UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended: June 30, 2001

OR

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

For the transition period from __________ to___________

Commission File Number 1-4471

XEROX CORPORATION
(Exact Name of Registrant as specified in its charter)

New York	16-0468020
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

P.O. Box 1600
Stamford, Connecticut 06904-1600
(Address of principal executive offices) (Zip Code)

(203) 968-3000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ______ No ___X___

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at July 31, 2001
Common Stock	716,989,392 shares

Forward-Looking Statements

From time to time Xerox Corporation (the Registrant or the Company) and its representatives may provide information, whether orally or in writing, including certain statements in this Form 10-Q, which are deemed to be "forward-looking" within the meaning of the Private Securities Litigation Reform Act of 1995 ("Litigation Reform Act"). These forward-looking statements and other information relating to the Company are based on the beliefs of management as well as assumptions made by and information currently available to management.

The words "anticipate", "believe", "estimate", "expect", "intend", "will", and similar expressions, as they relate to the Company or the Company's management, are intended to identify forward-looking statements. Such statements reflect the current views of the Registrant with respect to future events and are subject to certain risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described herein as anticipated, believed, estimated or expected. The Registrant does not intend to update these forward-looking statements.

In accordance with the provisions of the Litigation Reform Act we are making investors aware that such "forward-looking" statements, because they relate to future events, are by their very nature subject to many important factors which

could cause actual results to differ materially from those contained in the "forward-looking" statements. Such factors include but are not limited to the following:

Competition - the Registrant operates in an environment of significant competition, driven by rapid technological advances and the demands of customers to become more efficient. There are a number of companies worldwide with significant financial resources which compete with the Registrant to provide document processing products and services in each of the markets served by the Registrant, some of whom operate on a global basis. The Registrant's success in its future performance is largely dependent upon its ability to compete successfully in its currently-served markets and to expand into additional market segments.

Transition to Digital - presently black and white light-lens copiers represent approximately 25% of the Registrant's revenues. This segment of the market is mature with anticipated declining industry revenues as the market transitions to digital technology. Some of the Registrant's new digital products replace or compete with the Registrant's current light-lens equipment. Changes in the mix of products from light-lens to digital, and the pace of that change as well as competitive developments could cause actual results to vary from those expected.

Expansion of Color - color printing and copying represents an important and growing segment of the market. Printing from computers has both facilitated and increased the demand for color. A significant part of the Registrant's strategy and ultimate success in this changing market is its ability to develop and market machines that produce color prints and copies quickly and at reduced cost. The Registrant's continuing success in this strategy depends on its ability to make the investments and commit the necessary resources in this highly competitive market.

Pricing - the Registrant's ability to succeed is dependent upon its ability to obtain adequate pricing for its products and services which provide a reasonable return to shareholders. Depending on competitive market factors, future prices the Registrant can obtain for its products and services may vary from historical levels. In addition, pricing actions to offset currency devaluations may not prove sufficient to offset further devaluations or may not hold in the face of customer resistance and/or competition.

Customer Financing Activities - On average, 75 - 80 percent of the Registrant's equipment sales are financed through the Registrant. To fund these arrangements, the Registrant must access the credit markets and the long-term viability and profitability of its customer financing activities is dependent on its ability to borrow and its cost of borrowing in these markets. This ability and cost, in turn, is dependent on the Registrant's credit ratings. Currently the Registrant's credit ratings effectively preclude its ready access to capital markets and the Registrant is currently funding its customer financing activity from available sources of liquidity including cash on hand. There is no assurance that the Registrant will be able to continue to fund its customer financing activity at present levels. The Registrant is actively seeking third parties to provide financing to its customers. In the near-term the Registrant's ability to continue to offer customer financing and be successful in the placement of its equipment with customers is largely dependent upon obtaining such third party financing.

Productivity - the Registrant's ability to sustain and improve its profit margins is largely dependent on its ability to maintain an efficient, cost-effective operation. Productivity improvements through process reengineering, design efficiency and supplier cost improvements are required to offset labor cost inflation and potential materials cost changes and competitive price pressures.

International Operations - the Registrant derives approximately half its revenue from operations outside of the United States. In addition, the Registrant manufactures or acquires many of its products and/or their components outside the United States. The Registrant's future revenue, cost and profit results could be affected by a number of factors, including changes in foreign currency exchange rates, changes in economic conditions from country to country, changes in a country's political conditions, trade protection measures, licensing requirements and local tax issues. Our ability to enter into new foreign exchange contracts to manage foreign exchange risk is currently severely limited and, therefore, we anticipate increased volatility in our results of operations due to changes in foreign exchange rates.

New Products/Research and Development - the process of developing new high technology products and solutions is inherently complex and uncertain. It requires accurate anticipation of customers' changing needs and emerging technological trends. The Registrant must then make long-term investments and commit significant resources before knowing whether these investments will eventually result in products that achieve customer acceptance and generate the

revenues required to provide anticipated returns from these investments.

Revenue Growth - the Registrant's ability to attain a consistent trend of revenue growth over the intermediate to longer term is largely dependent upon expansion of its equipment sales worldwide and usage growth (i.e., an increase in the number of images produced by customers). The ability to achieve equipment sales growth is subject to the successful implementation of our initiatives to provide industry-oriented global solutions for major customers and expansion of our distribution channels in the face of global competition and pricing pressures. The ability to grow usage may be adversely impacted by the movement towards distributed printing and electronic substitutes. Our inability to attain a consistent trend of revenue growth could materially affect the trend of our actual results.

Turnaround Program - In October 2000, the Registrant announced a turnaround program which includes a wide-ranging plan to generate cash, return to profitability and pay down debt. The success of the turnaround program is dependent upon successful and timely sales of assets, restructuring the cost base, placement of greater operational focus on the core business and the transfer of the financing of customer equipment purchases to third parties. Cost base restructuring is dependent upon effective and timely elimination of employees, closing and consolidation of facilities, outsourcing of certain manufacturing and logistics operations, reductions in operational expenses and the successful implementation of process and systems changes.

The Registrant's liquidity is dependent on the timely implementation and execution of the various turnaround program initiatives as well as its ability to generate positive cash flow from operations and various financing strategies including securitizations. Should the Registrant not be able to successfully complete the turnaround program, including positive cash generation on a timely or satisfactory basis, the Registrant will need to obtain additional sources of funds through other operating improvements, financing from third parties, or a combination thereof.

Xerox Corporation
Form 10-Q
June 30, 2001

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For additional information about The Document Company Xerox, please visit our World-Wide Web site at www.xerox.com/investor

PART I - FINANCIAL INFORMATION

Item 1

Xerox Corporation

Consolidated Statements of Operations (Unaudited)

(In millions, except per-share data)	Three months ended June 30, 2001	Three months ended June 30, 2000*	Six months ended June 30, 2001	Six months ended June 30, 2000*
Revenues				
Sales	$ 1,981	$ 2,569	$ 4,036	$ 4,920
Service, outsourcing, financing and rentals	2,156	2,209	4,303	4,398
Total Revenues	4,137	4,778	8,339	9,318
Costs and Expenses				
Cost of sales	1,354	1,535	2,787	2,878
Cost of service, outsourcing, financing and rentals	1,278	1,313	2,633	2,642
Inventory charges	24	-	24	90
Research and development expenses	249	254	495	506
Selling, administrative and general expenses expenses	1,263	1,377	2,415	2,647
Restructuring charge and asset impairments	291	(2)	391	504
Gain on sale of half of interest in Fuji Xerox	-	-	(769)	-
Gain on affiliate's sale of stock	-	-	-	(21)
Purchased in-process research and development	-	-	-	27
Other, net	161	54	251	159
Total Costs and Expenses	4,620	4,531	8,227	9,432
Income (Loss) before Income Taxes (Benefits), Equity Income and Minorities' Interests	(483)	247	112	(114)
Income taxes (benefits)	(160)	79	243	(40)
Income (loss) after Income Taxes (Benefits) before Equity income and Minorities' Interests	(323)	168	(131)	(74)
Equity in net income of unconsolidated affiliates	30	46	32	50
Minorities' interests in earnings of subsidiaries	6	12	13	23
Net income (loss) before extraordinary gain and cumulative effect of change in accounting principle	(299)	202	(112)	(47)
Extraordinary gain on early extinguishment of debt (less income taxes of $12 and $23, respectively)	18	-	35	-
Cumulative effect of change in accounting principle (less income tax benefit of $1)	-	-	(2)	-
Net Income (Loss)	$ (281)	$ 202	$ (79)	$ (47)
Basic earnings (loss) per share:				
Income (loss) before extraordinary gain and cumulative effect of change in accounting principle	$ (0.43)	$ 0.29	$ (0.18)	$ (0.10)
Extraordinary gain, net	0.03	-	0.05	-
Cumulative effect of change in accounting principle, net	-	-	(0.00)	-
Basic Earnings (Loss) per Share	$ (0.40)	$ 0.29	$ (0.13)	$ (0.10)
Diluted earnings (loss) per share:				
Income (loss) before extraordinary gain and cumulative effect of change in accounting principle	$ (0.43)	$ 0.27	$ (0.18)	$ (0.10)
Extraordinary gain, net	0.03	-	0.05	-
Cumulative effect of change in accounting principle, net	-	-	(0.00)	-
Diluted Earnings (Loss) per Share	$ (0.40)	$ 0.27	$ (0.13)	$ (0.10)

See accompanying notes

* As restated, see Note 2

Xerox Corporation

Consolidated Balance Sheets

	June 30,	December 31,

(In millions, except share data in thousands) Assets	2001 (Unaudited)	2000
Cash and cash equivalents	$ 2,177	$ 1,741
Accounts receivable, net	2,006	2,281
Finance receivables, net	4,837	5,097
Inventories, net	1,566	1,932
Equipment on operating leases, net	621	724
Deferred taxes and other current assets	1,221	1,247
Total Current Assets	12,428	13,022
Finance receivables due after one year, net	7,130	7,957
Land, buildings and equipment, net	2,160	2,495
Investments in affiliates, at equity	641	1,362
Intangible and other assets, net	3,462	3,061
Goodwill, net	1,477	1,578
Total Assets	$ 27,298	$ 29,475
Liabilities and Equity		
Short-term debt and current portion of long-term debt	$ 2,754	$ 2,693
Accounts payable	824	1,033
Accrued compensation and benefit costs	654	662
Unearned income	259	250
Other current liabilities	1,779	1,630
Total Current Liabilities	6,270	6,268
Long-term debt	13,512	15,404
Postretirement medical benefits	1,216	1,197
Deferred taxes and other liabilities	1,839	1,876
Deferred ESOP benefits	(221)	(221)
Minorities' interests in equity of subsidiaries	116	141
Obligation for equity put options	-	32
Company-obligated, mandatorily redeemable preferred securities of subsidiary trust holding solely subordinated debentures of the Company	639	638
Preferred stock	620	647
Common shareholders' equity	3,307	3,493
Total Liabilities and Equity	$ 27,298	$ 29,475
Shares of common stock issued and outstanding	715,374	668,576

See accompanying notes.

Xerox Corporation
Consolidated Statements of Cash Flows (Unaudited)

Six months ended June 30 (In millions)	2001	2000*
Cash Flows from Operating Activities		
Net Loss	$ (79)	$ (47)
Adjustments required to reconcile net income (loss) to cash flows from operating activities, net of effects of acquisitions:		
Depreciation and amortization	462	453
Provisions for doubtful accounts	215	245
Restructuring and other charges	407	621
Gains on sales of businesses and assets	(747)	(84)
Gain on early extinguishment of debt	(58)	-
Cumulative effect of change in accounting principle	3	-
Cash payments for restructurings	(265)	(131)
Minorities' interests in earnings of subsidiaries	13	23
Undistributed equity in income of affiliated companies	(1)	(11)
Decrease (increase) in inventories	255	(245)
Increase in on-lease equipment	(123)	(246)
Decrease (increase) in finance receivables	219	(509)
Decrease (increase) in accounts receivable	97	(362)
Decrease in accounts payable and accrued compensation and benefit costs	(197)	(216)
Net change in current and deferred income taxes	338	(365)
Change in other current and non-current liabilities	(111)	(277)
Other, net	43	(327)

Net cash provided by (used in) operating activities	471	(1,478)
Cash Flows from Investing Activities		
Cost of additions to land, buildings and equipment	(121)	(240)
Proceeds from sales of land, buildings and equipment	47	55
Acquisitions, net of cash acquired	-	(856)
Proceeds from divestitures	1,635	50
Other, net	-	(17)
Net cash provided by (used in) investing activities	1,561	(1,008)
Cash Flows from Financing Activities		
Net change in debt	(1,195)	2,759
Cash paid to fund Ridge Re Trust	(255)	-
Dividends on common and preferred stock	(93)	(294)
Proceeds from sales of common stock	28	18
Settlements of equity put options, net	(28)	-
Dividends to minority shareholders	(2)	(3)
Net cash (used in) provided by financing activities	(1,545)	2,480
Effect of Exchange Rate Changes on Cash and Cash Equivalents	(51)	-
Increase (Decrease) in Cash and Cash Equivalents	436	(6)
Cash and Cash Equivalents at Beginning of Period	1,741	126
Cash and Cash Equivalents at End of Period	$ 2,177	$ 120

See accompanying notes.
* As restated, see Note

1. Basis of Presentation:

The unaudited consolidated interim financial statements presented herein have been prepared by Xerox Corporation (the Company) in accordance with the accounting policies described in its 2000 Annual Report to Shareholders and should be read in conjunction with the notes thereto.

In the opinion of management, all adjustments (consisting only of normal recurring adjustments) which are necessary for a fair statement of operating results for the interim periods presented have been made.

We adopted Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities", and SFAS No. 138 as of January 1, 2001. See Note 9 for additional details.

Prior years' financial statements have been reclassified to reflect certain reclassifications to conform with the 2001 presentation. The impact of these changes is not material and did not affect net income.

The term "pre-tax income (loss)" as used herein refers to the Consolidated Statement of Operations line item "Income (Loss) before Income Taxes (Benefits), Equity Income and Minorities' Interests".

References herein to "we" or "our" refer to Xerox and consolidated subsidiaries unless the context specifically requires otherwise.

2. Restatement:

We have restated our Consolidated Financial Statements for the three and six month periods ended June 30, 2000 as a result of two separate investigations conducted by the Audit Committee of the Board of Directors. These investigations involved previously disclosed issues in our Mexico operations and a review of our accounting policies and procedures and the application thereof. This filing should be read in conjunction with Amendment No. 1 to our Annual Report on Form 10-K for the fiscal year ended December 31, 2000. The adjustments made to the Consolidated Financial Statements for the three months and six months ended June 30, 2000 reflect the changes discussed in such amendment. All amounts included herein have been restated to reflect the changes as discussed in that report.

These adjustments relate primarily to the imprudent and improper business practices in Mexico, the acquisition contingencies associated with our acquisition of the remaining ownership interest in Xerox Limited from the Rank Group Plc, the misapplications of GAAP under SFAS No. 13 "Accounting for Leases," and certain other items.

The following table presents the effects of the adjustments on pre-tax income (loss)(in millions):

	Three months ended June 30,		Six months ended June 30,	
	2001	2000	2001	2000

Increase (decrease) to pre-tax income (loss):				
Mexico	$ -	$ 82	$ -	$ 48
Lease issues, net	15	23	28	50
Other, net	-	(17)	58	(22)
Total	$ 15	$ 88	$ 86	$ 76

The following tables present the impact of the adjustments and restatements on a condensed basis (in millions):

Statement of Operations: Three months ended June 30, 2000	Previously Reported	As Restated
Revenues	$ 4,688	$ 4,778
Costs and expenses	4,529	4,531
Net income (loss) before extraordinary gain and cumulative effect of change in accounting principle	145	202
Basic earnings per share	$ 0.21	$ 0.29
Diluted earnings per share	$ 0.19	$ 0.27

Statement of Operations: Six months ended June 30, 2000	Previously Reported	As Restated
Revenues	$ 9,119	$ 9,318
Costs and expenses	9,309	9,432
Net income (loss) before extraordinary gain and cumulative effect of change in accounting principle	(98)	(47)
Basic loss per share	$ (0.17)	$ (0.10)
Diluted loss per share	$ (0.17)	$ (0.10)

3. Inventories:

Inventories consist of the following (in millions):

	June 30, 2001	December 31, 2000
Finished products	$ 1,051	$ 1,439
Work in process	141	147
Raw materials and supplies	374	346
Total	$ 1,566	$ 1,932

4. Restructurings and Turnaround Program:

March 2000 Restructuring. In March 2000, we announced details of a worldwide restructuring program. In connection with this program, we recorded a pre-tax provision of $596 ($423 after taxes, including our $18 share of a restructuring provision recorded by Fuji Xerox, an unconsolidated affiliate). The $596 pre-tax charge included severance costs related to the elimination of 5,200 positions worldwide. Approximately 65 percent of the positions to be eliminated are in the U.S., 20 percent are in Europe, and the remainder are predominantly in Latin America. The employment reductions primarily affected employees in manufacturing, logistics, customer service and back office support functions. For facility fixed assets classified as assets to be disposed of, the impairment loss recognized is based on the fair value less cost to sell, with fair value based on estimates of existing market prices for similar assets. The inventory charges relate primarily to the consolidation of distribution centers and warehouses and the exit from certain product lines.

Included in the original provision were reserves related to liabilities due to various third parties and several asset impairment charges. Liabilities recorded for lease cancellation and other costs originally aggregated $51 and included $32 for various contractual commitments, other than facility occupancy leases, that will be terminated early as a result of the restructuring. The commitments include cancellation of supply contracts and outsourced vendor contracts. Included in the asset impairment charge of $71 was: $44 for machinery and tooling for products that were discontinued or will be alternatively sourced; $7 for leasehold improvements at facilities that will be closed; and $20 of sundry surplus assets, individually insignificant, from various parts of our business. These impaired assets were primarily located in the U.S. and the related product lines generated an immaterial amount of revenue. Approximately $71 of the $90 of inventory charges related to excess

inventory in many product lines created by the consolidation of distribution centers and warehouses. The remainder was primarily related to the transition to inkjet technology in our wide format printing business.

