounts payable.

(E) Common Stock

In 1986 there was no change in the equity capital of the Company. The equity capital of the Company increased by \$9.6 and \$145.0 million in 1985 and 1984, respectively, through equity investments made by NYNEX and by \$5.0 and \$6.9 million in 1985 and 1984, respectively, in connection with the NYNEX Corporation Employee Stock Ownership Plan.

NOTES TO FINANCIAL STATEMENTS (continued)

(F) Long-Term Debt

Interest rates and maturities on long-term debt outstanding at December 31, 1986 are as follows:

Dollars in Millions	Interest rates				Total Outstanding
	3 1/8% to 4 5/8%	6 1/8% to 7 3/8%	8% to 9%	9 1/2% to 12 1/8%	
Debentures:					
1988-1999.	\$150.0	\$ -	\$ -	\$ -	\$ 150.0
2002-2010.	110.0	425.0	545.0	55.0	1,135.0
2017-2026.	-	-	350.0	200.0	550.0
Other.	-	-	-	10.2	10.2
	<u>\$260.0</u>	<u>\$425.0</u>	<u>\$895.0</u>	<u>\$265.2</u>	<u>1,845.2</u>
Unamortized (discount) premium - net.					<u>(74.5)</u>
Total					<u>\$1,770.7</u>

In 1988 and 1991, respectively, \$30.0 million of the Debentures will mature.

The Company's Debentures are callable upon thirty days' notice, at the option of the Company, five years after the issue date.

During 1986, the Company issued its Forty Year, 9% Debentures due March 1, 2026, in the aggregate principal amount of \$350.0 million, with a discount and related expenses of approximately \$6.0 million. The proceeds were applied to repurchase its Thirty-Seven Year, 12 1/5% Debentures due May 15, 2017 and its remaining Thirty-Seven Year, 15 1/4% Debentures due June 15, 2018 in the outstanding principal amounts of \$300.0 and \$18.4 million, respectively.

Call premiums on the repurchase or redemption of Debentures, as well as associated expenses, are deferred and amortized, to the extent permitted, over periods stipulated by the FCC. These deferrals are included as a reduction to Long-term debt in the accompanying balance sheets and amount to \$54.9 and \$23.0 million as of December 31, 1986 and 1985, respectively.

At December 31, 1986, the Company had \$200.0 million aggregate principal amount remaining of unissued, senior, unsecured debt securities registered with the Securities and Exchange Commission.

NOTES TO FINANCIAL STATEMENTS (continued)

(G) Debt Maturing Within One Year

Debt maturing within one year and related weighted average interest rates are as follows:

Dollars in Millions	December 31,			Weighted average interest rate		
	1986	1985	1984	1986	1985	1984
Advances from NYNEX. . .	\$36.7	\$115.7	\$ -	7.88%	8.02%	-
Notes payable:						
Bank loans	2.0	-	-	7.40%	-	-
Commercial paper . . .	-	-	185.7	-	-	8.24%
Other short-term debt. .	2.0	1.7	.7			
Total . . .	<u>\$40.7</u>	<u>\$117.4</u>	<u>\$186.4</u>			
Dollars in Millions	1986	1985	1984	1986#	1985#	1984#
Average amount of advances from NYNEX outstanding during the year.	\$ 70.8+	\$ 22.3+	-	7.13%	7.94%	-
Average amount of notes payable outstanding during the year.	\$ 1.7+	\$ 17.7+	\$186.3+	8.15%	8.34%	10.46%
Maximum amount of advances from NYNEX payable at any month end during the year	\$203.0	\$115.7	-			
Maximum amount of notes payable at any month end during the year.	\$ 2.0	\$111.0	\$281.0			

Interest expense on advances from NYNEX was \$5.0 and \$1.8 million in 1986 and 1985, respectively.

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

+ Computed by dividing the sum of the aggregate principal amounts outstanding each day during the year by the total number of calendar days in the year.