Weakening business conditions and operating results during 2000 required a re-evaluation of the initiatives announced in March 2000. Accordingly, during the fourth quarter of 2000, and in connection with the Turnaround Program discussed below, $71 ($47 after taxes), of the original $596 provision was reversed, $59 related to severance costs for 1,000 positions and $12 related to lease cancellation and other costs. The reversals primarily relate to delays in the consolidation and outsourcing of certain of our warehousing and logistics operations and the cancellation of certain European initiatives no longer necessary as a result of higher than expected attrition.

During the first quarter 2001 we recorded a net reversal to the March 2000 restructuring reserve of $7 ($6 after taxes). This included the reversal of $43 of previously recorded charges and additional charges of $36. These amounts relate to the adjustment of the originally recorded reserves based on management's most recent estimate of the costs to complete previously announced actions. There were no reversals recorded in the second quarter of 2001.

Turnaround Program. During 2000, the significant business challenges that we began to experience in the second half of 1999 continued to adversely affect our financial performance. These challenges include: the ineffective execution of a major sales force realignment, the ineffective consolidation of our U.S. customer administrative centers, increased competition and adverse economic conditions.

These operational challenges, exacerbated by significant technology and acquisition investments, led to a net loss in 2000, credit rating agency downgrades, limited access to capital markets and marketplace concerns regarding our liquidity. In response to these challenges, in October 2000, we announced a Turnaround Program that includes a wide-ranging plan to sell assets, cut costs and strengthen core operations. Additionally, we are in substantive negotiations to provide financing for customers in a manner that does not involve the Xerox balance sheet, and over time will provide financing for customers using third parties. In December 2000, we sold our operations in China to Fuji Xerox for $550 and in March 2001 we sold half of our ownership interest in Fuji Xerox Co., Ltd. (Fuji Xerox) to Fuji Photo Film Co, Ltd. (Fujifilm) for $1,283. In April 2001, we sold our leasing business in four Nordic countries to Resonia Leasing AB for cash proceeds of $352(see Note 11). We are engaged in other activities that will enhance our liquidity. These activities include asset sales, strategic alliances, securitizations, and the sale or outsourcing of certain manufacturing operations.

Regarding the cost reductions, we have implemented actions that account for more than 75 percent of our goal to reduce costs by at least $1.0 billion annually. During the second quarter of 2001, and in connection with the Turnaround Program, we recorded an additional pre-tax restructuring provision totaling $41 ($35 after taxes), in connection with finalized initiatives under the Turnaround Program. This charge consists of estimated costs for severance associated with work force reductions related to the elimination of approximately 700 positions worldwide. The severance costs relate to continued streamlining of existing work processes, elimination of redundant resources and the consolidation of existing activities into other existing operations.

The following table summarizes the status of the March 2000 Restructuring Reserve and the Turnaround Program (in millions):

	Original Reserve	Net Reversals	New Actions(2)	Charges Against Reserve	6/30/01 Balance
March 2000 restructuring:					
Cash charges					
Severance and related costs	$ 384	$ (66)	-	$ (279)(1)	$ 39
Lease cancellation and other costs	51	(12)	-	(37)(1)	2
Subtotal	435	(78)	-	(316)	41
Non-cash charges					
Asset impairment	71	-	-	(71)	-
Inventory charges	90	-	-	(90)	-
Subtotal	161	-	-	(161)	-
Subtotal March 2000	596	(78)	-	(477)	41
Turnaround Program:					
Severance and related costs	71	-	138	(94)(1)	115
Asset impairment	34	-	11	(45)	-
Subtotal Turnaround	105	-	149	(139)	115

Grand Total	$ 701	$ (78)	149	$ (616)	$ 156

(1) Including the impact of currency translation adjustments.
(2) Year to date values for 2001.

At June 30, 2001, the ending reserve balance for the March 2000 restructuring program is $41 and for the Turnaround Program is $115, resulting in a total reserve balance of $156 as of June 30, 2001. The remaining reserve relates to cash expenditures to be incurred primarily during 2001 and is included in Other current liabilities.

In June 2001, the Ad Hoc Committee of the Board of Directors approved the disengagement from our worldwide SOHO business. In connection with exiting this business, we recorded a second-quarter pretax charge of $274 ($196 after taxes). The charge includes provisions for the elimination of approximately 1,200 jobs worldwide by the end of 2001, the closing of facilities and the write-down of certain assets to net realizable value. The charges associated with this action include approximately $37 in employee termination costs, $146 of asset impairments including facilities and equipment, $24 in inventory charges, $25 in purchase commitments, $25 in decommitment costs, and $17 in other miscellaneous charges. The SOHO disengagement reserve balance at June 30, 2001 was $103.

5. Common Shareholders' Equity:

Common shareholders' equity consists of (in millions):

	June 30, 2001	December 31, 2000
Common & class B stock	$ 717	$ 670
Additional paid-in-capital	1,842	1,556
Retained earnings	3,316	3,441
Accumulated other comprehensive loss (1)	(2,568)	(2,174)
Total	$ 3,307	$ 3,493

(1) Accumulated other comprehensive loss at June 30, 2001 is composed of cumulative translation of $(2,506), minimum pension liability of $(27),unrealized losses on marketable securities of $(16), and mark to market losses on cash flow hedges of $(19).

In January 2001, 0.8 million put options with a strike price of $40.56 per share were net cash settled for $28. Funds for this net cash settlement were obtained by selling 5.9 million unregistered shares of our common stock for proceeds of $28.

Comprehensive income (loss) for the three months and six months ended June 30, 2001 and 2000 is as follows (in millions):

	Three months ended		Six months ended	
	June 30, 2001	June 30, 2000	June 30, 2001	June 30, 2000
Net income (loss)	$ (281)	$ 202	$ (79)	$ (47)
Translation adjustments	(100)	(169)	(366)	(134)
Unrealized gains (losses)on marketable securities	(11)	-	(9)	14
Cash flow hedge adjustments	5	-	(19)	-
Comprehensive income (loss)	$ (387)	$ 33	$ (473)	$ (167)

6. Interest expense and income:

Interest expense totaled $264 and $247 for the three months ended June 30, 2001 and 2000, respectively, and $551 and $474 for the six months ended June 30, 2001 and 2000, respectively. Interest income totaled $235 and $239 for the three months ended June 30, 2001 and 2000, respectively, and $477 and $475 for the six months ended June 30, 2001 and 2000, respectively.

7. Segment Reporting:

In the first quarter of 2001, we completed the realignment of our operations in order to more closely align our reportable segments with the markets that we serve. As a result of this realignment our reportable segments have been revised accordingly and are as follows: Production, Office, Small Office/Home Office, and Developing Markets Operations.

The Production segment includes DocuTech, production printing, color products for the production and graphic arts markets and light-lens copiers over 90 pages per minute sold to Fortune 1000, graphic arts and government, education and other public sector customers predominantly through direct sales channels

in North America and Europe.

The Office segment includes our family of Document Centre digital multi-function products, light-lens copiers under 90 pages per minute, color laser, solid ink and monochrome laser desktop printers, digital copiers and facsimile products sold through direct and indirect sales channels in North America and Europe. The Office market is comprised of global, national and mid-size commercial customers as well as government, education and other public sector customers.

The Small Office/Home Office (SOHO) segment includes inkjet printers and personal copiers sold through indirect channels in North America and Europe to small offices, home offices and personal users (consumers). As more fully discussed in Note 4, in June 2001 the Ad Hoc Committee of the Board of Directors approved the disengagement from the worldwide SOHO business.

The Developing Markets Operations segment (DMO) includes Latin America, Russia, India, the Middle East and Africa.

Other includes several units, none of which met the thresholds for separate segment reporting. This group primarily includes Xerox Engineering Systems and Xerox Supplies Group (predominantly paper). Other segment profit/(loss) includes certain corporate items such as non-financing interest expense which have not been allocated to the operating segments.

Operating segment profit/(loss) information for the three months ended June 30, 2001 and 2000 is as follows (in millions):

	Production	Office	SOHO	Developing Markets	Other	Total
2001						
Revenues from external customers	$ 1,453	$ 1,709	$ 95	$ 435	$ 445	$ 4,137
Intercompany revenues	-	5	-	-	(5)	-
Total segment revenues	$ 1,453	$ 1,714	$ 95	$ 435	$ 440	$ 4,137
Segment profit/ (loss)	$ 147	$ 159	$ (79)	$ (131)	$ (234)	$ (138)
2000						
Revenues from external customers	$ 1,621	$ 1,829	$ 139	$ 644	$ 545	$ 4,778
Intercompany revenues	-	5	-	-	(5)	-
Total segment revenues	$ 1,621	$ 1,834	$ 139	$ 644	$ 540	$ 4,778
Segment profit/ (loss)	$ 246	$ 65	$ (57)	$ 52	$ (15)	$ 291

Operating segment profit/(loss) information for the six months ended June 30, 2001 and 2000 is as follows (in millions):

	Production	Office	SOHO	Developing Markets	Other	Total
2001						
Revenues from external customers	$ 2,897	$ 3,414	$ 215	$ 894	$ 919	$ 8,339
Intercompany revenues	-	8	2	-	(10)	-
Total segment revenues	$ 2,897	$ 3,422	$ 217	$ 894	$ 909	$ 8,339
Segment profit/ (loss)(1)	$ 278	$ 224	$ (157)	$ (204)	$ (351)	$ (210)
2000						
Revenues from external customers	$ 3,133	$ 3,527	$ 300	$ 1,240	$ 1,118	$ 9,318
Intercompany revenues	-	7	-	-	(7)	-
Total segment revenues	$ 3,133	$ 3,534	$ 300	$ 1,240	$ 1,111	$ 9,318
Segment profit/ (loss)(1)	$ 483	$ 175	$ (106)	$ 78	$ (73)	$ 557

(1) The following is a reconciliation of segment profit/(loss) to total Company Income (Loss) before Income Taxes (Benefits), Equity Income and Minorities' Interest:

	Three months ended June 30, 2001	Three months ended June 30, 2000	Six months ended June 30, 2001	Six months ended June 30, 2000
Total segment profit (loss)	$ (138)	$ 291	$ (210)	$ 557
Restructuring:				
Inventory charges	(24)	-	(24)	(90)
Restructuring charge and asset impairments	(291)	2	(391)	(504)
Gain on sale of half of ownership interest in Fuji Xerox	-	-	769	-
Purchased in-process R&D	-	-	-	(27)
Equity in net income of unconsolidated affiliates	(30)	(46)	(32)	(50)
Income (Loss) before Income Taxes (Benefits),Equity Income and Minorities' Interests	$ (483)	$ 247	$ 112	$ (114)

8. Receivables - Financing transactions:

In January 2001, we transferred $898 of finance receivables to a special purpose entity for cash proceeds of $435, received from an affiliate of General Electric Capital Corporation (GE Capital), and a retained interest of $463. The proceeds were accounted for as a secured borrowing. At June 30, 2001 the balance of receivables transferred was $635 and is included in Finance receivables, net in the Consolidated Balance Sheets. The remaining secured borrowing balance of $243 is included in Debt. The total proceeds of $435 are included in the Net Change in debt in the Consolidated Statements of Cash Flows. The borrowing will be repaid over 18 months and bears interest at the rate of 8.98 percent.

Refer to Note 11 - Divestitures for a discussion of the sale of certain of our European leasing businesses and Note 14 - Subsequent Events for a discussion of the sale of certain finance receivables subsequent to June 30, 2001.

9. Accounting Changes - Accounting for Derivative Instruments:

We adopted Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities", (SFAS No. 133) and SFAS 138 as of January 1, 2001. SFAS No. 133 requires companies to recognize all derivatives as assets or liabilities measured at their fair value. Gains or losses resulting from changes in the fair value of derivatives would be recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and, if it is, depending on the type of hedge transaction.

Upon adoption of SFAS No. 133, we recorded a net cumulative after-tax loss of $2 in the first quarter statement of operations and a net cumulative after-tax loss of $19 in Accumulated Other Comprehensive Income. Further, as a result of recognizing all derivatives at fair value, including the differences between the carrying values and fair values of related hedged assets, liabilities and firm commitments, we recognized a $403 increase in Total Assets and a $424 increase in Total Liabilities. Approximately $4 of the after-tax loss of $19 recorded in Accumulated Other Comprehensive Income at transition has been reclassified to year to date earnings.

The adoption of SFAS 133 is expected to increase the future volatility of reported earnings and other comprehensive income. In general, the amount of volatility will vary with the level of derivative and hedging activities and the market volatility during any period. However, as more fully described in management's discussion of capital resources and liquidity, our ability to enter into new derivative contracts is severely constrained. The following is a summary of our FAS 133 activity during the first half:

Interest Rate/Cross Currency Swaps. We enter into several types of derivative agreements primarily to manage interest rate and currency exposures related to our indebtedness and to "match fund" our customer financing assets. We attempt to manage our exposures in total on an economic basis, considering our total portfolio of indebtedness, which includes fixed rate, variable rate and foreign currency borrowings with varying terms. Accordingly, while all of our derivative instruments are intended to economically hedge currency and interest rate risk, differences between the contract terms of our derivatives and the underlying related debt result in our inability to obtain hedge accounting

treatment in accordance with SFAS No. 133. This will result in mark-to-market valuation of these derivatives directly through earnings, which will lead to increased volatility in our earnings.

During the second quarter and first half, the net effect from the mark-to-market valuation of our interest rate derivatives recorded in earnings was not material. However, the mark-to-market valuation of certain cross currency interest rate swap agreements did result in a net gain/(loss) during the second quarter and first half of $(12) and $12, respectively, which is net of the remeasurement of the underlying foreign currency debt and is included in Other, net.

As of May 2001, we designated certain cross currency interest rate swaps associated with 65 billion in Yen borrowings as fair value type hedges and accounted for them accordingly on a prospective basis. These borrowings have an underlying Yen fixed interest rate, which the swaps convert to a US dollar variable based rate. The net ineffective portion of these fair value hedges, recorded in earnings during the second quarter, was immaterial.

Currency Derivatives. We utilize forward exchange contracts and option contracts to hedge against the potentially adverse impacts of foreign currency fluctuations on foreign currency denominated assets and liabilities. Changes in the value of these currency derivatives are recorded in earnings together with the offsetting foreign exchange gains and losses on the underlying assets and liabilities.

We also utilize currency derivatives to hedge anticipated transactions, primarily forecasted purchases of foreign-sourced inventory and lease payments. These contracts are accounted for as cash flow hedges, and changes in their value are deferred in Accumulated Other Comprehensive Income (AOCI) until the anticipated transaction is recognized through earnings. During the second quarter and first half, the impacts of our cash flow hedges recorded through AOCI were not material.

Net Investment Hedges. We also utilize currency derivatives to hedge against the potentially adverse impacts of foreign currency fluctuations on certain of our investments in foreign entities. During the second quarter and first half, $(9) and $17, respectively, of net after-tax gains/(losses) related to hedges of our net investments in Xerox Brazil, Xerox Limited and Fuji Xerox were included in the cumulative translation adjustments account.

10. Debt for Equity Exchanges:

In the first quarter 2001, we retired $122 of long-term debt through the exchange of 15.5 million shares of common stock valued at $94. In the second quarter 2001, we retired an additional $205 of debt through the exchange of 20.7 million shares of common stock valued at $179. The second quarter retirements resulted in a pre-tax extraordinary gain of $30 ($18 after taxes) for a net equity increase of approximately $197. For the six months, the retirements resulted in a pre-tax extraordinary gain of $58 ($35 after taxes) for a net equity increase of $308.

11. Divestitures:

In March 2001, we completed the sale of half of our ownership interest in Fuji Xerox to Fujifilm for $1,283 in cash. The sale resulted in a pre-tax gain of $769 ($300 after taxes). Under the agreement, Fujifilm's ownership interest in Fuji Xerox increased from 50 percent to 75 percent. While Xerox's ownership interest decreased to 25 percent, we retain significant rights as a minority shareholder. All product and technology agreements between us and Fuji Xerox will continue, ensuring that the two companies retain uninterrupted access to each other's portfolio of patents.

In the second quarter of 2001, we sold our leasing businesses in four Nordic countries to Resonia Leasing AB for $352 in cash and retained interests in certain finance receivables for total proceeds of approximately $370. The carrying value of the assets transferred was approximately $385. These sales are part of an agreement under which Resonia will provide on-going, exclusive equipment financing to our customers in those countries.

12. Litigation:

On April 11, 1996, an action was commenced by Accuscan Corp. (Accuscan), in the United States District Court for the Southern District of New York, against the Company seeking unspecified damages for infringement of a patent of Accuscan which expired in 1993. The suit, as amended, was directed to facsimile and certain other products containing scanning functions and sought damages for sales between 1990 and 1993. On April 1, 1998, the jury entered a verdict in favor of Accuscan for $40. However, on September 14, 1998, the court granted the Company's motion for a new trial on damages. The trial ended on

October 25, 1999 with a jury verdict of $10. The Company's motion to set aside the verdict or, in the alternative, to grant a new trial was denied by the court. The Company is appealing to the Court of Appeals for the Federal Circuit. Accuscan is appealing the new trial grant which reduced the verdict from $40 and seeking a reversal of the jury's finding of no willful infringement. On May 31, 2001 the U.S. Court of Appeals for the federal circuit ruled that the Company did not infringe the patent and reversed this judgment for Accuscan. On June 11, 2001 Accuscan filed a petition for a rehearing.

On June 24, 1999, the Company was served with a summons and complaint filed in the Superior Court of the State of California for the County of Los Angeles. The complaint was filed on behalf of 681 individual plaintiffs claiming damages as a result of the Company's alleged disposal and/or release of hazardous substances into the soil, air and groundwater. On July 22, 1999, April 12, 2000, November 30, 2000, March 31,2001 and May 24, 2001, respectively, five additional complaints were filed in the same court on behalf of an additional 79, 141, 76, 51, and 29 plaintiffs, respectively, with the same claims for damages as the June 1999 action. Four of the five additional cases have been served on the Company.

Plaintiffs in all six cases further allege that they have been exposed to such hazardous substances by inhalation, ingestion and dermal contact, including but not limited to hazardous substances contained within the municipal drinking water supplied by the City of Pomona and the Southern California Water Company. Plaintiffs' claims against Registrant include personal injury, wrongful death, property damage, negligence, trespass, nuisance, fraudulent concealment, absolute liability for ultra-hazardous activities, civil conspiracy, battery and violation of the California Unfair Trade Practices Act. Damages are unspecified.