NOTES TO FINANCIAL STATEMENTS (continued)

(H) Lease Commitments

The Company leases certain facilities and equipment used in its operations and reflects lease payments as rental expense for the periods to which they relate. Rental expense was \$49.9, \$64.7 and \$62.4 million for 1986, 1985 and 1984, respectively. At December 31, 1986, the minimum lease commitments under noncancelable operating and capital leases for the periods shown are as follows:

Dollars in Millions

Year	Operating	Capital
1987	\$ 26.6	\$ 8.4
1988	20.4	8.3
1989	17.6	7.9
1990	14.9	6.5
1991	13.1	4.3
Thereafter	79.4	13.2
Total minimum lease payments	<u>\$172.0</u>	48.6
Less: executory costs		8.7
Net minimum lease payments		39.9
Less: interest		11.4
Present value of net minimum lease payments		<u>\$28.5</u>

Included in rental expense is \$38.0, \$51.8 and \$40.0 million for 1986, 1985 and 1984, respectively, representing a portion of the costs incurred under an agreement with AT&T for the use of shared network facilities. The Company can terminate or extend the period of use of these facilities by providing notice in accordance with the terms of the agreement. Furthermore, the amounts payable vary according to the volume of use of these facilities. Accordingly, no amounts for such shared network facilities have been included in the above schedule of minimum lease commitments.

In accordance with Statement No. 71, capital leases with inception dates after December 31, 1982 have been recorded in the financial statements. The amount of net assets and related obligations included in the accompanying balance sheets is not significant. Capital leases with inception dates before January 1, 1983 were accounted for as operating leases and will be recorded in the balance sheets beginning in 1987. Had such leases been capitalized, the amount of net assets and related obligations included in the accompanying balance sheets would have increased by \$21.1 and \$28.5 million at December 31, 1986 and 1985, respectively.

NOTES TO FINANCIAL STATEMENTS (continued)

(I) Transactions with AT&T

In 1986, 1985 and 1984, AT&T provided approximately 27%, 31% and 31%, respectively, of the Company's total operating revenues, primarily Network access revenues. Included in Directory and other revenues are charges for billing and collection services performed by the Company for AT&T. In connection with such services, the Company purchases the related receivables with recourse.

(J) Transactions with Affiliates

The Company receives a number of management and support services from NYNEX and NYNEX Service. NYNEX Service owns a one-seventh interest in Bell Communications Research, Inc. ("Bellcore"). Bellcore furnishes to NYNEX and its subsidiaries, including the Company, technical and support services relating to exchange telecommunications and exchange access services which include research and development. For 1986, 1985 and 1984, the Company recorded charges of \$297.6, \$106.3 and \$74.1 million, respectively, for these services. Effective January 1, 1986, the Company and New York Telephone Company transferred certain personnel performing internal data processing and related services to NYNEX Service. Under the terms of the transfer, NYNEX Service performs such data processing and related services on behalf of the Company and New York Telephone Company on a centralized basis. In December 1986, the Company made an equity investment of \$34.6 million into NYNEX Service. The investment is reflected in Other assets and deferred charges in the accompanying balance sheets.

The Company was charged approximately \$322.7, \$344.5 and \$210.2 million in 1986, 1985 and 1984, respectively, by NYNEX Materiel Enterprises for the purchase of materials (including items charged to plant accounts) and for various other procurement support activities including materials management, warehousing and transportation services.

The Company entered into an agreement with NYNEX Information Resources pursuant to which NYNEX Information Resources publishes directories previously published by the Company and in return pays to the Company a publishing rights fee for the right to produce, publish and distribute alphabetical and classified directories for the Company. For the years ended December 31, 1986, 1985 and 1984 publishing rights fees amounted to \$74.4, \$73.9 and \$64.8 million, respectively.

NOTES TO FINANCIAL STATEMENTS (continued)

During 1984, the Company transferred certain portions of its sales and marketing workforce to NYNEX Business Information Systems Company ("NYNEX Business Information Systems") under an agreement which stated that the Company would be provided with a sales and marketing effort by NYNEX Business Information Systems in return for sales commissions. For 1986, 1985 and 1984, the Company recorded \$13.2, \$10.5 and \$4.2 million, respectively, in sales commissions, to NYNEX Business Information Systems, pursuant to this agreement.