The Company denies any liability for the plaintiffs' alleged damages and intends to vigorously defend these actions. The Company has not answered or appeared in any of the cases because of an agreement among the parties and the court to stay these cases pending resolution of several similar cases currently pending before the California Supreme Court. However, the court recently directed that the six cases against the Company be coordinated with a number of other unrelated groundwater cases pending in Southern California.

A consolidated securities law action entitled In re Xerox Corporation Securities Litigation is pending in the United States District Court for the District of Connecticut. Defendants are Registrant, Barry Romeril, Paul Allaire and G. Richard Thoman, former Chief Executive Officer, and purports to be a class action on behalf of the named plaintiffs and all other purchasers of Common Stock of the Company during the period between October 22, 1998 through October 7, 1999 (Class Period). The amended consolidated complaint in the action alleges that in violation of Section 10(b) and/or 20(a) of the Securities Exchange Act of 1934, as amended (34 Act), and Securities and Exchange Commission Rule 10b-5 thereunder, each of the defendants is liable as a participant in a fraudulent scheme and course of business that operated as a fraud or deceit on purchasers of the Company's Common Stock during the Class Period by disseminating materially false and misleading statements and/or concealing material facts. The amended complaint further alleges that the alleged scheme: (i) deceived the investing public regarding the economic capabilities, sales proficiencies, growth, operations and the intrinsic value of the Company's Common Stock; (ii) allowed several corporate insiders, such as the named individual defendants, to sell shares of privately held Common Stock of the Company while in possession of materially adverse, non-public information; and (iii) caused the individual plaintiffs and the other members of the purported class to purchase Common Stock of the Company at inflated prices. The amended consolidated complaint seeks unspecified compensatory damages in favor of the plaintiffs and the other members of the purported class against all defendants, jointly and severally, for all damages sustained as a result of defendants' alleged wrongdoing, including interest thereon, together with reasonable costs and expenses incurred in the action, including counsel fees and expert fees. The defendants' motion for dismissal of the complaint is pending. The named individual defendants and the Company deny any wrongdoing and intend to vigorously defend the action.

A consolidated putative shareholder derivative action entitled In re Xerox Derivative Actions is pending in the Supreme Court of the State of New York, County of New York. Two separate actions have been filed in that court on behalf of the Company against all current members of the Board of Directors (with the exception of Anne M. Mulcahy) and G. Richard Thoman (in one of the actions) and the Company, as a nominal defendant. Another, now dismissed, putative shareholder derivative action was pending in the United States District Court for the District of Connecticut. Plaintiffs claim breach of fiduciary duties and/or gross mismanagement related to certain of the alleged accounting practices of the Company's operations in Mexico. The complaints in all three actions alleged that the individual named defendants breached their fiduciary duties and/or mismanaged the Company by, among other things, permitting wrongful business/accounting practices to occur and in-adequately

supervising and failing to instruct employees and managers of the Company. In one of the New York actions it is claimed that the individual defendants disseminated or permitted the dissemination of misleading information. In the other New York action it is also alleged that the individual defendants failed to vigorously investigate potential and known problems relating to accounting, auditing and financial functions and to take affirmative steps in good faith to remediate the alleged problems. In the federal action in Connecticut it was also alleged that the individual defendants failed to take steps to institute appropriate legal action against those responsible for unspecified wrongful conduct. Plaintiffs claim that the Company has suffered unspecified damages. Among other things, the existing complaints in the (now consolidated) New York actions seek unspecified monetary damages, removal and replacement of the individuals as directors of the Company and/or institution and enforcement of appropriate procedural safeguards to prevent the alleged wrongdoing. Defendants filed a motion to dismiss in one of the New York actions. Subsequently, the parties to the federal action in Connecticut agreed to dismiss that action without prejudice in favor of the earlier-filed New York action. The parties also agreed, subject to court approval, to seek consolidation of the New York actions and a withdrawal, without prejudice, of the motion to dismiss. On May 10, 2001 the court entered an order which, among other things, approved that agreement. Plaintiffs have indicated that they intend to file and serve a consolidated amended complaint. On August 2, 2001 the Commonwealth Court of Pennsylvania issued an order which, among other things, purports to stay, for a period of 180 days from August 2, 2001, certain actions pending against insured parties of Reliance Insurance Company, including this derivative action. With respect to suits filed outside the Commonwealth of Pennsylvania and in the federal courts, the order purports to request comity to effectuate the stay in the court where the matter is pending. The individual defendants deny the wrongdoing alleged and intend to vigorously defend the litigation.

Twelve purported class actions had been pending in the United States District Court for the District of Connecticut against Registrant, KPMG LLP (KPMG), and Paul A. Allaire, G. Richard Thoman, Anne M. Mulcahy and Barry D. Romeril. A court order consolidated these twelve actions and established a procedure for consolidating any subsequently filed related actions. The consolidated action purports to be a class action on behalf of the named plaintiffs and all purchasers of securities of, and bonds issued by, Registrant during the period between February 15, 1998 through February 6, 2001 (Class). Among other things, the consolidated complaint generally alleges that each of the Company, KPMG, the individuals and additional defendants Philip Fishbach and Gregory Tayler violated Sections 10(b) and/or 20(a) of the 34 Act and Securities and Exchange Commission Rule 10b-5 thereunder, by participating in a fraudulent scheme that operated as a fraud and deceit on purchasers of the Company's Common Stock by disseminating materially false and misleading statements and/or concealing material adverse facts relating to the Company's Mexican operations and other matters relating to the Company's financial condition beyond the Company's Mexican operations. The amended complaint generally alleges that this scheme deceived the investing public regarding the true state of the Company's financial condition and caused the named plaintiff and other members of the alleged Class to purchase the Company's Common Stock and Bonds at artificially inflated prices. The amended complaint seeks unspecified compensatory damages in favor of the named plaintiff and the other members of the alleged Class against the Company, KPMG and the individual defendants, jointly and severally, including interest thereon, together with reasonable costs and expenses, including counsel fees and expert fees. Following the entry of the order of consolidation, several (nine) additional related class action complaints were filed in the same Court. In each of these cases, the plaintiffs defined a class consisting of persons who purchased the Common Stock of the Company during the period February 15, 1998 through and including February 6, 2001. Some of these plaintiffs filed objections to the consolidation order, challenging the appointment of lead plaintiffs and lead and liaison counsel and have separately moved for the appointment of lead plaintiff and lead counsel. The court has not rendered a decision with regard to the objections or motion. On August 2, 2001 the Commonwealth Court of Pennsylvania issued an order which, among other things, purports to stay, for a period of 180 days from August 2, 2001, certain actions pending against insured parties of Reliance Insurance Company, including this consolidated securities law action. With respect to suits filed outside the Commonwealth of Pennsylvania and in the federal courts, the order purports to request comity to effectuate the stay in the court where the matter is pending. The individual defendants and the Company deny any wrongdoing alleged in the complaints and intend to vigorously defend the actions.

A lawsuit has been instituted in the Superior Court, Judicial District of Stamford/Norwalk, Connecticut, by James F. Bingham, a former employee of the Company against the Company, Barry D. Romeril, Eunice M. Filter and Paul Allaire. The complaint alleges that the plaintiff was wrongfully terminated in violation of public policy because he attempted to disclose to senior management and to remedy alleged accounting fraud and reporting irregularities. The plaintiff further claims that the Company and the individual defendants violated the Company's policies/commitments to refrain from retaliating against

employees who report ethics issues. The plaintiff also asserts claims of defamation and tortious interference with a contract. He seeks: (a) unspecified compensatory damages in excess of $15 thousand, (b) punitive damages, and (c) the cost of bringing the action and other relief as deemed appropriate by the court. The individuals and the Company deny any wrongdoing and intend to vigorously defend the action.

A putative shareholder derivative action is pending in the Supreme Court of the State of New York, Monroe County against certain current and former members of the Board of Directors, namely G. Richard Thoman, Paul A. Allaire, B. R. Inman, Antonia Ax:son Johnson, Vernon E. Jordan Jr., Yotaro Kobayashi, Ralph S. Larsen, Hilmar Kopper, John D. Macomber, George J. Mitchell, N. J. Nicholas, Jr., John E. Pepper, Patricia L. Russo, Martha R. Seger and Thomas C. Theobald (collectively, the "Individual Defendants"), and the Company, as a nominal defendant. Plaintiff claims the Individual Defendants breached their fiduciary duties of care and loyalty to the Company and engaged in gross mismanagement by allegedly awarding former CEO, G. Richard Thoman, compensation including elements that were unrelated in any reasonable way to his tenure with the Company, his job performance, or the Company's financial performance. The complaint further specifically alleges that the Individual Defendants failed to exercise business judgment in granting Thoman lifetime compensation, a special bonus award, termination payments, early vesting of stock compensation, and certain transportation perquisites, all which allegedly constituted gross, wanton and reckless waste of corporate assets of the Company and its shareholders. Plaintiff claims that the Company has suffered damages and seeks judgment against the Individual Defendants in an amount equal to the sum of the special bonus, the present value of the $800 thousand per year lifetime compensation, the valuation of all options unexercised upon termination, the cost of transportation to and from France, and/or an amount equal to costs already incurred under the various compensation programs, cancellation of unpaid balances of these obligations, and/or cancellation of unexercised options and other deferred compensation at the time of his resignation, plus the cost and expenses of the litigation, including reasonable attorneys', accountants' and experts' fees and other costs and disbursements. On May 31, 2001 defendants filed a motion to dismiss the complaint. The Individual Defendants deny the wrongdoing alleged in the complaint and intend to vigorously defend the action.

A class was certified in an action originally filed in the United States District Court for the Southern District of Illinois last August against the Company's Retirement Income Guarantee Plan ("RIGP"). Plaintiffs bring this action on behalf of themselves and an alleged class of over 25,000 persons who received lump sum distributions from RIGP after January 1, 1990. Plaintiffs assert violations of the Employee Retirement Income Security Act ("ERISA"), claiming that the lump sum distributions were improperly calculated. The damages sought are not specified. On July 3, 2001 the court granted the Plaintiffs' motion for summary judgment, finding that the lump sum calculations violated ERISA. RIGP denies any wrongdoing and intends to appeal the District Court's ruling.

In 2000, the Company was advised that the Securities and Exchange Commission (SEC) had entered an order of a formal, non-public investigation into our accounting and financial reporting practices in Mexico and other areas. We are cooperating fully with the SEC. The Company cannot predict when the SEC will conclude its investigation or its outcome.

On June 19, 2001, an action was commenced by Pitney Bowes in the United States District Court for the District of Connecticut against the Company seeking unspecified damages for infringement of a patent of Pitney Bowes which expired on May 31, 2000. Plaintiff claims that two printers containing image enhancement functions infringe the patent and seeks damages in an unspecified amount for sales between June 1995 and May 2000. The Company denies any wrongdoing and intends to vigorously defend the action.

Note 13 - New Accounting Pronouncement

In June of 2001, the Financial Accounting Standards Board issued Statement No. 142 "Goodwill and Other Intangible Assets" (SFAS No. 142). The statement addresses financial accounting and reporting for acquired goodwill and other intangible assets. This statement recognizes that goodwill has an indefinite useful life and will no longer be subject to periodic amortization. The Company recognized $15 of goodwill amortization expense in the second quarter of 2001 and $30 in the first half 2001. The statement also requires an evaluation of existing acquired goodwill and other intangible assets for proper classification under the new requirements. The Company is currently evaluating the impacts of this new standard on our financial statements. The Company will adopt this standard, as required, in 2002.

Note 14 - Subsequent Events:

In July 2001, we completed the offering of $513 of floating rate asset

backed notes and received cash proceeds of $483 million. The remaining cash proceeds of approximately $30 will be held in reserve over the term of the asset backed notes. As part of the transaction we sold approximately $628 of domestic finance receivables to a qualified special purpose entity in which we have a retained interest of approximately $148, including the cash proceeds held in reserve. The transaction will be accounted for as a sale of finance receivables.

In July 2001, the Board of Directors decided to eliminate the payment of dividends on the Company's common stock. Additionally the Board of Directors chose not to declare the dividend on the Employee Stock Ownership Program (ESOP) preferred stock. Instead we will make an additional contribution to the ESOP trust.

Item 2 Xerox Corporation

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

Results of Operations

Summary

As discussed in Note 2 to the Consolidated Financial Statements, we have restated our 1999 and 1998 financial statements. This restatement has also impacted the quarterly and year to date financial information previously presented for the period ended June 30, 2000. All dollar and per share amounts and financial ratios have been revised, as appropriate, for the effects of the restatement.

Total second quarter 2001 revenues of $4.1 billion declined 13 percent (12 percent pre-currency) from $4.8 billion in the 2000 second quarter. 2001 second quarter year over year pre-currency revenue declines of 4 percent in North America and 7 percent in Europe reflected in part, a weakened economic environment that impacted equipment sales. Developing Markets Operations second quarter 2001 revenues were 33 percent below the 2000 second quarter as we reconfigure our Latin American Operations to a new business approach prioritizing cash and profitable revenue.

Total revenues in the first half 2001 of $8.3 billion declined 11 percent (9 percent pre-currency) from $9.3 billion in the first half 2000. 2001 year to date pre-currency revenue declines of 1 percent in North America and 5 percent in Europe were the result of a weak economic environment partly offset by stabilization of the U.S. direct sales force.

Including a $196 million after-tax charge associated with the company's disengagement from the small office/home office (SOHO) business, an additional net after-tax restructuring provision of $35 million associated with the company's previously announced Turnaround Program and an $18 million after tax gain on early retirement of debt, the second quarter 2001 net loss was $281 million. Excluding all these special items, the second quarter 2001 loss was $68 million including a loss of $56 million in our worldwide SOHO operations from which we have recently announced our disengagement. Second quarter 2000 net income was $202 million. The 2001 second quarter loss reflected the revenue decline as well as a gross margin decline partially offset by lower selling, administrative and general expenses (SAG) reflecting the continuing benefits from our Turnaround Program.

The 2001 first half net loss was $79 million compared to a net loss of $47 million in the first half 2000. 2001 special items included the following after-tax charges - $196 million associated with the company's disengagement from the SOHO business, $96 million related to the company's previously announced Turnaround Program, and a $2 million loss from the implementation of SFAS 133. Special items also included the following after-tax gains - $300 million related to the March 2001 sale of half of our investment in Fuji Xerox Co., Ltd. (Fuji Xerox) to Fuji Photo Film Co. Ltd. (Fujifilm), and $35 million associated with the early retirement of debt. 2000 special items include a $423 million after tax restructuring provision and a $19 million after tax in-process research and development charge associated with the January 1, 2000 acquisition of the Tektronix, Inc. Color Printing and Imaging Division (CPID).

Excluding all special items, the first half 2001 net loss was $120 million compared with net income of $394 million in the 2000 first half. Including the $0.28 SOHO disengagement charge, $0.05 restructuring provision and the $0.03 gain from the early retirement of debt, our loss per share was $0.40 in the 2001 second quarter. Excluding these items the second quarter 2001 loss per share was $0.10 compared with $0.27 earnings per share in the 2000 second quarter.

Including the $0.28 SOHO disengagement charge, $0.14 restructuring provision, $0.43 gain on the sale of Fuji Xerox, and $0.05 gain from the early retirement

of debt, the first half 2001 loss per share was $0.13. The first half 2000 loss per share was $0.10 including charges of $0.66 for restructuring and acquired CPID in-process R&D. Excluding all special items, the 2001 first half loss per share was $0.19 compared with $0.56 earnings per share in the 2000 first half.

In the ordinary course of business, management makes many estimates in the accounting for items that affect our reported results of operations and financial position. The following table summarizes the more significant of these estimates, and the changes therein, and their impacts on pre-tax income (loss):

	Three months ended June 30,		Six months ended June 30,	
	2001	2000	2001	2000
Impact on pre-tax income (loss):				
Provisions for doubtful accounts	$(123)	$(134)	$(215)	$(245)
Provisions for obsolete and excess inventory	(63)	(34)	(121)	(62)
Revenue allocations	(16)	22	(17)	33
Finance discount rates	(9)	5	(18)	22

The preceding items are analyzed as appropriate in succeeding sections of this Management's Discussion and Analysis of Operations and Financial Condition and/or the accompanying Notes to Consolidated Financial Statements.

Pre-Currency Growth

To understand the trends in the business, we believe that it is helpful to adjust revenue and expense growth (except for ratios) to exclude the impact of changes in the translation of European and Canadian currencies into U.S. dollars. We refer to this adjusted growth as "pre-currency growth." Latin American currencies are shown at actual exchange rates for both pre-currency and post-currency reporting, since these countries generally have volatile currency and inflationary environments.

A substantial portion of our consolidated revenues is derived from operations outside of the United States where the U.S. dollar is not the functional currency. When compared with the average of the major European and Canadian currencies on a revenue-weighted basis, the U.S. dollar was approximately 6 percent stronger in the 2001 second quarter than in the 2000 second quarter. As a result, currency translation had an unfavorable impact of approximately two percentage points on revenue growth.

Segment Analysis

Revenues and year-over-year revenue growth rates by segment are as follows (Dollars are in billions):

	2000 Full Year	Pre-Currency Revenue Growth							Q2 2001 Post Currency	
		2000					2001			
	Revenues	Q1	Q2	Q3	Q4	FY	Q1	Q2	Revenues	Growth
Total Revenues	$18.7	8%	-%	(2)%	(9)%	(1)%	(5)%	(12)%	$4.1	(13)%
Production	6.3	1	(2)	(8)	(12)	(6)	(2)	(8)	1.5	(10)
Office	7.1	4	5	4	(3)	2	3	(5)	1.7	(6)
SOHO	0.6	35	(3)	(2)	1	6	(24)	(30)	0.1	(31)
DMO	2.5	36	4	(3)	(21)	-	(21)	(31)	0.4	(33)
Other	2.2	7	(9)	(1)	(4)	(2)	(16)	(17)	0.4	(19)
Memo: Color	2.9	64	60	74	54	62	17	1	0.7	(1)

		YTD 2001 Revenue Growth	
	Revenues	Pre Currency	Post Currency
Total Revenues	$8.3	(9) %	(11)%
Production	2.9	(5)	(7)
Office	3.4	(1)	(3)
SOHO	0.2	(27)	(28)
DMO	0.9	(27)	(28)
Other	0.9	(17)	(19)
Memo: Color	1.4	8	5

2000 pre-currency revenue growth includes the beneficial impact of the January 1, 2000 acquisition of the Tektronix, Inc. Color Printing and Imaging Division.

Production revenues include DocuTech, production printing, color products for the production and graphic arts markets and light-lens copiers over 90 pages per minute sold predominantly through direct sales channels in North America and Europe. Second quarter 2001 revenues declined 10 percent (8 percent pre-currency). Monochrome production revenues declined reflecting the weaker economic environment and continued movement to distributed printing and electronic substitutes. Post equipment install revenues continue to be adversely affected by reduced equipment placements in earlier quarters. Production color revenues grew modestly reflecting continued strong sales of the successful DocuColor 2000 series which began shipments in June, 2000, partially offset by DocuColor 30/40 and mid-range color revenue declines. Production revenues represented 35 percent of second quarter 2001 revenues compared with 34 percent in the 2000 second quarter. Second quarter 2001 gross margin for the production segment declined from the 2000 second quarter primarily as a result of the greater proportion of our gross profits from lower margin color equipment sales.

Production revenues declined 7 percent (5 percent pre-currency) in the first half 2001 from the first half 2000 due to a weaker economic environment and continued movement to distributed printing and electronic substitutes. Strong growth in production color revenues are not yet sufficient to offset monochrome declines.

Office revenues include our family of Document Centre digital multi-function products, light-lens copiers under 90 pages per minute, color laser, solid ink and monochrome laser desktop printers, digital copiers and facsimile products sold through direct and indirect sales channels in North America and Europe. Second quarter 2001 revenues declined 6 percent (5 percent pre-currency) from the second quarter 2000. Black and white copying revenues declined as strong Document Centre installations, including the Document Centre 480 which prints and copies at 75 pages per minute, was more than offset by increased pricing pressures, continued light lens declines and our decision in Europe to reduce our participation in very aggressively priced competitive customer bids and tenders as we reorient our focus from marketshare to profitable revenue. Shipments of the recently announced Document Centre 490, the fastest in its class at 90 pages-per-minute will begin in September. Excellent 2001 second quarter monochrome laser printing revenue growth reflected excellent equipment sales and supplies revenue growth. Good office color revenue growth was driven by continued excellent placements and strong Document Centre ColorSeries 50 recurring revenue growth. The Document Centre ColorSeries 50 is the industry's first color-enabled digital multi-function product. Office revenues represented 41 percent of second quarter 2001 revenues compared with 38 percent in the 2000 second quarter. Second quarter 2001 gross margin for the office segment improved from the 2000 second quarter primarily as a result of stabilizing Document Centre margins, facilitated by strong Document Centre 480 placements, and improvements in laser and solid ink printers.

Office revenues decreased 3 percent (one percent pre-currency) in the first half 2001 from the first half 2000 as modest black and white copying revenue declines were only partially offset by strong office color revenue growth.

Small Office/Home Office (SOHO) revenues include inkjet printers and personal copiers sold through indirect channels in North America and Europe. On June 14 we announced our disengagement from the worldwide SOHO business. Second quarter 2001 SOHO revenues declined 31 percent (30 percent pre-currency) from the 2000 second quarter and declined 28 percent (27 percent pre-currency) in the first half 2001 from the first half 2000. Gross margin declined significantly in a very difficult market environment. SOHO revenues represented 2 percent of second quarter 2001 revenues and 3 percent of the first half 2001 revenues compared with 3 percent in the 2000 second quarter and 3 percent in the first half 2000.

Developing Markets Operations (DMO) includes operations in Latin America, Russia, India, the Middle East and Africa. Second quarter 2001 revenue declined significantly in Brazil from the 2000 second quarter reflecting reduced equipment placements and lower prices as the company focused on reducing inventory and transitioning its business model to maximize cash rather than market share, compounded by a 21 percent devaluation in the Real. Second quarter and first half 2000 revenues in Brazil included structured transactions, as discussed below, of $35 million and $81 million, respectively; there were no similar arrangements in the 2001 second quarter and first half.

Revenue declined throughout the other Latin American countries due to weaker economies and our decision to focus on cash and profitable revenue generation rather than market share. The Middle East and Africa had good revenue growth in the 2001 second quarter and Russia had excellent revenue growth. DMO incurred a substantial pre-tax loss in the second quarter 2001. Gross margin declined in DMO as a result of lower equipment and service margins primarily due to an increased competitive environment, currency devaluation not offset by price increases, lower selling prices as we focused on reducing inventory, weak mix,

and the absence of any structured transaction in Brazil.

DMO revenues decreased 28 percent (27 percent pre-currency) in the first half 2001 from the first half 2000 reflecting reduced equipment placements, an increased competitive environment, the lack of structured transactions in 2001, and lower prices as we focused on reducing inventory, compounded by a 20 percent devaluation in the Real.

Since 1985 the company, primarily in North America, has sold pools of equipment subject to operating leases to third party finance companies (the counter-party) and recorded these transactions as sales at the time the equipment is accepted by the counter-party. The various programs provided us with additional funding sources and/or enhanced credit positions. The counter-party accepts the risks of ownership of the equipment. Remanufacturing and remarketing of off-lease equipment belonging to the counter-party is performed by the company on a nondiscriminatory basis for a fee. North American transactions are structured to provide cash proceeds up front from the counter-party versus collection over time from the underlying customer lessees. There were no sales of equipment subject to operating leases in North America in either the first half 2001 or 2000. The reduction of operating lease revenues as a result of prior year sales of equipment on operating leases was $9 million and $18 million in the second quarter of 2001 and 2000, respectively and $21 million and $36 million in the first half 2001 and 2000, respectively.

Beginning in 1999 several Latin American affiliates entered into certain structured transactions involving contractual arrangements which transferred the risks of ownership of equipment subject to operating leases to third party financial companies who are obligated to pay the Company a fixed amount each month. The Company accounts for these transactions similar to its sales-type leases. The counter-party assumes the risks associated with the payments from the underlying customer lessees thus mitigating risk and variability from the cash flow stream. The following shows the effects of such sales of equipment under structured finance arrangements offset by the associated reductions of operating lease revenues from current and prior year transactions:

	Three months Ended June 30,		Six months Ended June 30,	
	2001	2000	2001	2000
Sales of equipment	$ -	$ 35	$ -	$ 81
Reduced Operating Lease Revenue	(30)	(31)	(62)	(57)
Net revenue impact	$ (30)	$ 4	$ (62)	$ 24

Over time the number and value of the contracts will vary depending on the number of operating leases entered into in any given period, the willingness of third party financing institutions to accept the risks of ownership, and our consideration as to the desirability of entering into such arrangements.

Key Ratios and Expenses

The trend in key ratios was as follows:

	2000					2001		
	Q1	Q2	Q3	Q4	FY	Q1	Q2	YTD
Gross Margin	39.1%*	40.4%	35.0%	35.1%	37.4%*	33.6%	35.8%**	34.7%**
SAG % Revenue	28.0	28.8	31.7	32.2	30.2	27.4	30.6	29.0

*Includes inventory charges associated with the 2000 restructuring. If excluded the gross margin would have been 41.1 percent and 37.9 percent, respectively.
**Includes inventory charges associated with the SOHO disengagement. If excluded the gross margin would have been 36.4 percent for second quarter and 35.0 percent for the first half 2001.

Including inventory charges associated with the SOHO disengagement, the second quarter 2001 gross margin declined by 4.6 percentage points from the 2000 second quarter. Excluding these charges, the second quarter 2001 gross margin of 36.4 percent declined by 4.0 percentage points from the 2000 second quarter. Approximately 2 percentage points of the year over year decline were due to weak performance in Developing Markets Operations. Increased SOHO price pressures and unfavorable mix resulted in one percentage point of the decline. Cost savings and productivity improvements resulting from our Turnaround Program offset increased pricing pressures. Improved asset management practices, lower activity levels and unfavorable mix adversely impacted gross margin. Excluding the gross margin in the SOHO operations, the gross margin in the 2001 second quarter was 38.1 percent.

Including inventory charges associated with the SOHO disengagement, the gross margin was 34.7 percent for the first half 2001, a decline of 5.1 percentage points from the first half 2000 gross margin which includes inventory charges associated with the 2000 restructuring program. Excluding the 2001 SOHO

inventory charges and the 2000 restructuring inventory charges, the first half 2001 gross margin was 35.0 percent compared to 40.8 percent in the first half 2000. Approximately 2 percentage points of the decline was due to weak activity in Developing Markets, primarily in Brazil, as well as lower lease residual values being recognized in 2001 versus the prior year, and the absence of the previously described structured transactions. In addition, improved asset management practices, lower activity levels and unfavorable mix adversely impacted gross margin. The first half 2000 gross margin benefited by approximately 0.5 percentage points from increased licensing and stand-alone software revenues associated with the licensing of a number of patents from our intellectual property portfolio.

Selling, administrative and general expenses (SAG) declined 8 percent (7 percent pre-currency) in the 2001 second quarter from the second quarter 2000. 2001 first half SAG declined 9 percent (7 percent pre-currency) from the 2000 first half. SAG declines in both the second quarter and first half reflect continued benefits from our Turnaround Program including significantly lower labor costs and advertising and marketing communications spending. These reductions were partially offset by second quarter professional costs related to our regulatory filings and related matters and higher costs incurred by Developing Markets Operations in the renegotiation of customer contracts associated with implementation of their new business approach. Second quarter and first half 2001 bad debt provisions of $123 million and $215 million, respectively, were $12 million and $30 million lower than the 2000 second quarter and first half. In the 2001 second quarter, SAG represented 30.6 percent of revenue compared with 28.8 percent of revenue in the 2000 second quarter. First half 2001 SAG represented 29.0 percent of revenue compared with 28.4 percent of revenue in the 2000 first half.

Research and development (R&D) expense was $5 million lower in the 2001 second quarter and $11 million lower in the 2001 first half compared to the 2000 second quarter and first half. The decrease in R&D is due to lower inkjet spending in our SOHO operations reflecting our disengagement from this business. R&D spending was 6 percent of revenue in both the 2001 second quarter and first half as we continue to invest in technological development, particularly color, to maintain our position in the rapidly changing document processing market. Xerox R&D remains technologically competitive and is strategically coordinated with Fuji Xerox.

Worldwide employment declined by 2,300 and 6,600 in the 2001 second quarter and first half respectively to 85,600 primarily as a result of employees leaving the company under our restructuring programs. Excluding divestitures, worldwide employment has declined by 8,600 since implementation of our Turnaround Program in October, 2000.

Other, net was $161 million in the 2001 second quarter compared to $54 million in the second quarter 2000. Second quarter 2000 results benefited from gains of $75 million associated with the sale of the North American commodity paper business and sales of other assets. In the second quarter 2001 we incurred $14 million of net currency losses resulting from the remeasurement of unhedged foreign currency-denominated assets and liabilities and $6 million of mark-to-market losses recorded as a result of the new accounting required under FAS 133. Due to the inherent volatility in the foreign currency markets, the company is unable to predict the amount of any such mark-to-market gains or losses in future periods. Second quarter 2001 net non-financing interest expense of $90 million was $3 million lower than the 2000 second quarter.

The 2001 first half increase in Other, net of $92 million was primarily due to an increase of $32 million in net non-financing interest expense, a $39 million increase in Brazilian indirect taxes and gains in the first half 2000 of $75 million associated with the sale of the North American commodity paper business and sales of other assets partially offset by $27 million of net currency gains resulting from the remeasurement of unhedged foreign currency-denominated assets and liabilities, $16 million of mark-to-market gains recorded as a result of the new accounting required under FAS 133 and an $8 million credit to adjust the remaining 1998 restructuring reserves.

During the fourth quarter of 2000 we announced a Turnaround Program in which we outlined a wide-ranging plan to sell assets, cut costs and strengthen our strategic core. We announced plans that were designed to reduce costs by at least $1.0 billion annually, the majority of which will affect 2001. As part of the cost cutting program, we continue to take additional charges for finalized initiatives under the Turnaround Program. As a result of these actions, in the second quarter of 2001 we provided an incremental $41 million to complete our open initiatives under the Turnaround plan. For the first half, we have provided a total of $141 million under this plan. We expect additional provisions will be required in 2001 as additional plans are finalized. The restructuring reserve balance at June 30, 2001 for both the Turnaround Program and the March 2000 program amounted to $156 million.

In June 2001, the Ad Hoc Committee of the Board of Directors approved the

disengagement from our SOHO business. In connection with this disengagement, we recorded a second-quarter pretax charge of $274 million ($196 million after taxes). The charge includes provisions for the elimination of approximately 1,200 jobs worldwide by the end of 2001, the closing of facilities and the write-down of certain assets to net realizable value. The charges associated with this action include approximately $37 million in employee termination costs, $146 million of asset impairments, $24 million in inventory charges, $25 million in purchase commitments, $25 million in decommitment costs, and $17 million in other miscellaneous charges. The SOHO disengagement reserve balance at June 30, 2001 was $103 million.

Over the remainder of the year we will discontinue our line of personal inkjet and xerographic printers, copiers, facsimile machines and multi-function devices which are sold primarily through retail channels to small offices, home offices and personal users (consumers). We intend to sell the remaining inventory through current channels. We will continue to provide service, support and supplies, including the manufacturing of such supplies, for customers who currently own SOHO products during a phase-down period to meet customer commitments.

Income Taxes, Equity in Net Income of Unconsolidated Affiliates and Minorities' Interests in Earnings of Subsidiaries

Pre-tax income (loss) was $(483) million in the 2001 second quarter including the SOHO disengagement and Turnaround restructuring provisions. Excluding these items, the pre-tax loss was $(169) million in the 2001 second quarter. The 2000 second quarter pre-tax income of $247 million included a $2 million restructuring credit.

Including the effect of special items, pre-tax income was $112 million in the 2001 first half compared to a $(114) million loss for the first half 2000. Excluding special items, the pre-tax loss was $(250) million for the first half 2001 compared to pre-tax income of $507 million for the first half 2000. 2001 special items included a charge of $274 million related to the SOHO disengagement, a $133 million net charge in connection with our existing restructuring programs and a gain of $769 million related to the sale of our 25 percent ownership in Fuji Xerox. In the 2000 first half, special items included a $594 million charge related to the 2000 restructuring program and a $27 million charge for acquired in-process research and development associated with the CPID acquisition.

The effective tax rate, including the tax benefit related to the SOHO disengagement provision and the additional restructuring provision, was 33.2 percent in the 2001 second quarter. Excluding special items and other tax adjustments, the underlying 2001 second quarter and first half tax rates were 42.0 percent compared to 32.0 percent in the 2000 second quarter. The increase in the underlying effective tax rate from 32.0 percent to 42.0 percent in 2001 is due primarily to continued losses in a low-tax rate jurisdiction.

Equity in net income of unconsolidated affiliates is principally our 25 percent share of Fuji Xerox income. Total equity in net income declined by $16 million and $18 million in the 2001 second quarter and first half, respectively, due to our reduced ownership in Fuji Xerox. Our share of total Fuji Xerox net income of $29 million and $34 million in the 2001 second quarter and first half, respectively, decreased by $19 million and $20 million from the 2000 periods. In the first quarter 2001, we retired $122 million of long-term debt through the exchange of 15.5 million shares of common stock valued at $94 million. In the second quarter 2001, we retired an additional $205 million of debt through the exchange of 20.7 million shares of common stock valued at $179 million. The second quarter retirements resulted in a pre-tax extraordinary gain of $30 million ($18 million after taxes) for a net equity increase of approximately $197 million. For the six months, the retirements resulted in a pre-tax extraordinary gain of $58 million ($35 million after taxes) for a net equity increase of $308 million.

We adopted Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS No. 133), and SFAS No. 138, as of January 1, 2001. Upon adoption of SFAS 133 we recorded a net cumulative after-tax loss of $2 million in the first quarter Income Statement and a net cumulative after-tax loss of $19 million in Accumulated Other Comprehensive Income. The adoption of SFAS 133 is expected to increase the future volatility of reported earnings and other comprehensive income. In general, the amount of volatility will vary with the level of derivative and hedging activities and the market volatility during any period.

Additional details regarding the effects of SFAS 133 on the quarter and year-to-date results are included in Note 9 of the "Notes to Consolidated Financial Statements".

The $21 million gain on affiliate's sale of stock in the first quarter 2000 reflected our proportionate share of the increase in equity of Scansoft Inc.

(NASDAQ:SSFT) resulting from Scansoft's issuance of stock in connection with an acquisition. This gain was partially offset by a $5 million charge reflecting our share of Scansoft's write-off of in-process research and development associated with this acquisition, which is included in Equity in net income of unconsolidated affiliates.

Capital Resources and Liquidity

Xerox and its material subsidiaries and affiliates have cash management systems and internal policies and procedures for managing the availability of worldwide cash, cash equivalents and liquidity resources. They are subject to (i) statutes, regulations and practices of the local jurisdictions in which the companies operate, (ii) legal requirements of the agreements to which the companies are parties and (iii) the policies and continuing cooperation of the financial institutions utilized by the companies to maintain such cash management systems.

At June 30, 2001, cash on hand was $2,177 million versus $1,741 million at December 31, 2000, and total debt was $16,266 million versus $18,097 million at December 31, 2000. Total debt, net of cash on hand (Net Debt), decreased by $2,267 million in the first six months of 2001 versus an increase of $2,551 million in the first six months of 2000. As of June 30, 2001, Net Debt has decreased by $2,954 million since our Turnaround Program was initiated on September 30, 2000.

The consolidated ratio of total debt to common and preferred equity was 4.1:1 as of June 30, 2001 compared to 4.4:1 at December 31, 2000. This ratio reflects our decision, beginning in the fourth quarter of 2000, to accumulate cash to maintain financial flexibility, rather than continue our historical practice of using available excess cash to pay down debt. Had our cash balance at June 30, 2001 and December 31, 2000 been reduced to historical levels by paying off debt, the debt to equity ratio would have been approximately 3.6:1 and 4.0:1, respectively.