(K) Other Operating Taxes

The major components of Other operating taxes are as follows:

Dollars in Millions	1986	1985	1984
Gross receipts	\$ 60.1	\$ 58.6	\$ 57.5
Payroll-related.	56.9	59.4	59.9
Other. . . . .	.6	.6	5.1
Total.	<u>\$117.6</u>	<u>\$118.6</u>	<u>\$122.5</u>

(L) Litigation and Other Contingencies

Various legal actions and regulatory proceedings are pending which may affect the Company, including matters involving antitrust treble damage and tax deficiency claims. The outcome of these matters is not presently determinable, but, in the opinion of management based on the advice of counsel, the ultimate resolution of such matters will not have a material adverse impact on the Company's financial position.

SUPPLEMENTARY INFORMATION

Quarterly Financial Information (Unaudited)

<u>Dollars in Millions</u>			
<u>Calendar Quarter</u>	<u>Total Operating Revenues</u>	<u>Operating Income</u>	<u>Net Income</u>
<u>1986</u>			
1st.	\$ 791.3	\$133.5	\$ 96.5
2nd.	811.2	133.1	103.6
3rd.	830.7	142.6	110.5
4th.	<u>825.6</u>	<u>143.5</u>	<u>99.7</u>
Total	<u>\$3,258.8</u>	<u>\$552.7</u>	<u>\$410.3</u>
<u>1985</u>			
1st.	\$ 768.8	\$141.1	\$102.9
2nd.	760.9	126.3	93.4
3rd.	776.2	133.7	99.8
4th.	<u>780.5</u>	<u>121.1</u>	<u>83.4</u>
Total	<u>\$3,086.4</u>	<u>\$522.2</u>	<u>\$379.5</u>

All adjustments (consisting only of normal recurring accruals) necessary for a fair statement of income for each period have been included in the table above.

Results for the fourth quarter of 1985 reflect the charges related to the antitrust settlement reached with MCI Communications Corporation and elevated expenses associated with Hurricane Gloria.

Item 9. DISAGREEMENTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

During 1985 and 1986, the Company did not change its auditors and there was no disagreement on any matter of accounting principles or practices or financial statement disclosure which would have required the filing of a Current Report on Form 8-K.

PART IV

Item 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K.

(a) Documents filed as a part of this Annual Report on Form 10-K.

(1) Financial Statements filed as part of this report are listed in the Table of Contents on page 2 and contained in Item 8 herein.

(2) Financial Statement Schedules. The following financial statement schedules of the Registrant are included herein in response to Item 14:

	<u>Page(s) In This Annual Report On Form 10-K</u>
V - Telephone Plant.....	44-46
VI - Accumulated Depreciation, Depletion, and Amortization of Telephone Plant.....	47
VIII - Allowance for Uncollectibles.....	48

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 Securities and Exchange Commission ("SEC"), are incorporated herein by reference as exhibits hereto.

Exhibit
Number

- (3)a Certificate of Incorporation of the Company as amended December 22, 1980 (Exhibit (3)a to Form 10-K for 1980; File No. 1-1150).
- (3)b By-Laws of the Company as amended October 18, 1983 (Exhibit (3)b to Form 10-K for 1983; File No. 1-1150).
- (4) No instrument which defines the rights of holders of long and intermediate term debt of the Registrant is filed herewith pursuant to Regulation S-K, Item 601(b)(4)(iii)(A). Pursuant to this regulation, the Registrant hereby agrees to furnish a copy of any such instrument to the SEC upon request.
- (10)(i)1 Reorganization and Divestiture Agreement among American Telephone and Telegraph Company, NYNEX Corporation and Affiliates dated as of November 1, 1983 (Exhibit (10)(i)1 to Form 10-K of NYNEX Corporation for 1983, File No. 1-8608).
- (10)(i)2 Shared Network Facilities Agreement among American Telephone and Telegraph Company, AT&T Communications of New England, Inc. and New England Telephone and Telegraph Company dated as of November 1, 1983 (Exhibit (10)(i)21 to Form 10-K of NYNEX Corporation for 1983, File No. 1-8608).
- (10)(i)3 Procurement and Central Office Engineering, Records and Installation Software Agreement dated as of November 1, 1983 and amendment thereto dated as of February 14, 1984 between American Telephone and Telegraph Company, Western Electric Company, Inc. and NYNEX Corporation (Exhibit (10)(i)3 to Form 10-K of NYNEX Corporation for 1983, File No. 1-8608).
- (10)(i)4 Agreement Concerning Termination of the Standard Supply Contract among American Telephone and Telegraph Company, Western Electric Company, Incorporated, New England Telephone and Telegraph Company and Central Services Organization dated as of November 1, 1983 (Exhibit (10)(i)23 to Form 10-K of NYNEX Corporation for 1983, File No. 1-8608).
- (10)(i)5 Agreement Concerning Certain Centrally Developed Computer Systems between American Telephone and Telegraph Company, Western Electric Company, Incorporated, New England Telephone and Telegraph Company and Central Services Organization dated as of November 1, 1983 (Exhibit (10)(i)25 to Form 10-K of NYNEX Corporation for 1983, File No. 1-8608).
- (10)(i)6 Agreement Concerning Patents, Technical Information, and Copyrights between American Telephone and Telegraph Company and NYNEX Corporation dated as of November 1, 1983 (Exhibit (10)(i)5 to Form 10-K of NYNEX Corporation for 1983, File No. 1-8608).