We historically managed the capital structures of our non-financing operations and our captive financing operations separately. We have announced our intent to exit customer equipment financing as part of our global Turnaround Program, and we are no longer managing our liquidity on a financing / non-financing basis. Accordingly, we believe that a review of operating cash flow and earnings before interest, income taxes, depreciation, amortization and special items (EBITDA) provides the most meaningful understanding of our changes in cash and debt balances.

The following is a summary of EBITDA, operating and other cash flows for the six months ended June 30, 2001 and 2000:

	2001	2000
Loss from continuing operations	$ (79)	$ (47)
Income tax provision (benefit)	265	(40)
Depreciation and amortization	462	453
Restructuring charges	407	594
Interest expense	551	474
Gains on sales of businesses	(754)	(63)
Other items	(4)	53
EBITDA	848	1,424
Less financing and interest income	(477)	(475)
Adjusted EBITDA	371	949
Working capital and other changes	437	(1,456)
On-Lease inventory spending	(123)	(246)
Capital spending	(121)	(240)
Restructuring payments	(265)	(131)
Financing cash flow, net of interest	90	(507)
Operating Cash Flow (Usage)*	389	(1,631)
Dividends	(93)	(294)
Proceeds from sales of businesses	1,635	50
Acquisitions	-	(856)
Other non-operating items	(300)	(34)
Debt borrowings (repayments), net	(1,195)	2,759
Net Change in Cash	$ 436	$ (6)

*The primary variation from cash flow from operations as reported on the Consolidated Statement of Cash Flows is the inclusion above of capital spending as an operational use of cash.

Operating cash flow improved by approximately $2.0 billion, to $389 million in the first six months of 2001 versus $(1,631) million usage in the prior year period. A major portion of the improvement was driven by significant reductions

in working capital. Lower EBITDA, reflecting weaker operating results, and higher restructuring payments were offset by improvements in financing cash flow and lower investments in on-lease equipment and capital spending. The working capital improvements stem largely from reductions in accounts receivable, inventories, and tax payments in the first six months of 2001 compared to the same period in 2000. The inventory reduction reflects management actions to improve inventory turns, and changes in the supply/demand and logistics processes. We expect to continue to reduce inventory levels in 2001. The accounts receivable decrease reflects progress in our efforts to reduce average days' sales outstanding, which effort has been hampered by the persisting effects of changes we made in 1998 to the U.S. customer administration centers. The significant decline in 2001 capital spending versus 2000 is due primarily to substantial completion of our Ireland projects as well as significant spending constraints. We expect 2001 capital spending to be approximately 30 percent below 2000 levels. Investments in on-lease equipment reflect the growth in our document outsourcing business, which we expect will continue to grow in 2001. The increase in financing cash flow, net in 2001 reflects the lower equipment sales in the first six months of 2001 versus the year ago period, which resulted in a lower level of finance receivable originations. This improvement was partially offset by an increase in interest costs in 2001.

Cash restructuring payments of $265 million reflect continued progress with respect to our Turnaround Program. The status of the restructuring reserves is discussed in Note 4 to the Consolidated Financial Statements.

Other non-operating cash usage in the first six months of 2001 totaled $300 million, including a premium payment of $45 million to Ridge Reinsurance. The remaining $255 million of non-operating cash usage related to our replacement of Ridge Reinsurance letters of credit. In April 2001, letters of credit totaling $660 million, which supported Ridge Reinsurance ceded reinsurance obligations, were replaced with trusts collateralized by the Ridge Reinsurance investment portfolio of approximately $405 million plus cash of $255 million. The Ridge Reinsurance investment portfolio is included in Intangible and Other Assets in our Consolidated Balance Sheets.

In the first six months of 2001, we generated approximately $1.7 billion of cash from the sale of half our interest in Fuji Xerox and the sale of our leasing businesses in four European countries as discussed below. Net of amounts paid to Ridge Reinsurance, these asset sales, together with the previously announced dividend reductions, the significant improvement in operating cash flow, and the non-cash exchange of $328 million of debt for equity described below, enabled us to reduce Net Debt by $2,267 million. In the comparable 2000 period, the significant operating cash usage, together with the acquisition of the Color Printing and Imaging Division of Tektronix, Inc., resulted in an increase in Net Debt of $2,551 million.

Liquidity and Funding Plans for 2001

Historically, our primary sources of funding have been cash flows from operations, borrowings under our commercial paper and term funding programs, and securitizations of finance and trade receivables. Our overall funding requirements have been to finance customers' purchases of our equipment, to fund working capital and capital expenditure requirements, and to finance acquisitions.

During 2000, the agencies that assign ratings to our debt downgraded the Company's senior and short-term debt several times. As of August 7, 2001, debt ratings by Moody's are Ba1 and Not Prime, respectively, and the ratings outlook is negative; debt ratings by Fitch are BB and B, respectively, and the ratings outlook is stable; and debt ratings by Standard and Poors (S&P) are BBB- and A-3, respectively, and the ratings outlook is negative. Since October 2000, uncommitted bank lines of credit and the unsecured capital markets have been, and are expected to continue to be, largely unavailable to us and our affiliates. We expect this to result in higher borrowing costs going forward. This may also result in our having to increase our level of intercompany lending to affiliates.

Consequently, in the fourth quarter 2000 we drew down the entire $7.0 billion available to us under our Revolving Credit Agreement (the Revolver), primarily to maintain financial flexibility and pay down debt obligations as they came due. We are in compliance with the covenants, terms and conditions in the Revolver, which matures on October 22, 2002. The only financial covenant in the Revolver requires us to maintain a minimum of $3.2 billion of Consolidated Tangible Net Worth, as defined (CTNW). At June 30, 2001, our CTNW was $489 million in excess of the minimum requirement, a decrease of $111 million from the December 31, 2000 level. Further operating losses, restructuring costs and adverse currency translation adjustments would erode this excess, while operating income, gains on asset sales, additional exchanges of debt for equity, and favorable currency translation would improve this excess.

As of June 30, 2001, we had approximately $1.4 billion of debt obligations expected to be repaid during the remainder of 2001, and $9.0 billion maturing in 2002, as summarized below (in billions):

	2001	2002
First Quarter	-	$0.3
Second Quarter	-	1.0
Third Quarter	$0.4	0.1
Fourth Quarter	1.0	7.6*
Full Year	$1.4	$9.0

* Includes $7.0 billion maturity under the Revolver

In the first six months of 2001, we retired $328 million of long-term debt through the exchange of 36.1 million shares of common stock of the Company, which increased CTNW by approximately $308 million.

We do not have any other material obligations scheduled to mature in 2001 unless our debt ratings are further downgraded as discussed below.

We are implementing a global Turnaround Program which includes initiatives to reduce costs on an annualized basis by at least $1 billion by the end of 2001, improve operations, and sell certain assets. We believe these actions will positively affect our capital resources and liquidity position when completed. In connection with these initiatives, we announced and completed the sale of our China operations to Fuji Xerox Co., Ltd. ("Fuji Xerox") in the fourth quarter of 2000, which generated $550 million of cash and transferred debt of $118 million to Fuji Xerox. In March 2001, we sold half of our interest in Fuji Xerox to Fuji Photo Film Co., Ltd. for $1,283 million in cash.

We have initiated discussions to implement third-party vendor financing programs which, when implemented, will significantly reduce our debt and finance receivables levels going forward. In addition, we are in discussions to consider selling portions of our existing finance receivables portfolio, and we continue to actively pursue alternative forms of financing including securitizations and secured borrowings. In connection with these initiatives, in January 2001, we received $435 million in financing from an affiliate of GE Capital, secured by our portfolio of lease receivables in the United Kingdom. As of June 30, 2001, the remaining balance of this secured borrowing was $243 million. In the second quarter of 2001, we sold our leasing businesses in four Nordic countries to Resonia Leasing AB for $352 million in cash plus certain retained interests. These sales are part of an agreement under which Resonia will provide on-going, exclusive equipment financing to our customers in those countries. In July 2001, Xerox Corporation sold $513 million of asset-backed securities, supported by domestic finance receivables, for cash proceeds of $483 million and certain retained interests.

We believe our liquidity is presently sufficient to meet current and anticipated needs going forward, subject to timely implementation and execution of the various global initiatives discussed above. Should we be unable to successfully complete these initiatives on a timely or satisfactory basis, we will need to obtain additional sources of funds through other operating improvements, financing from third parties, additional asset sales, or a combination thereof. The adequacy of our continuing liquidity depends on our ability to successfully generate positive cash flow from an appropriate combination of these sources.

On December 1, 2000, Moody's reduced its rating of our debt to below investment grade, significantly constraining our ability to enter into new foreign-currency and interest rate derivative agreements, and requiring us to immediately repurchase certain of our then-outstanding derivative agreements. To minimize the resulting exposures, we also voluntarily terminated other derivative agreements. At June 30, 2001, the remaining derivative portfolio had a net positive value to us of $33 million. Should our debt ratings be downgraded by Standard and Poors to below investment grade, we may be required to repurchase certain of the out-of-the-money derivative agreements currently in place, in the approximate aggregate amount as of June 30, 2001 of $124 million. However, it is also possible that some counterparties may require, or agree to, the repurchase of certain of the in-the-money derivatives currently in place, which could reduce or eliminate this cash requirement.

There is no assurance that our credit ratings will be maintained, or that the various counterparties to derivative agreements would not require us to repurchase the obligations in cases where the agreements permit such termination.

In December 2000, as a result of the debt downgrade discussed above, Xerox Corporation renegotiated a $315 million accounts receivable securitization facility, reducing the facility size to $290 million. The facility size will remain at $290 million unless and until our debt is downgraded to or below BB by S&P and Ba2 by Moody's, at which time we would seek to renegotiate the terms

of the facility.

As of December 31, 2000, 0.8 million equity put options were outstanding, at a strike price of approximately $41 per share. In January 2001, we paid $28 million to settle these put options, which we funded by issuing 5.9 million unregistered common shares.

On May 10, 2001, a European affiliate of Xerox Corporation convened a meeting of holders of its GBP 125 million 8-3/4 percent Guaranteed Bonds, issued in 1993 and maturing in 2003 (the "Bonds"), which are guaranteed by Xerox Limited, in order to consider a proposal to repay the Bonds early at par plus accrued interest. Repaying the Bonds early would reduce outstanding indebtedness and interest costs, and would eliminate certain restrictive covenants in the Bonds and related documents, thereby providing additional flexibility to Xerox and its subsidiaries and affiliates in connection with their cash management systems and practices. At the May 10 meeting, the Bondholders rejected the proposal to repay the Bonds early. Therefore, the Bonds remain outstanding. We are maintaining cash of $194 million in a trust, which represents the par value plus one year's interest on the Bonds. We can withdraw this cash upon 21 days' written notice to the trustee.

Risk Management

We are typical of multinational corporations because we are exposed to market risk from changes in foreign currency exchange rates and interest rates that could affect our results of operations and financial condition.

We have historically entered into certain derivative contracts, including interest rate swap agreements, forward exchange contracts and foreign currency swap agreements, to manage interest rate and foreign currency exposures. These instruments are held solely to hedge economic exposures; we do not enter into derivative instrument transactions for trading purposes, and we employ long-standing policies prescribing that derivative instruments are only to be used to achieve a set of very limited objectives. As described above, our ability to currently enter into new derivative contracts is severely constrained. Therefore, while the following paragraphs describe our overall risk management strategy, our ability to employ that strategy effectively has been severely limited. Any future downgrades of our debt could further limit our ability to execute this risk management strategy effectively.

Currency derivatives are primarily arranged in conjunction with underlying transactions that give rise to foreign currency-denominated payables and receivables. For example, we would purchase an option to buy foreign currency to settle the importation of goods from foreign suppliers denominated in that same currency, or a forward exchange contract to fix the dollar value of a foreign currency-denominated loan.

Our primary foreign currency market exposures include the Japanese Yen, Euro, Brazilian Real, British Pound Sterling and Canadian Dollar. In order to manage the risk of foreign currency exchange rate fluctuations, we have historically hedged a significant portion of all cross-border cash transactions denominated in a currency other than the functional currency applicable to each of our legal entities. From time to time (when cost-effective) foreign-currency debt and foreign-currency derivatives are used to hedge international equity investments. Consistent with the nature of economic hedges of such foreign currency exchange contracts, associated unrealized gains or losses would be offset by corresponding changes in the value of the underlying asset or liability being hedged.

Virtually all customer-financing assets earn fixed rates of interest. Therefore, we have historically sought to "lock in" an interest rate spread by arranging fixed-rate liabilities with similar maturities as the underlying assets, and we have funded the assets with liabilities in the same currency. We refer to the effect of these conservative practices as "match funding" customer financing assets. This practice effectively eliminates the risk of a major decline in interest margins during a period of rising interest rates. Conversely, this practice effectively eliminates the opportunity to materially increase margins when interest rates are declining.

Pay-fixed-rate/receive-variable-rate interest rate swaps are often used in place of more expensive fixed-rate debt. Additionally, pay-variable-rate/receive-fixed-rate interest rate swaps are used from time to time to transform longer-term fixed-rate debt into variable-rate obligations. The transactions performed within each of these categories enable more cost-effective management of interest rate exposures. The potential risk attendant to this strategy is the non-performance of the swap counterparty. We address this risk by arranging swaps with a diverse group of strong-credit counterparties, regularly monitoring their credit ratings and determining the replacement cost, if any, of existing transactions.

Many of the financial instruments we use are sensitive to changes in interest

rates. Hypothetically, interest rate changes result in gains or losses related to the market value of our term debt and interest rate swaps due to differences between current market interest rates and the stated interest rates within the instrument.

Our currency and interest rate hedging are typically unaffected by changes in market conditions as forward contracts, options and swaps are normally held to maturity consistent with our objective to lock in currency rates and interest rate spreads on the underlying transactions.

As described above, the downgrades of our debt during 2000 significantly reduced our access to capital markets. Furthermore, the specific downgrade of our debt on December 1, 2000 triggered the repurchase of a number of derivative contracts which were in place at that time, and further downgrades could require us to repurchase additional outstanding contracts. Therefore, our ability to continue to effectively manage the risks associated with interest rate and foreign currency fluctuations, including our ability to continue effectively employing our match funding strategy, is severely constrained, and we anticipate increased volatility in our results of operations due to market changes in interest rates and foreign currency rates.

Item 3. Quantitative and Qualitative Disclosure about Market Risk

The information set forth under the caption "Risk Management" on pages 33-34 of this Quarterly Report on Form 10-Q is hereby incorporated by reference in answer to this Item.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

The information set forth under Note 12 contained in the "Notes to Consolidated Financial Statements" on pages 17-21 of this Quarterly Report on Form 10-Q is incorporated by reference in answer to this item.

Item 2. Changes in Securities

(a) During the quarter ended June 30, 2001, Registrant issued the following securities in transactions which were not registered under the Securities Act of 1933, as amended (the Act):

(1) Securities Sold: on April 1, 2001, Registrant issued 9,925 shares of Common stock, par value $1 per share.

(2) No underwriters participated. The shares were issued to each of the non-employee Directors of Registrant: B.R. Inman, A.A.Johnson, V.E. Jordan, Jr., Y. Kobayashi, H. Kopper, R.S. Larsen, G.J. Mitchell, N.J. Nicholas, Jr., J.E. Pepper, M.R. Seger and T.C.Theobald.

(3) The shares were issued at a deemed purchase price of $9.57 per share (aggregate price $94,875), based upon the market value on the date of issuance, in payment of the quarterly Directors' fees pursuant to Registrant's Restricted Stock Plan for Directors.

(4) Exemption from registration under the Act was claimed based upon Section 4(2) as a sale by an issuer not involving a public offering.

(b) In addition, during the quarter ended June 30, 2001, Registrant issued an aggregate of 20,658,067 shares of Common Stock in the following transactions, all of which were not registered under the Act by reason of the exemption from registration under the Act provided by Section 3(a)(9) of the Act:

Date issued ...	May 23	May 29	June 12	June 14	June 14	June 15
Aggregate amount of consideration received by Registrant ..	$ 6,000,000	$ 7,790,000	$21,930,000	$12,000,000	$11,225,000	$12,280,000
Aggregate number of shares of Common Stock issued by Registrant ..	485,459	679,236	1,885,549	1,101,904	1,044,393	1,110,204

Aggregate value of Common Stock delivered by Registrant ..	$ 5,230,000	$ 7,011,000	$19,413,050	$10,545,000	$ 9,990,250	$9,660,000
Names of the principal underwriters ...	None	None	None	None	None	None

Date issued ...	June 21	June 18	June 21	June 19	June 26	June 27
Aggregate amount of consider-ation received by Registrant ..	$10,000,000	$12,900,000	$18,420,000	$11,842,000	$33,500,000	$11,535,000
Aggregate number of shares of Common Stock issued by Registrant . .	1,038,933	1,317,679	1,736,993	1,221,773	3,637,520	,322,173
Aggregate value of Common Stock delivered by Registrant ..	$ 8,787,500	$11,545,500	$14,700,000	$10,545,000	$29,150,000	10,275,000
Names of the principal underwriters ...	None	None	None	None	None	None

Date issued ...	June 29	June 29	June 29
Aggregate amount of consider-ation received by Registrant ...	$12,000,000	$12,000,000	$12,000,000
Aggregate number of shares of Common Stock issued by Registrant ...	1,340,218	1,361,386	1,374,647
Aggregate value of Common Stock delivered by Registrant ...	$10,395,000	$10,560,000	$10,470,000
Names of the principal underwriters ...	None	None	None

The "Aggregate amount of consideration received by Registrant" in Item 2(b) above represents the aggregate principal amount (or the aggregate accreted value, in the case of original issue discount securities) of the outstanding publicly-issued debt securities of Registrant which the holders of such debt securities exchanged for the number of shares of Common Stock specified in "Aggregate number of shares of Common Stock issued by Registrant" in Item 2(b) above.

The "Aggregate value of Common Stock delivered by Registrant" in Item 2(b) above represents the multiple of the "Aggregate number of shares of Common Stock issued by Registrant", times either a fixed price per share of Common Stock or the average of the closing price, or the volume weighted average price, per share of Common Stock on the New York Stock Exchange over a certain number of days.