Exhibit
Number

- (10)(i)7 Agreement Concerning Contingent Liabilities, Tax Matters and Termination of Certain Agreements among American Telephone and Telegraph Company, Bell System Operating Companies, Regional Holding Companies and Affiliates dated as of November 1, 1983 (Exhibit (10)(i)8 to Form 10-K of NYNEX Corporation for 1983, File No. 1-8608).
- (10)(i)8 Agreement Concerning Trademarks, Trade Names and Service Marks between American Telephone and Telegraph Company, NYNEX Corporation, other Regional Holding Companies, Cincinnati Bell, Incorporated and Southern New England Telephone Company dated as of November 1, 1983 (Exhibit (10)(i)9 to Form 10-K of NYNEX Corporation for 1983, File No. 1-8608).
- (10)(i)9 Shared Service Order Processing, Billing and Collection Facilities Agreement, between AT&T Information Systems Inc. and New England Telephone and Telegraph Company dated as of November 1, 1983 (Exhibit (10)(i)33 to Form 10-K of NYNEX Corporation for 1983, File No. 1-8608).
- (10)(i)10 Shared Shelf Space and Supporting Power Agreement between AT&T Information Systems Inc., and New England Telephone and Telegraph Company dated as of November 1, 1983 (Exhibit (10)(i)35 to Form 10-K of NYNEX Corporation for 1983, File No. 1-8608).
- (10)(i)11 Synchronization Reference Signal Agreement between American Telephone and Telegraph Company and New England Telephone and Telegraph Company dated as of November 1, 1983 (Exhibit (10)(i)37 to Form 10-K of NYNEX Corporation for 1983, File No. 1-8608).
- (10)(i)12 Post-Divestiture Shared Services Force Transfer Agreement between American Telephone and Telegraph Company and New England Telephone and Telegraph Company dated as of January 1, 1984 (Exhibit (10)(i)39 to Form 10-K of NYNEX Corporation for 1983, File No. 1-8608).
- (10)(i)13 Agreement concerning Certain Computer Systems and Services Required on a Transition Basis among American Telephone and Telegraph Company, AT&T Communications, Incorporated, Central Services Organization, New England Telephone and Telegraph Company and New York Telephone Company dated as of November 1, 1983 (Exhibit (10)(i)40 to Form 10-K of NYNEX Corporation for 1983, File No. 1-8608).
- (10)(i)14 Directory Software and Information Agreement between American Telephone and Telegraph Company, NYNEX Corporation and Central Services Organization dated as of November 1, 1983 (Exhibit (10)(i)4 to Form 10-K of NYNEX Corporation for 1983, File No. 1-8608).

Exhibit
Number

- (10)(i)15 Agreement concerning the sharing of Contingent Liabilities dated as of January 28, 1985. (Exhibit (19)(i)1 to Form 10-K of NYNEX Corporation for 1984, File No. 1-8608).
- (10)(ii)(B)1 Service Agreement concerning provision of technical, regulatory, government relations, marketing and other services between New England Telephone and Telegraph Company and NYNEX Service Company effective January 1, 1984 (Exhibit (10)(ii)(B)2 to Form 10-K of NYNEX Corporation for 1983, File No. 1-8608).
- (10)(ii)(B)2 Directory Publishing Agreement between New England Telephone and Telegraph Company and NYNEX Information Resources Company dated as of January 1, 1984 (Exhibit (10)(ii)(B)4 to Form 10-K of NYNEX Corporation for 1983, File No. 1-8608).
- (10)(ii)(B)3 Agreement concerning centralized procurement services between New England Telephone and Telegraph Company and NYNEX Materiel Enterprises Company dated as of December 30, 1983 (Exhibit (10)(ii)(B)6 to Form 10-K of NYNEX Corporation for 1983, File No. 1-8608),
- (12) Computation of Ratio of Earnings to Fixed Charges.
- (24) Consent of Coopers & Lybrand.
- (25) Powers of Attorney.