In each of the transactions described in Item 2(b) above, Registrant issued shares of Common Stock pursuant to the exemption from registration under the Act provided by Section 3(a)(9) of the Act. Registrant's reliance upon the Section 3(a)(9) exemption from registration is premised upon the facts that the shares of Common Stock were issued by Registrant to the then holders of

outstanding publicly-issued debt securities of Registrant solely in exchange for such debt securities, that each of the exchanges was effected pursuant to an unsolicited offer from such holder of debt securities, and that no commission or remuneration was paid or given directly or indirectly in connection with any such exchange.

Item 5. Other Information

None.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibit 3(a)(1) Restated Certificate of Incorporation of Registrant filed by the Department of State of the State of New York on October 29, 1996. Incorporated by reference to Exhibit 3(a)(1) to Registrant's Quarterly Report on Form 10-Q for the Quarter Ended September 30, 1996.

Exhibit 3 (b) By-Laws of Registrant, as amended through August 1, 2001.

Exhibit 10 (b) Registrant's 1991 Long-Term Incentive Plan, as amended through October 9, 2000.

Exhibit 10 (t) Form of Salary Continuance Agreement entered into with certain executive officers.

Exhibit 11 Computation of Net Income (Loss) per Common Share.

Exhibit 12 Computation of Ratio of Earnings to Fixed Charges.

(b) Current reports on Form 8-K dated April 2, 2001, April 4, 2001, April 19, 2001, May 8, 2001, May 30, 2001 and June 14, 2001 reporting Item 5 "Other Events" were filed during the quarter for which this Quarterly Report is filed.

SIGNATURES

Pursuant to the requirements 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.

XEROX CORPORATION
(Registrant)

/s/ Gregory B. Tayler
____

Date: August 13, 2001

By Gregory B. Tayler
Vice President and Controller
(Principal Accounting Officer)

EXHIBIT 3 (b)

BY-LAWS

of

XEROX CORPORATION

August 1, 2001

ARTICLE I

MEETINGS OF STOCKHOLDERS

SECTION 1. Annual Meetings: A meeting of shareholders entitled to vote shall be held for the election of Directors and the transaction of other business each year in such month and on such day (except a Saturday, Sunday, or holiday) as determined by the Board of Directors.

SECTION 2. Special Meetings: Special Meetings of the shareholders may be called at any time by the Chairman of the Board, the President or the Board of Directors.

SECTION 3. Place of Meetings: Meetings of shareholders shall be held at the principal office of the Company or at such other place, within or without the State of New York, as may be fixed by the Board of Directors.

SECTION 4. Notice of Meetings:

(a) Notice of each meeting of shareholders shall be in writing and shall state the place, date and hour of the meeting. Notice of a Special Meeting shall state the purpose or purposes for which it is being called and shall also indicate that it is being issued by or at the direction of the person or persons calling the meeting. If, at any meeting, action is proposed to be taken which would, if taken, entitle shareholders, fulfilling the requirements of Section 623 of the Business Corporation Law to receive payment for their shares, the notice of such meeting shall include a statement of that purpose and to that effect.

(b) A copy of the notice of any meeting shall be given, personally or by mail, not less than ten nor more than sixty days before the date of the meeting, to each shareholder entitled to vote at such meeting. If mailed, such notice is given when deposited in the United States mail, with postage thereon prepaid, directed to the shareholder at his or her address as it appears on the record of shareholders, or, if he or she shall have filed with the Secretary a written request that notices to him or her be mailed to some other address, then directed to him or her at such other address.

(c) Notice of meeting need not be given to any shareholder who submits a signed waiver of notice, in person or by proxy, whether before or after the meeting. The attendance of any shareholder at a meeting, in person or by proxy, without protesting prior to the conclusion of the meeting the lack of notice of such meeting, shall constitute a waiver of notice by him or her.

SECTION 5. Quorum and Adjourned Meetings:

(a) At any Annual or Special Meeting the holders of a majority of the votes of shares entitled to vote thereat, present in person or by proxy, shall constitute a quorum for the transaction of any business, provided that when a specified item of business is required to be voted on by a class or series, voting as a class, the holders of a majority of the votes of shares of such class or series shall constitute a quorum for the transaction of such specified item of business. When a quorum is once present to organize a meeting, it is not broken by the subsequent withdrawal of any shareholders.

(b) Despite the absence of a quorum, the shareholders present may adjourn the meeting to another time and place, and it shall not be necessary to give any notice of the adjourned meeting if the time and place to which the meeting is adjourned are announced at the meeting at which the adjournment is taken. At the adjourned meeting any business may be transacted that might have been transacted on the original date of the meeting. If after the adjournment, however, the Board of Directors fixes a new record date for the adjourned meeting, a notice of the adjourned meeting shall be given to each shareholder on the new record date entitled to notice under Section 4 of this Article I of the By-Laws.

SECTION 6. Nominations and Business at Meetings:

At any annual meeting of shareholders, only persons who are nominated or business which is proposed in accordance with the procedures set forth in this Section 6 shall be eligible for election as Directors or considered for action by shareholders. Nominations of persons for election to the Board of Directors of the Company may be made or business proposed at a meeting of shareholders (i) by or at the direction of the Board of Directors or (ii) by any shareholder of the Company entitled to vote at the meeting who complies with the notice and other procedures set forth in this Section 6. Such nominations or business proposals, other than those made by or at the direction of the Board of Directors, shall be made pursuant to timely notice in writing to the Secretary of the Company and such business proposals must, under applicable law, be a proper matter for shareholder action. To be timely, a shareholder's notice shall be delivered to or mailed and received at the principal executive offices of the Company not less than 120 days nor more than 150 days in advance of the date which is the anniversary of the date the Company's proxy statement was released to security holders in connection with the previous year's annual meeting; provided, that, if the Company did not hold such previous year's annual meeting or if the anniversary date of the current year's annual meeting has been changed by more than 30 days from the date of the previous year's annual meeting, then such shareholder's notice shall be so delivered or mailed and received within a reasonable time before the Company begins to print and mail its proxy statement.

Such shareholder's notice shall set forth (a) as to each person whom such shareholder proposes to nominate for election or reelection as a Director, all information relating to such person that is required to be disclosed in solicitations of proxies for election of directors, or is otherwise required, in each case pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended (including such person's written consent to being named in the proxy statement as a nominee and to serving as a Director if elected); (b) as to any other business that the shareholder proposes to bring before the meeting, a brief description of the business desired to be brought before the annual meeting, the reasons for conducting such business at the annual meeting and any material interest in such business of such person on whose behalf such proposal is made; and (c) as to the shareholder giving the notice and the beneficial owner, if any, on whose behalf the nomination or proposal is made, (i) the name and address of such shareholder, as they appear on the Company's books and (ii) the class and number of shares of the Company which are beneficially owned by such shareholder. No person shall be eligible for election as a Director of the Company and no business shall be conducted at the annual meeting of shareholders unless nominated or proposed in accordance with the procedures set forth in this Section 6. The Chairman of the meeting may, if the facts warrant, determine and declare to the meeting that a nomination or proposal was not made in accordance with the provisions of this Section 6 and, if he or she should so determine, he or she shall so declare to the meeting and the defective nomination or proposal shall be disregarded.

SECTION 7. Organization: At every meeting of the shareholders, the Chairman of the Board, or in his or her absence if the President is a Director, the President, or if the President is not a Director or is absent, a Vice Chairman, or in the absence of such officers, an Executive Vice President designated by the Chairman of the Board, or in the absence of such officers, a person selected by the meeting, shall act as chairman of the meeting. The Secretary or, in his or her absence, an Assistant Secretary shall act as secretary of the meeting, and in the absence of both the Secretary and an Assistant Secretary, a person selected by the meeting shall act as secretary of the meeting.

SECTION 8. Voting:

(a) Whenever any corporate action, other than the election of Directors, is to be taken by vote of the shareholders, it shall, except as otherwise required by law or by the Certificate of Incorporation be authorized by a majority of the votes cast in favor of or against such action at a meeting of shareholders by the holders of shares entitled to vote thereon. An abstention shall not constitute a vote cast.

(b) Directors shall, except as otherwise required by law, be elected by a plurality of the votes cast at a meeting of shareholders by holders of shares entitled to vote in the election.

SECTION 9. Qualification of Voters:

(a) Every shareholder of record of Common Stock and Series B Convertible Preferred Stock of the Company shall be entitled at every meeting of such shareholders to one vote for every share of Common Stock and Series B Convertible Preferred Stock, respectively, standing in his or her name on the record of shareholders.

(b) Shares of stock belonging to the Company and shares held by another domestic or foreign corporation of any type or kind, if a majority of the shares entitled to vote in the election of directors of such other corporation is held by the Company, shall not be shares entitled to vote or to be counted in determining the total number of outstanding shares.

(c) Shares held by an administrator, executor, guardian, conservator, committee, or other fiduciary, except a trustee, may be voted by him or her, either in person or by proxy, without transfer of such shares into his or her name. Shares held by a trustee may be voted by him or her, either in person or by proxy, only after the shares have been transferred into his or her name as trustee or into the name of his or her nominee.

(d) Shares standing in the name of another domestic or foreign corporation of any type or kind may be voted by such officer, agent or proxy as the By-Laws of such corporation may provide, or in the absence of such provision, as the Board of Directors of such corporation may provide.

SECTION 10. Proxies:

(a) Every shareholder entitled to vote at a meeting of shareholders or to express consent or dissent without a meeting may authorize another person or persons to act for him or her by proxy.

(b) No proxy shall be valid after the expiration of eleven months from the date thereof unless otherwise provided in the proxy. Every proxy shall be revocable at the pleasure of the shareholder executing it, except as otherwise provided by law.

(c) The authority of the holder of a proxy to act shall not be revoked by the incompetence or death of the shareholder who executed the proxy unless, before the authority is exercised, written notice of an adjudication of such incompetence or of such death is received by the Secretary or an Assistant Secretary.

(d) Without limiting the manner in which a shareholder may authorize another person or persons to act for him or her as proxy pursuant to paragraph (a) of this Section, the following shall constitute a valid means by which a shareholder may grant such authority:

(1) A shareholder may execute a writing authorizing another person or persons to act for him or her as proxy. Execution may be accomplished by the shareholder or the shareholder's authorized officer, director, employee or agent signing such writing or causing his or her signature to be affixed to such writing by any reasonable means including, but not limited to, by facsimile signature.

(2) A shareholder may authorize another person or persons to act for the shareholder as proxy by transmitting or authorizing the transmission of a telegram, cablegram or other means of electronic transmission to the person who will be the holder of the proxy or to a proxy solicitation firm, proxy support service organization or like agent duly authorized by the person who will be the holder of the proxy to receive such transmission, provided that such telegram, cablegram or other means of electronic transmission must either set forth or be submitted with information from which it can be reasonably determined that the telegram, cablegram or other electronic transmission was authorized by the shareholder. If it is determined that such telegrams, cablegrams or other electronic transmissions are valid, the inspectors shall specify the nature of the information upon which they relied.

(e) Any copy, facsimile telecommunication or other reliable reproduction of the writing or transmission created pursuant to paragraph (d) of this Section may be substituted or used in lieu of the original writing or transmission for any and all purposes for which the original writing or transmission could be used, provided that such copy, facsimile, telecommunication or other reproduction shall be a complete reproduction of the entire original writing or transmission.

SECTION 11. Inspectors of Election:

(a) The Board of Directors, in advance of any shareholders' meeting, shall appoint one or more inspectors to act at the meeting or any adjournment thereof. The Board of Directors may designate one or more persons as alternate inspectors to replace any inspector who fails to act. If no inspector or alternate has been appointed, or if such persons are unable to act at a meeting of shareholders, the person presiding at a shareholders' meeting shall appoint one or more inspectors. Each inspector, before entering upon the discharge of his or her duties, shall take and sign an oath faithfully to execute the duties of inspector at such meeting with strict impartiality and according to the best of his or her ability.

(b) The inspectors shall determine the number of shares outstanding and the voting power of each, the shares represented at the meeting, the existence of a quorum, the validity and effect of proxies, and shall receive votes, ballots or consents, hear and determine all challenges and questions arising in connection with the right to vote, count and tabulate all votes, ballots or consents, determine the result, and do such acts as are proper to conduct the election or vote with fairness to all shareholders. On request of the person presiding at the meeting or any shareholder entitled to vote thereat, the inspectors shall make a report in writing of any challenge, question or matter determined by them and execute a certificate of any fact found by them. Any report or certificate made by them shall be prima facie evidence of the facts stated and of the vote as certified by them.

SECTION 12. List of Shareholders at Meetings: A list of shareholders as of the record date, certified by the Secretary or by the transfer agent, shall be produced at any meeting of shareholders upon the request thereat or prior thereto of any shareholder. If the right to vote at any meeting is challenged, the inspectors of election, or person presiding thereat shall require such list of shareholders to be produced as evidence of the right of the persons challenged to vote at such meeting, and all persons who appear from such list to be shareholders entitled to vote thereat may vote at such meeting.

ARTICLE II

BOARD OF DIRECTORS

SECTION 1. Power of Board and Qualification of Directors: The business of the Company shall be managed under the direction of the Board of Directors, each of whom shall be at least eighteen years of age.

SECTION 2. Number, Term of Office and Classification:

(a) The Board of Directors shall consist of not less than five nor more than twenty-one members. The number of Directors shall be determined from time to time by resolution of a majority of the entire Board of Directors then in office, provided that no decrease in the number of Directors shall shorten the term of any incumbent Director. At each Annual Meeting of shareholders Directors shall be elected to hold office until the next annual meeting.

(b) If and whenever six full quarter-yearly dividends (whether or not consecutive) payable on the Cumulative Preferred Stock of any series shall be in arrears, in whole or in part, the number of Directors then constituting the Board of Directors shall be increased by two and the holders of the Cumulative Preferred Stock, voting separately as a class, regardless of series, shall be entitled to elect the two additional Directors at any annual meeting of shareholders or special meeting held in place thereof, or at a special meeting of the holders of the Cumulative Preferred Stock called as hereinafter provided. Whenever all arrears in dividends on the Cumulative Preferred Stock then outstanding shall have been paid and dividends thereon for the current quarter-yearly dividend period shall have been paid or declared and set apart for payment, then the right of the holders of the Cumulative Preferred Stock to elect such additional two Directors shall cease (but subject always to the same provisions for the vesting of such voting rights in the case of any similar future arrearages in dividends), and the terms of office of all persons elected as Directors by the holders of the Cumulative Preferred Stock shall forthwith terminate and the number of the Board of Directors shall be reduced accordingly. At any time after such voting power shall have been so vested in the Cumulative Preferred Stock, the Secretary of the Company may, and upon the written request of any holder of the Cumulative Preferred Stock (addressed to the Secretary at the principal office of the Company) shall, call a special meeting of the holders of the Cumulative Preferred Stock for the election of the two Directors to be elected by them as herein provided, such call to be made by notice similar to that provided in the By-Laws for a special meeting of the shareholders or as required by law. If any such special meeting required to be called as above provided shall not be called by the Secretary within twenty days after receipt of any such request, then any holder of Cumulative Preferred Stock may call such meeting, upon the notice above provided, and for that purpose shall have access to the stock books of the Company. The Directors elected at any such special meeting shall hold office until the next annual meeting of the shareholders or special meeting held in place thereof. In case any vacancy shall occur among the Directors elected by the holders of the Cumulative Preferred Stock, a successor shall be elected to serve until the next annual meeting of the shareholders or special meeting held in place thereof by the then remaining Director elected by the holders of the Cumulative Preferred Stock or the successor of such remaining Director.

(c) All Directors shall have equal voting power.

SECTION 3. Organization: At each meeting of the Board of Directors, the Chairman of the Board, or in his or her absence, the President, or in his or her absence, a chairman chosen by a majority of the Directors present shall preside. The Secretary shall act as secretary of the Board of Directors. In the event the Secretary shall be absent from any meeting of the Board of Directors, the meeting shall select its secretary.

SECTION 4. Resignations: Any Director of the Company may resign at any time by giving written notice to the Chairman of the Board, the President or to the Secretary of the Company. Such resignation shall take effect at the time specified therein or, if no time be specified, then on delivery.

SECTION 5. Vacancies: Newly created directorships resulting from an increase in the number of Directors and vacancies occurring in the Board of Directors for any reason except the removal of Directors without cause may be filled by a vote of a majority of the Directors then in office, although less than a quorum exists. A Director elected to fill a vacancy shall hold office until the next annual meeting.

SECTION 6. Place of Meeting: The Board of Directors may hold its meetings at such place or places within or without the State of New York as the Board of Directors may from time to time by resolution determine.

SECTION 7. First Meeting: On the day of each annual election of Directors, the Board of Directors shall meet for the purpose of organization and the transaction of other business. Notice of such meeting need not be given. Such first meeting may be held at any other time which shall be specified in a notice given as hereinafter provided for special meetings of the Board of Directors.

SECTION 8. Regular Meetings: Regular meetings of the Board of Directors may be held at such times as may be fixed from time to time by resolution of the Board of Directors without notice.

SECTION 9. Special Meetings: Special meetings of the Board of Directors shall be held whenever called by the Chairman of the Board, the President, or by any two of the Directors. Oral, telegraphic or written notice shall be given, sent or mailed not less than one day before the meeting and shall state, in addition to the purposes, the date, place and hour of such meeting.

SECTION 10. Waivers of Notice: Notice of a meeting need not be given to any Director who submits a signed waiver of notice whether before or after the meeting, or who attends the meeting without protesting, prior thereto or at its commencement, the lack of notice to him or her.

SECTION 11. Quorum and Manner of Acting:

(a) If the number of Directors is twelve or more, seven Directors shall constitute a quorum for the transaction of business or any specified item of business. If the number of Directors is less than twelve, a majority of the entire Board of Directors shall constitute a quorum.

(b) A majority of the Directors present, whether or not a quorum is present, may adjourn any meeting to another time and place without notice to any Director.

SECTION 12. Written Consents: Any action required or permitted to be taken by the Board of Directors or any committee thereof may be taken without a meeting if all members of the Board or the committee consent in writing to the adoption of a resolution authorizing the action. The resolution and the written consents thereto by the members of the Board or committee shall be filed with the minutes of the proceedings of the Board or committee.

SECTION 13. Participation At Meetings By Telephone: Any one or more members of the Board of Directors or any committee thereof may participate in a meeting of such Board or committee by means of a conference telephone or similar communications equipment allowing all persons participating in the meeting to hear each other at the same time. Participation by such means shall constitute presence in person at a meeting.

SECTION 14. Compensation: The Board of Directors shall have authority to fix the compensation of Directors for services in any capacity.

SECTION 15. Interested Directors:

(a) No contract or other transaction between the Company and one or more of its Directors, or between the Company and any other corporation, firm, association or other entity in which one or more of its Directors are directors or officers, or are financially interested, shall be either void or voidable for this reason alone or by reason alone that such Director or Directors are present at the meeting of the Board of Directors, or of a

committee thereof, which approves such contract or transaction, or that his or her or their votes are counted for such purpose, provided that the parties to the contract or transaction establish affirmatively that it was fair and reasonable as to the Company at the time it was approved by the Board, a committee, or the shareholders.

(b) Any such contract or transaction may not be avoided by the Company for the reasons set forth in (a) if

(1) the material facts as to such Director's interest in such contract or transaction and as to any such common directorship, officership or financial interest are disclosed in good faith or known to the Board or committee, and the Board or committee approves such contract or transaction by a vote sufficient for such purpose without counting the vote of such interested Director or, if the votes of the disinterested Directors are insufficient for such purpose, by unanimous vote of the disinterested Directors (although common or interested Directors may be counted in determining the presence of a quorum at a meeting of the Board or of a committee which approves such contract or transactions), or

(2) the material facts as to such Director's interest in such contract or transaction and as to any such common directorship, officership or financial interest are disclosed in good faith or known to the shareholders entitled to vote thereon, and such contract or transaction is approved by vote of such shareholders.

SECTION 16. Loans to Directors: The Company may not lend money to or guarantee the obligation of a Director of the Company unless the particular loan or guarantee is approved by the shareholders, with the holders of a majority of the shares entitled to vote thereon constituting a quorum, but shares held of record or beneficially by Directors who are benefited by such loan or guarantee shall not be entitled to vote or to be included in the determination of a quorum.

ARTICLE III

EXECUTIVE COMMITTEE

SECTION 1. How Constituted and Powers: There shall be an Executive Committee, consisting of not less than three nor more than nine Directors, including the Chairman of the Board, the Chairman of the Executive Committee and the President, if the President is a Director, elected by a majority of the entire Board of Directors, who shall serve at the pleasure of the Board. The Executive Committee shall have all the authority of the Board, except it shall have no authority as to the following matters:

(a) The submission to shareholders of any action that needs shareholders' authorization.

(b) The filling of vacancies in the Board or in any committee.

(c) The fixing of compensation of the Directors for serving on the Board or on any committee.

(d) The amendment or repeal of the By-Laws, or the adoption of new By-Laws.

(e) The amendment or repeal of any resolution of the Board which, by its terms, shall not be so amendable or repealable.

(f) The declaration of dividends.

SECTION 2. Meetings: Meetings of the Executive Committee, of which no notice shall be necessary, shall be held on such days and at such place as shall be fixed, either by the Chairman of the Board, the Chairman of the Executive Committee, or by a vote of the majority of the whole Committee.

SECTION 3. Quorum and Manner of Acting: Unless otherwise provided by resolution of the Board of Directors, a majority of the Executive Committee shall constitute a quorum for the transaction of business and the act of a majority of all of the members of the Committee, whether present or not, shall be the act of the Executive Committee. The members of the Executive Committee shall act only as a Committee. The procedure of the Committee and its manner of acting shall be subject at all times to the directions of the Board of Directors.

SECTION 4. Additional Committees: The Board of Directors by resolution adopted by a majority of the entire Board may designate from among its members additional committees, each of which shall consist of one or more Directors and shall have such authority as provided in the resolution designating the

committee, except such authority shall not exceed the authority conferred on the Executive Committee by Section 1 of this Article.

SECTION 5. Alternate Members: The Board of Directors may designate one or more eligible Directors as alternate members of the Executive Committee, or of any other committee of the Board, who may replace any absent or disqualified member or members at any meeting of any such committee.

ARTICLE IV

OFFICERS

SECTION 1. Number: The officers of the Company shall be a Chairman of the Board, a President, a Chairman of the Executive Committee, one or more Vice Chairman of the Board, one or more Vice Presidents, a Treasurer, a Secretary, a Controller, and such other officers as the Board of Directors may in its discretion elect. Any two or more offices may be held by the same person.

SECTION 2. Term of Offices and Qualifications: Those officers whose titles are specifically mentioned in Section 1 of this Article IV shall be chosen by the Board of Directors on the day of the Annual Meeting. Unless a shorter term is provided in the resolution of the Board electing such officer, the term of office of such officer shall extend to and expire at the meeting of the Board held on the day of the next Annual Meeting. The Chairman of the Board, the Chairman of the Executive Committee and the Vice Chairmen shall be chosen from among the Directors.

SECTION 3. Additional Officers: Additional officers other than those whose titles are specifically mentioned in Section 1 of this Article IV shall be elected for such period, have such authority and perform such duties, either in an administrative or subordinate capacity, as the Board of Directors may from time to time determine.

SECTION 4. Removal of Officers: Any officer may be removed by the Board of Directors with or without cause, at any time. Removal of an officer without cause shall be without prejudice to his or her contract rights, if any, but his or her election as an officer shall not of itself create contract rights.

SECTION 5. Resignation: Any officer may resign at any time by giving written notice to the Board of Directors, or to the Chairman of the Board, or the President, or to the Secretary. Any such resignation shall take effect at the time specified therein, or if no time be specified, then upon delivery.

SECTION 6. Vacancies: A vacancy in any office shall be filled by the Board of Directors.

SECTION 7. Chairman of the Board: The Chairman of the Board shall preside at all meetings of the shareholders at which he or she is present, unless at such meetings the shareholders shall appoint a chairman other than the Chairman of the Board. The Chairman of the Board shall preside at all meetings of the Directors at which he or she is present. In the absence or inability to act of the President, or if the office of the President be vacant, the Chairman of the Board, subject to the right of the Board from time to time to extend or confine such powers and duties or to assign them to others, shall perform all the duties and may exercise all the powers of the President. The Chairman of the Board shall have such powers and perform such other duties as may be assigned to him or her by the Board.

SECTION 8. President: The President shall, if he or she is also a Director, in the absence of the Chairman of the Board, preside at all meetings of the shareholders, Directors or the Executive Committee at which he or she is present. The President shall act as the Chief Executive Officer of the Company and it shall be his or her duty to supervise generally the management of the business of the Company with responsibility direct to the Board and subject to the control of the Board. The President shall have such powers and perform such other duties as may be assigned to him or her by the Board.

SECTION 9. Chairman of the Executive Committee: The Chairman of the Executive Committee shall have such powers and perform such duties as may be assigned to him or her by the Board. The Chairman of the Executive Committee shall preside at meetings of the Executive Committee of the Board of Directors.

SECTION 10. The Vice Chairmen: Each Vice Chairman of the Board shall have such power and shall perform such duties as may be assigned to him or her by the Board of Directors, the Chairman of the Board or the President.

SECTION 11. The Vice Presidents: Each Vice President shall have such powers and shall perform such duties as may be assigned to him or her by the

Board of Directors, the Chairman of the Board or the President.

SECTION 12. The Treasurer: The Treasurer shall, if required by the Board of Directors, give a bond for the faithful discharge of his or her duties, in such sum and with such sureties as the Board of Directors shall require. He or she shall have charge and custody of, and be responsible for, all funds and securities of the Company, and deposit all such funds in the name of and to the credit of the Company in such banks, trust companies, or other depositories as shall be selected by the Board of Directors. The Treasurer may sign certificates for stock of the Company authorized by the Board of Directors. He or she shall also perform all other duties customarily incident to the office of Treasurer and such other duties as from time to time may be assigned to him or her by the Board of Directors.

SECTION 13. The Controller: The Controller shall keep and maintain the books of account for internal and external reporting purposes. He or she shall also perform all other duties customarily incident to the office of Controller and such other duties as may be assigned to him or her from time to time by the Board of Directors.

SECTION 14. The Secretary: It shall be the duty of the Secretary to act as secretary of all meetings of the Board of Directors, and of the shareholders, and to keep the minutes of all such meetings at which he or she shall so act in a proper book or books to be provided for that purpose; he or she shall see that all notices required to be given by the Company are duly given and served; he or she may sign and execute in the name of the Company certificates for the stock of the Company, deeds, mortgages, bonds, contracts or other instruments authorized by the Board of Directors; he or she shall prepare, or cause to be prepared, for use at meetings of shareholders the list of shareholders as of the record date referred to in Article I, Section 12 of these By-Laws and shall certify, or cause the transfer agent to certify, such list; he or she shall keep a current list of the Company's Directors and officers and their residence addresses; he or she shall be custodian of the seal of the Company and shall affix the seal, or cause it to be affixed, to all agreements, documents and other papers requiring the same. The Secretary shall have custody of the Minute Book containing the minutes of all meetings of shareholders, Directors, the Executive Committee, and any other committees which may keep minutes, and of all other contracts and documents which are not in the custody of the Treasurer or the Controller of the Company, or in the custody of some other person authorized by the Board of Directors to have such custody.

SECTION 15. Appointed Officers: The Board of Directors may delegate to any officer or committee the power to appoint and to remove any subordinate officer, agent or employee.

SECTION 16. Assignment and Transfer of Stocks, Bonds, and Other Securities: The Chairman of the Board, the President, the Treasurer, the Secretary, any Assistant Secretary, any Assistant Treasurer, and each of them, shall have power to assign, or to endorse for transfer, under the corporate seal, and to deliver, any stock, bonds, subscription rights, or other securities, or any beneficial interest therein, held or owned by the Company.

ARTICLE V

CONTRACTS, CHECKS, DRAFTS AND BANK ACCOUNTS

SECTION 1. Execution of Contracts: The Board of Directors, except as in these By-Laws otherwise provided, may authorize any officer or officers, agent, or agents, in the name of and on behalf of the Company to enter into any contract or execute and dliver any instrument, and such authority may be general or confined to specific instances; but, unless so authorized by the Board of Directors, or expressly authorized by these By-Laws, no officer, agent or employee shall have any power or authority to bind the Company by any contract or engagement or to pledge its credit or to render it liable pecuniarily in any amount for any purpose.

SECTION 2. Loans: No loans shall be contracted on behalf of the Company, and no negotiable paper shall be issued in its name unless specifically authorized by the Board of Directors.

SECTION 3. Checks, Drafts, etc.: All checks, drafts, and other orders for the payment of money out of the funds of the Company, and all notes or other evidences of indebtedness of the Company, shall be signed on behalf of the Company in such manner as shall from time to time be determined by resolution of the Board of Directors.

SECTION 4. Deposits: All funds of the Company not otherwise employed shall be deposited from time to time to the credit of the Company in such banks, trust companies or other depositories as the Board of Directors may select.

ARTICLE VI
STOCKS AND DIVIDENDS

SECTION 1. Shares of Stock: Shares of stock of the Company shall be represented by certificates except to the extent that the Board of Directors of the Company shall provide by resolution that some or all of any or all classes and series of the Company's shares shall be uncertificated shares, provided that such resolution shall not apply to shares represented by a certificate until such certificate is surrendered to the Company. Except as otherwise expressly provided by law, the rights and obligations of holders of uncertificated shares and the rights and obligations of the holders of certificates representing shares of the same class and series shall be identical.

SECTION 2. Certificates For Shares. To the extent that shares of stock of the Company are to be represented by certificates, the certificates therefor shall be in such form as shall be approved by the Board of Directors. The certificates of stock shall be numbered in order of their issue, shall be signed by the Chairman of the Board, the President, a Vice Chairman or a Vice President, and the Secretary or an Assistant Secretary, or the Treasurer or an Assistant Treasurer. The signature of the officers upon a certificate may be facsimiles if the certificate is countersigned by a transfer agent or registered by a registrar other than the Company itself or its employee. In case any officer who has signed or whose facsimile signature has been placed upon a certificate shall have ceased to be such officer before such certificate is issued, it may be issued by the Company with the same effect as if he or she were an officer at the date of issue.

SECTION 3. Transfer of Stock: Transfers of stock of the Company shall be made only on the books of the Company by the holder thereof, or by his or her duly authorized attorney, on surrender of the certificate or certificates for stock represented by certificates, properly endorsed, or in the case of shares of stock not represented by certificates, on delivery to the Company of proper transfer instructions. Within a reasonable time after the issuance or transfer of uncertificated stock, the Company shall send to the registered owner thereof a written notice containing the information required to be set forth or stated on certificates pursuant to the Business Corporation Law of the State of New York. Every certificate surrendered to the Company shall be marked "Canceled", with the date of cancellation, and no new certificate shall be issued in exchange therefor until the old certificate has been surrendered and canceled. A person in whose name stock of the Company stands on the books of the Company shall be deemed the owner thereof as regards the Company; provided that, whenever any transfer of stock shall be made for collateral security, and not absolutely, such fact, if known to the Secretary of the Company, or to its transfer agent shall be so expressed in the entry of the transfer. No transfer of stock shall be valid as against the Company, or its shareholders for any purpose, until it shall have been entered in the stock records of the Company as specified in these By-Laws by an entry showing from and to whom transferred.

SECTION 4. Transfer and Registry Agents: The Company may, from time to time, maintain one or more transfer offices or agencies and/or registry offices at such place or places as may be determined from time to time by the Board of Directors; and the Board of Directors may, from time to time, define the duties of such transfer agents and registrars and make such rules and regulations as it may deem expedient, not inconsistent with these By-Laws, concerning the issue, transfer and registration of certificates for stock or uncertificated stock of the Company.

SECTION 5. Lost, Destroyed and Mutilated Certificates: The holder of any certificated stock of the Company shall immediately notify the Company of any loss, destruction or mutilation of the certificate therefor. The Company may issue a new certificate or uncertificated stock in place of the lost or destroyed certificate, but as a condition to such issue, the holder of such certificate must make satisfactory proof of the loss or destruction thereof, and must give to the Company a bond of indemnity in form and amount and with one or more sureties satisfactory to the Treasurer, the Secretary or any Assistant Treasurer or Assistant Secretary. Such bond of indemnity shall also name as obligee each of the transfer agents and registrars for the stock the certificate for which has been lost or destroyed.

SECTION 6. Record Dates for Certain Purposes: The Board of Directors of the Company shall fix a day and hour not more than sixty days preceding the date of any meeting of shareholders, or the date for payment of any cash or stock dividend, or the date for the allotment of any rights of subscription, or the date when any change or conversion or exchange of capital stock shall go into effect, as a record date for the determination of the shareholders entitled to notice of, and to vote at, any such meeting and any adjournment thereof, or entitled to receive payment of any such dividend, or entitled to receive any such allotment of rights of subscription, or entitled to exercise

rights in respect of any such change, conversion or exchange of capital stock, and in such case, such shareholders and only such shareholders as shall be shareholders of record on the day and hour so fixed shall be entitled to such notice of, and to vote at, such meeting or any adjournment thereof, or to receive payment of such dividend, or to receive such allotment of rights of subscription, or to exercise rights in connection with such change or conversion or exchange of capital stock, as the case may be, notwithstanding any transfer of any stock on the books of the Company after such day and hour fixed as aforesaid.

SECTION 7. Dividends and Surplus: Subject to the limitations prescribed by law, the Board of Directors (1) may declare dividends on the stock of the Company whenever and in such amounts as, in its opinion, the condition of the affairs of the Company shall render it advisable, (2) may use and apply, in its discretion, any part or all of the surplus of the Company in purchasing or acquiring any of the shares of stock of the Company, and (3) may set aside from time to time out of such surplus or net profits such sum or sums as it in its absolute discretion, may think proper as a reserve fund to meet contingencies or for equalizing dividends, or for the purpose of maintaining or increasing the property or business of the Company, or for any other purpose it may think conducive to the best interest of the Company.

ARTICLE VII

OFFICES AND BOOKS

SECTION 1. Offices: The Company shall maintain an office at such place in the County of Monroe, State of New York, as the Board of Directors may determine. The Board of Directors may from time to time and at any time establish other offices of the Company or branches of its business at whatever place or places seem to it expedient.

SECTION 2. Books and Records:

(a) There shall be kept at one or more offices of the Company (1) correct and complete books and records of account, (2) minutes of the proceedings of the shareholders, Board of Directors and the Executive Committee, (3) a current list of the Directors and officers of the Company and their residence addresses, and (4) a copy of these By-Laws.

(b) The stock records may be kept either at the office of the Company or at the office of its transfer agent or registrar in the State of New York, if any, and shall contain the names and addresses of all shareholders, the number and class of shares held by each and the dates when they respectively became the owners of record thereof.

ARTICLE VIII

GENERAL

SECTION 1. Seal: The corporate seal shall be in the form of a circle and shall bear the full name of the Company and the words and figures "Incorporated 1906, Rochester, N. Y.".

SECTION 2. Indemnification of Directors and Officers: Except to the extent expressly prohibited by law, the Company shall indemnify any person, made or threatened to be made, a party in any civil or criminal action or proceeding, including an action or proceeding by or in the right of the Company to procure a judgment in its favor or by or in the right of any other corporation of any type or kind, domestic or foreign, or any partnership, joint venture, trust, employee benefit plan or other enterprise, which any Director or officer of the Company served in any capacity at the request of the Company, by reason of the fact that he or she, his or her testator or intestate is or was a Director or officer of the Company or serves or served such other corporation, partnership, joint venture, trust, employee benefit plan or other enterprise, in any capacity, against judgments, fines, penalties, amounts paid in settlement and reasonable expenses, including attorneys' fees, incurred in connection with such action or proceeding, or any appeal therein, provided that no such indemnification shall be required with respect to any settlement unless the Company shall have given its prior approval thereto. Such indemnification shall include the right to be paid advances of any expenses incurred by such person in connection with such action, suit or proceeding, consistent with the provisions of applicable law. In addition to the foregoing, the Company is authorized to extend rights to indemnification and advancement of expenses to such persons by i) resolution of the shareholders, ii) resolution of the Directors or iii) an agreement, to the extent not expressly prohibited by law.

ARTICLE IX

FISCAL YEAR

SECTION 1. Fiscal Year: The fiscal year of the Company shall end on the 31st day of December in each year.