(b) Reports on Form 8-K.

The Company's Current Report on Form 8-K, dated February 7, 1986 and filed February 18, 1986, reporting on Item 5.

The Company's Current Report on Form 8-K, dated February 27, 1986 and filed March 4, 1986, reporting on Item 7.

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.

New England Telephone and Telegraph Company

By P. C. MANUS
P. C. Manus
Vice President-Finance and Comptroller

March 25, 1987

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:

G. M. Freche* President

Principal Financial and
Accounting Officer:

P. C. Manus* Vice President-Finance
and Comptroller

Directors:

R. F. Burke*
Kenneth M. Curtis*
G. M. Freche*
Luther F. Hackett*
Ronald A. Homer*
William C. Mercer*
Paul C. O'Brien*
David B. Perini*
Donald A. Roach*
Hester L. Sargent*
Maurice Segall*
Adele S. Simmons*
Kimon S. Zachos*

*By P. C. MANUS
(P. C. Manus, as attorney-in-fact,
and on his own behalf as Principal
Financial and Accounting Officer)

March 25, 1987

NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY
FINANCIAL STATEMENT SCHEDULE
SCHEDULE V - TELEPHONE PLANT
(Dollars in Millions)

COLUMN A	COLUMN B	COLUMN C	COLUMN D	COLUMN E	COLUMN F
Classification	Balance at 12/31/85	Additions at Cost Note (a)	Retirements Note (b)	Other Changes Note (c)	Balance at 12/31/86
Land	\$ 29.5	\$ 1.4	\$.2	\$ -	\$ 30.7
Buildings	518.2	18.0	1.9	-	534.3
Central Office Equipment	3,090.0	390.0	220.6	10.3	3,269.7
Station Apparatus	22.6	-	3.1	(.2)	19.3
Station Connections	629.3	-	8.4	-	620.9
Large Private Branch Exchanges	68.8	7.7	2.5	.6	74.6
Public Telephone Equipment	45.8	3.8	3.5	1.3	47.4
Pole Lines	329.8	34.1	5.3	-	358.6
Aerial Cable	1,295.3	145.5	21.4	.1	1,419.5
Underground Cable	586.5	58.5	2.7	-	642.3
Buried Cable	198.4	17.5	4.7	-	211.2
Submarine Cable	8.1	.2	.1	-	8.2
Aerial Wire	19.6	2.6	.7	-	21.5
Underground Conduit	489.4	29.1	(.5)	-	519.0
Furniture and Office Equipment	300.4	6.7	23.4	(9.9)	273.8
Other Communications Equipment	112.8	19.7	6.9	(.9)	124.7
Vehicles and Other Work Equipment	115.9	4.5	6.7	-	113.7
Capital Leases	8.4	4.3	.9	-	11.8
Total Telephone Plant in Service	7,868.8	743.6	312.5	1.3	8,301.2
Telephone Plant Under Construction	170.1	515.8	507.5(d)	-	178.4
Property Held for Future Telephone Use . . . . .	.1	.2	-	-	.3
Total Telephone Plant	\$8,039.0	\$1,259.6	\$ 820.0	\$ 1.3	\$8,479.9

- (a) These additions, other than additions to Land and Buildings, include material purchased from NYNEX Materiel Enterprises Company. Additions shown also include interest charged construction.
- (b) Items of telephone plant when retired or sold are deducted from the property accounts at the amounts at which they are included therein, estimated if not known.
- (c) Includes (1) the original cost (estimated if not known) of reused material which is concurrently credited to Material and supplies, (2) reclassifications between the Telephone Plant in Service classifications listed and (3) the transfer of assets to NYNEX Service Company.
- (d) Principally Central Office Equipment completed and transferred to plant in service accounts as "Additions at Cost" in Column C.

NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY
FINANCIAL STATEMENT SCHEDULE
SCHEDULE V - TELEPHONE PLANT
(Dollars in Millions)

COLUMN A	COLUMN B	COLUMN C	COLUMN D	COLUMN E	COLUMN F
Classification	Balance at 12/31/84	Additions at Cost Note (a)	Retirements Note (b)	Other Changes Note (c)	Balance at 12/31/85
Land	\$ 27.6	\$ 1.9	\$ -	\$ -	\$ 29.5
Buildings	497.0	24.5	3.3	-	518.2
Central Office Equipment	2,861.4	415.0	194.4	8.0	3,090.0
Station Apparatus	14.1	11.4	2.9	-	22.6
Station Connections	642.2	-	12.9	-	629.3
Large Private Branch Exchanges	53.5	16.2	1.4	.5	68.8
Public Telephone Equipment	43.5	4.4	3.1	1.0	45.8
Pole Lines	303.1	30.8	4.1	-	329.8
Aerial Cable	1,181.0	135.3	21.1	.1	1,295.3
Underground Cable	537.3	52.8	3.6	-	586.5
Buried Cable	188.9	14.3	4.8	-	198.4
Submarine Cable	8.1	.1	.1	-	8.1
Aerial Wire	17.6	2.8	.8	-	19.6
Underground Conduit	467.9	24.0	2.5	-	489.4
Furniture and Office Equipment	258.9	72.9	31.4	-	300.4
Other Communications Equipment	113.6	8.6	9.8	.4	112.8
Vehicles and Other Work Equipment	119.2	3.9	7.2	-	115.9
Capital Leases	3.2	5.8	.6	-	8.4
Total Telephone Plant in Service	7,338.1	824.7	304.0	10.0	7,868.8
Telephone Plant Under Construction	146.1	630.0	606.0(d)	-	170.1
Property Held for Future Telephone Use	-	.1	-	-	.1
Total Telephone Plant	\$7,484.2	\$1,454.8	\$ 910.0	\$ 10.0	\$8,039.0

- (a) These additions, other than additions to Land and Buildings, include material purchased from NYNEX Material Enterprises Company. Additions shown also include interest charged construction.
- (b) Items of telephone plant when retired or sold are deducted from the property accounts at the amounts at which they are included therein, estimated if not known.
- (c) Includes (1) the original cost (estimated if not known) of reused material which is concurrently credited to material and supplies, and (2) reclassifications between the Telephone Plant in Service classifications listed.
- (d) Principally Central Office Equipment completed and transferred to plant in service accounts as "Additions at Cost" in Column C.

NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY
FINANCIAL STATEMENT SCHEDULE
SCHEDULE V - TELEPHONE PLANT
(Dollars in Millions)

COLUMN A	COLUMN B	COLUMN C	COLUMN D	COLUMN E	COLUMN F
Classification	Balance at 1/1/84	Additions at Cost Note (a)	Retirements Note (b)	Other Changes Note (c)	Balance at 12/31/84
Land	\$ 27.4	\$.5	\$.3	\$ -	\$ 27.6
Buildings	480.2	28.3	11.5	-	497.0
Central Office Equipment	2,542.3	435.8	116.7	-	2,861.4
Station Apparatus	150.3	.3	(7.3)	(143.8)	14.1
Station Connections	798.8	2.6	1.7	(157.5)	642.2
Large Private Branch Exchanges	43.3	11.4	1.2	-	53.5
Public Telephone Equipment	-	2.6	2.7	43.6	43.5
Pole Lines	274.3	31.9	3.1	-	303.1
Aerial Cable	922.4	143.8	15.5	130.3	1,181.0
Underground Cable	483.8	55.9	2.4	-	537.3
Buried Cable	151.9	13.0	3.2	27.2	188.9
Submarine Cable	7.8	.4	.1	-	8.1
Aerial Wire	16.0	2.6	1.0	-	17.6
Underground Conduit	444.7	23.0	(.2)	-	467.9
Furniture and Office Equipment	237.3	39.0	17.4	-	258.9
Other Communications Equipment	-	19.0	5.6	100.2	113.6
Vehicles and Other Work Equipment	120.5	6.8	8.1	-	119.2
Capital Leases	2.8	-	-	.4	3.2
Total Telephone Plant in Service	6,703.8	816.9	183.0	.4	7,338.1
Telephone Plant Under Construction	196.0	535.2	585.1(d)	-	146.1
Property Held for Future Telephone Use . . . . .	.2	-	.2	-	-
Total Telephone Plant	\$6,900.0	\$1,352.1	\$ 768.3	\$.4	\$7,484.2

- (a) These additions, other than additions to Land and Buildings, include material purchased from NYNEX Material Enterprises Company. Additions shown also include (1) the original cost (estimated if not known) of reused material, which is concurrently credited to material and supplies, (2) Interest charged construction and (3) transfers between the classifications listed.
- (b) Items of telephone plant when retired or sold are deducted from the property accounts at the amounts at which they are included therein, estimated if not known.
- (c) Includes principally reclassifications between the Telephone Plant in Service classifications listed.
- (d) Principally Central Office Equipment completed and transferred to plant in service accounts as "Additions at Cost" in Column C.

NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY
 FINANCIAL STATEMENT SCHEDULE
 SCHEDULE VI - ACCUMULATED DEPRECIATION, DEPLETION, AND AMORTIZATION OF TELEPHONE PLANT
 (Dollars in Millions)

COLUMN A	COLUMN B	COLUMN C	COLUMN D	COLUMN E	COLUMN F
Description	Balance at Beginning of Period	Additions	Retirements Note (a)	Other Changes Note (b)	Balance at End of Period
Year 1986.....	\$2,306.3	\$628.9	\$317.6	\$(4.3)	\$2,613.3
Year 1985.....	\$2,036.3	\$577.8	\$308.2	\$.4	\$2,306.3
Year 1984.....	\$1,792.4	\$423.7	\$186.2	\$ 6.4	\$2,036.3

- (a) Retirements on this Schedule VI do not equal retirements per the related Schedule V due to the effects of accounting for cost of removal and salvage as prescribed by the FCC.
- (b) Comprises principally (1) depreciation provision for vehicles and other work equipment charged initially to clearing accounts and apportioned to Maintenance, Telephone Plant and other accounts on the basis of the usage of such equipment and (2) accumulated depreciation related to used plant acquired during the year from another company.

NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY
FINANCIAL STATEMENT SCHEDULE
SCHEDULE VIII - ALLOWANCE FOR UNCOLLECTIBLES

COLUMN A	COLUMN B	COLUMN C		COLUMN D	COLUMN E
Description	Balance at Beginning of Period	ADDITIONS		Deductions Note (d)	Balance at End of Period
		(1) Charged to Costs and Expenses(b)	(2) Charged to Other Accounts Note (c)		
Year 1986	\$11.8	\$30.5	\$18.0	\$43.5	\$16.8
Year 1985	\$16.7	\$23.5	\$31.6	\$60.0	\$11.8
Year 1984	\$16.9	\$23.6(a)	\$20.8	\$44.6	\$16.7

- (a) Provision for uncollectibles as stated in the Statements of Income includes certain minor uncollectible items which are not included in the allowance for uncollectibles account.
- (b) Includes amounts previously written off credited directly to the allowance for uncollectibles account when recovered.
- (c) Includes amounts to establish a reserve for purchased accounts receivable. Year 1984 includes amounts to establish a reserve for uncollectible joint interstate revenues which had previously been maintained by American Telephone and Telegraph Company.
- (d) Amounts written off as uncollectible.



New England Telephone

A **NYNEX** Company

185 Franklin Street
Boston, Massachusetts 02107

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Joseph R. Plati
Division Staff Manager-Taxes

March 31, 1987

City Clerk/Town Clerk

Dear Sir:

Enclosed is a copy of Form 10K Annual Report of New England Telephone and Telegraph Company to the Securities and Exchange Commission for the year 1986 filed in accordance with Massachusetts General Laws (Ter. Ed.), Chapter 166 Section 12A.

Very truly yours,

Joseph R Plati

Enclosure

4374A/0176A

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3-293

Comm. from Joseph R. Plati, Division Staff Mgr.
of Taxes, New England Telephone, transmitting
a copy of the Form 10K Annual Report of New
England Telephone and Telegraph Co. for the
year 1986.

In City Council,

April 27, 1987

Placed on file