ARTICLE X

AMENDMENTS

SECTION 1. Amendments: By-Laws of the Company may be amended, repealed or adopted by a majority of the votes of the shares at the time entitled to vote in the election of any Directors. If, at any meeting of shareholders, action is proposed to be taken to amend, repeal or adopt By-Laws, the notice of such meeting shall include a brief statement or summary of the proposed action. The By-Laws may also be amended, repealed or adopted by the Board of Directors, but any By-Law adopted by the Board may be amended or repealed by shareholders entitled to vote thereon as hereinabove provided. If any By-Law regulating an impending election of Directors is adopted, amended or repealed by the Board of Directors, there shall be set forth in the notice of the next meeting of shareholders for the election of Directors the By-Law so adopted, amended or repealed, together with a concise statement of the changes made.

EXHIBIT 10 (b)
As Amended Through 10/9/00

XEROX CORPORATION
1991 LONG-TERM INCENTIVE PLAN

1. Purpose

The purpose of the Xerox Corporation 1991 Long-Term Incentive Plan (the "Plan") is to advance the interests of Xerox Corporation (the "Company") and to increase shareholder value by providing officers and employees with a proprietary interest in the growth and performance of the Company and with incentives for continued service with the Company, its subsidiaries and affiliates.

2. Term

The Plan shall be effective as of May 16, 1991 and shall remain in effect until May 20, 2004 unless sooner terminated by the Company's Board of Directors (the "Board"). After termination of the Plan, no future awards may be granted but previously made awards shall remain outstanding in accordance with their applicable terms and conditions and the terms and conditions of the Plan.

3. Plan Administration

The Executive Compensation and Benefits Committee of the Board, or such other committee as the Board shall determine, comprised of not less than three members shall be responsible for administering the Plan (the "Compensation Committee"). To the extent specified by the Compensation Committee it may delegate its administrative responsibilities to a subcommittee of the Compensation Committee comprised of not less than three members (the Compensation Committee and such subcommittee being hereinafter referred to as the "Committee"). The Compensation Committee or such subcommittee members, as appropriate, shall be qualified to administer this Plan as contemplated by (a) Rule 16b-3 under the Securities and Exchange Act of 1934 (the "1934 Act") or any successor rule and (b) Section 162(m) of the Internal Revenue Code of 1986, as amended, and the regulations thereunder ("Section 162(m)"). The Committee, and such subcommittee to the extent provided by the Committee, shall have full and exclusive power to interpret, construe and implement the Plan and any rules, regulations, guidelines or agreements adopted hereunder and to adopt such rules, regulations and guidelines for carrying out the Plan as it may deem necessary or proper. These powers shall include, but not be limited to, (i) determination of the type or types of awards to be granted under the Plan; (ii) determination of the terms and conditions of any awards under the Plan; (iii) determination of whether, to what extent and under what circumstances awards may be settled, paid or exercised in cash, shares, other securities, or other awards, or other property, or canceled, forfeited or suspended; (iv) adoption of such modifications, amendments, procedures, subplans and the like as are necessary to comply with provisions of the laws of other countries in which the Company may operate in order to assure the viability of awards granted under the Plan and to enable participants employed in such other countries to receive advantages and benefits under the Plan and such laws; (v) subject to the rights of participants, modification, change, amendment or cancellation of any award to correct an administrative error and (vi) taking any other action the Committee deems necessary or desirable for the administration of the Plan. All determinations, interpretations, and other decisions under or with respect to the Plan or any award by the Committee shall be final, conclusive and binding upon the Company, any participant, any holder or beneficiary of any award under the Plan and any employee of the Company. Except for the power to amend this Plan as provided in Section 13 and except for determinations regarding employees who are subject to Section 16 of the 1934 Act or certain key employees who are or may become, as determined by the Committee, subject to the Section 162(m) compensation deductibility limit (the "Covered Employees"), the Committee may delegate any or all of its duties, powers and authority under the Plan pursuant to such conditions or limitations as the Committee may establish to any officer or officers of the Company.

4. Eligibility

Any employee of the Company shall be eligible to receive an award under the Plan. "Employee" shall also include any former employee of the Company eligible to receive a replacement award as contemplated in Sections 5 and 7, and "Company" shall include any entity that is directly or indirectly controlled by the Company or any entity in which the Company has a significant equity interest, as determined by the Committee.

5. Shares of Stock Subject to the Plan

For each calendar year from and including 1991 to but excluding 1999, a number of shares of Common Stock, par value $1.00 per share, of the Company ("Common

Stock") equal in an amount of up to one percent (1%) of the adjusted average shares of Common Stock outstanding used to calculate diluted earnings per share (previously known as fully diluted earnings per share) as reported in the annual report to shareholders for the preceding year shall become available for issuance under the Plan; and for the calendar year 1999, and for each calendar year thereafter, a number of shares of Common Stock equal in an amount to two percent (2%) of the adjusted average shares of Common Stock outstanding used to calculate diluted earnings per share (previously known as fully diluted earnings per share) as reported in the annual report to shareholders for the preceding year shall become available for issuance under the Plan.

For purposes of the preceding paragraph, the following shall not be counted against shares available for issuance under the Plan: (i) settlement of stock appreciation rights ("SAR") in cash or any form other than shares and (ii) payment in shares of dividends and dividend equivalents in conjunction with outstanding awards. Any shares that are issued by the Company, and any awards that are granted by, or become obligations of, the Company, through the assumption by the Company or an affiliate of, or in substitution for, outstanding awards previously granted by an acquired company shall not be counted against the shares available for issuance under the Plan.

In no event, however, except as subject to adjustment as provided in Section 6 shall more than (a) thirty million (30,000,000) shares of Common Stock be available for issuance pursuant to the exercise of incentive stock options ("ISOs") awarded under the Plan(1); (b) twenty-three million five hundred thirty-two thousand three hundred two (23,532,302) shares of Common Stock shall be available for issuance pursuant to stock awards granted under Section 7(c) of the Plan(1) ;and (c) ten million (10,000,000) shares of Common Stock shall be made the subject of awards under any combination of awards under Sections 7(a), 7(b) or 7(c) of the Plan to any single individual(2). SARs whether settled in cash or shares of Common Stock shall be counted against the limit set forth in (c).

(1) Effective February 1, 1999
(2) Effective February 1, 1999

Any shares issued under the Plan may consist in whole or in part, of authorized and unissued shares or of treasury shares, and no fractional shares shall be issued under the Plan. Cash may be paid in lieu of any fractional shares in settlements of awards under the Plan.

6. Adjustments and Reorganizations

The Committee may make such adjustments as it deems appropriate to meet the intent of the Plan in the event of changes that impact the Company's share price or share status, provided that any such actions are consistently and equitably applicable to all affected participants.

In the event of any stock dividend, stock split, combination or exchange of shares, merger, consolidation, spin-off or other distribution (other than normal cash dividends) of Company assets to shareholders, or any other change affecting shares, such adjustments, if any, as the Committee in its discretion may deem appropriate to reflect such change shall be made with respect to (i) the aggregate number of shares that may be issued under the Plan; (ii) the number of shares subject to awards of a specified type or to any individual under the Plan; and/or (iii) the price per share for any outstanding stock options, SARs and other awards under the Plan.

7. Awards

The Committee shall determine the type or types of award(s) to be made to each participant under the Plan and shall approve the terms and conditions governing such awards in accordance with Section 12. Awards may include but are not limited to those listed in this Section 7. Awards may be granted singly, in combination or in tandem so that the settlement or payment of one automatically reduces or cancels the other. Awards may also be made in combination or in tandem with, in replacement of, as alternatives to, or as the payment form for, grants or rights under any other employee or compensation plan of the Company, including the plan of any acquired entity. However, under no circumstances may stock option awards be made which provide by their terms for the automatic award of additional stock options upon the exercise of such awards.

(a) Stock Option is a grant of a right to purchase a specified number of shares of Common Stock during a specified period. The purchase price of each option shall be not less than 100% of Fair Market Value (as defined in Section 10) on the effective date of grant, except that, in the case of a stock option granted retroactively in tandem with or as a substitution for another award, the exercise or designated price may be no lower than the Fair Market Value of

a share on the date such other award was granted. A stock option may be exercised in whole or in installments, which may be cumulative. A stock option may be in the form of an ISO which complies with Section 422 of the Internal Revenue Code of 1986, as amended, and the regulations thereunder at the time of grant. The price at which shares of Common Stock may be purchased under a stock option shall be paid in full at the time of the exercise in cash or such other method as provided by the Committee at the time of grant or as provided in the form of agreement approved in accordance herewith, including tendering (either actually or by attestation) Common Stock, surrendering a stock award valued at Fair Market Value on the date of surrender, surrendering a cash award, or any combination thereof.

(b) Stock Appreciation Right is a right to receive a payment, in cash and/or Common Stock, as determined by the Committee, equal to the excess of the Fair Market Value of a specified number of shares of Common Stock on the date the SAR is exercised over the Fair Market Value on the date of grant of the SAR as set forth in the applicable award agreement, except that, in the case of a SAR granted retroactively in tandem with or as a substitution for another award, the exercise or designated price may be no lower than the Fair Market Value of a share on the date such other award was granted

(c) Stock Award is an award made in stock or denominated in units of stock. All or part of any stock award may be subject to conditions established by the Committee, and set forth in the award agreement, which may include, but are not limited to, continuous service with the Company, achievement of specific business objectives, and other measurements of individual, business unit or Company performance.

(d) Cash Award is an award denominated in cash with the eventual payment amount subject to future service and such other restrictions and conditions as may be established by the Committee, and as set forth in the award agreement, including, but not limited to, continuous service with the Company, achievement of specific business objectives, and other measurement of individual, business unit or Company performance. Cash Awards to any single Covered Employee, including dividend equivalents in cash or shares of Common Stock payable based upon attainment of specific performance goals, may not exceed in the aggregate $5,000,000 for each performance period established by the Committee under Section 23 of the Plan.

8. Dividends and Dividend Equivalents

The Committee may provide that awards denominated in stock earn dividends or dividend equivalents. Such dividend equivalents may be paid currently in cash or shares of Common Stock or may be credited to an account established by the Committee under the Plan in the name of the participant. In addition, dividends or dividend equivalents paid on outstanding awards or issued shares may be credited to such account rather than paid currently. Any crediting of dividends or dividend equivalents may be subject to such restrictions and conditions as the Committee may establish, including reinvestment in additional shares or share equivalents.

9. Deferrals and Settlements

Payment of awards may be in the form of cash, stock, other awards, or in such combinations thereof as the Committee shall determine at the time of grant, and with such restrictions as it may impose. The Committee may also require or permit participants to elect to defer the issuance of shares or the settlement of awards in cash under such rules and procedures as it may establish under the Plan. It may also provide that deferred settlements include the payment or crediting of interest on the deferral amounts or the payment or crediting of dividend equivalents on deferred settlements denominated in shares.

10. Fair Market Value

Fair Market Value for all purposes under the Plan shall mean the average of the high and low prices of Common Stock as reported in The Wall Street Journal in the New York Stock Exchange composite transactions or similar successor consolidated transactions reports for the relevant date, or if no sales of Common Stock were made on said exchange on that date, the average of the high and low prices of Common Stock as reported in said composite transaction report for the preceding day on which sales of Common Stock were made on said Exchange. Under no circumstances shall Fair Market Value be less than the par value of the Common Stock.

11. Transferability and Exercisability

All awards under the Plan will be nontransferable and shall not be assignable, alienable, saleable or otherwise transferable by the participant other than by will or the laws of descent and distribution except pursuant to a domestic relations order entered by a court of competent jurisdiction or as otherwise

determined by the Committee. In the event that a participant terminates employment with the Company to assume a position with a governmental, charitable, educational or similar non-profit institution, the Committee may authorize a third party, including but not limited to a "blind" trust, to act on behalf of and for the benefit of the respective participant with respect to any outstanding awards. Except as otherwise provided in this Section 11, during the life of the participant, awards under the Plan shall be exercisable only by him or her except as otherwise determined by the Committee. In addition, if so permitted by the Committee, a participant may designate a beneficiary or beneficiaries to exercise the rights of the participant and receive any distributions under this Plan upon the death of the participant.

12. Award Agreements

Awards under the Plan shall be evidenced by one or more agreements approved by the Committee that set forth the terms and conditions of and limitations on an award, except that in no event shall the term of any ISO exceed a period of ten years from the date of its grant. The Committee need not require the execution of any such agreement by a participant in which case acceptance of the award by the respective participant will constitute agreement to the terms of the award.

13. Plan Amendment

The Compensation Committee may amend the Plan as it deems necessary or appropriate, except that no such amendment which would cause the Plan not to comply with the requirements of (i) Section 162(m) with respect to performance-based compensation, (ii) the Code with respect to ISOs or (iii) the New York Business Corporation Law as in effect at the time of such amendment shall be made without the approval of the Company's shareholders. No such amendment shall adversely affect any outstanding awards under the Plan without the consent of all of the holders thereof.

14. Tax Withholding

The Company shall have the right to deduct from any settlement of an award made under the Plan, including the delivery or vesting of shares, an amount sufficient to cover withholding required by law for any federal, state or local taxes or to take such other action as may be necessary to satisfy any such withholding obligations. The Committee may permit shares to be used to satisfy required tax withholding and such shares shall be valued at the Fair Market Value as of the settlement date of the applicable award.

15. Other Company Benefit and Compensation Programs

Unless otherwise determined by the Committee, settlements of awards received by participants under the Plan shall not be deemed a part of a participant's regular, recurring compensation for purposes of calculating payments or benefits from any Company benefit plan, severance program or severance pay law of any country.

16. Unfunded Plan

Unless otherwise determined by the Committee, the Plan shall be unfunded and shall not create (or be construed to create) a trust or a separate fund or funds. The Plan shall not establish any fiduciary relationship between the Company and any participant or other person. To the extent any person holds any rights by virtue of a grant awarded under the Plan, such right (unless otherwise determined by the Committee) shall be no greater than the right of an unsecured general creditor of the Company.

17. Future Rights

No person shall have any claim or right to be granted an award under the Plan, and no participant shall have any right by reason of the grant of any award under the Plan to continued employment by the Company or any subsidiary of the Company.

18. General Restriction

Each award shall be subject to the requirement that, if at any time the Committee shall determine, in its sole discretion, that the listing, registration or qualification of any award under the Plan upon any securities exchange or under any state or federal law, or the consent or approval of any government regulatory body, is necessary or desirable as a condition of, or in connection with, the granting of such award or the exercise settlement thereof, such award may not be granted, exercised or settled in whole or in part unless such listing, registration, qualification, consent or approval shall have been effected or obtained free of any conditions not acceptable to the Committee.

19. Governing Law

The validity, construction and effect of the Plan and any actions taken or relating to the Plan shall be determined in accordance with the laws of the state of New York and applicable Federal law.

20. Successors and Assigns

The Plan shall be binding on all successors and permitted assigns of a participant, including, without limitation, the estate of such participant and the executor, administrator or trustee of such estate, or any receiver or trustee in bankruptcy or representative of such participant's creditors.

21. Rights as a Shareholder

A participant shall have no rights as a shareholder until he or she becomes the holder of record of Common Stock.

22. Change in Control

Notwithstanding anything to the contrary in the Plan, the following shall apply to all awards granted and outstanding under the Plan:

(a) Definitions. The following definitions shall apply to this Section 22:

A "Change in Control," unless otherwise defined by the Compensation Committee, shall be deemed to have occurred if (a) any "person," as such term in used in Section 13(d) and 14(d) of the 1934 Act, other than (1) the Company, (2) any trustee or other fiduciary holding securities under an employee benefit plan of the Company, (3) any company owned, directly or indirectly, by the shareholders of the Company in substantially the same proportions as their ownership of stock of the Company, or (4) any person who becomes a "beneficial owner" (as defined below) in connection with a transaction described in clause (1) of subparagraph (c) below, is or becomes the "beneficial owner" (as defined in Rule 13d-3 under the 1934 Act), directly or indirectly, of securities of the Company (not including in the securities beneficially owned by such person any securities acquired directly from the Company or its affiliates) representing 20 percent or more of the combined voting power of the Company's then outstanding voting securities; (b) the following individuals cease for any reason to constitute a majority of the directors then serving; individuals who, on October 9, 2000 constitute the Board and any new director (other than a director whose initial assumption of office is in connection with an actual or threatened election contest, including but not limited to a consent solicitation, relating to the election of directors of the Company) whose appointment or election by the Board or nomination for election by the Company's shareholders was approved or recommended by a vote of at least two-thirds of the directors then still in office who were directors on October 9, 2000 or whose appointment, election or nomination for election was previously so approved or recommended; (c) there is consummated a merger or consolidation of the Company or any direct or indirect subsidiary of the Company with any other corporation, other than (1) a merger or consolidation which results in the directors of the Company immediately prior to such merger or consolidation continuing to constitute at least a majority of the board of directors of the Company, the surviving entity or any parent thereof or (2) a merger or consolidation effected to implement a recapitalization of the Company (or similar transaction) in which no person is or becomes the beneficial owner, directly or indirectly, of securities of the Company (not including in the securities beneficially owned by such person any securities acquired directly from the Company or its affiliates) representing 20% or more of the combined voting power of the Company's then outstanding securities; or (d) the shareholders of the Company approve a plan of complete liquidation or dissolution of the Company or there is consummated an agreement for the sale or disposition by the Company of all or substantially all of the Company's assets, other than a sale or disposition by the Company of all or substantially all of the Company's assets to an entity, at least 50% of the combined voting power of the voting securities of which are owned by stockholders of the Company in substantially the same proportions as their ownership of the Company immediately prior to such sale.

"CIC Price" shall mean the higher of (a) the highest price paid for a share of the Company's Common Stock in the transaction or series of transactions pursuant to which a Change in Control of the Company shall have occurred, or (b) the highest price paid for a share of the Company's Common Stock during the 60 day period immediately preceding the date upon which the event constituting a Change in Control shall have occurred as reported in The Wall Street Journal in the New York Stock Exchange Composite Transactions or similar successor consolidated transactions reports.

(b) Acceleration of Vesting and Payment of SARs, Stock Awards, Cash Awards, and Dividends and Dividend Equivalents.

(1) Upon the occurrence of an event constituting a Change in Control, all SARs, stock awards, cash awards, dividends and dividend equivalents outstanding on such date shall become 100% vested and shall be paid in cash as soon as may be practicable. Upon such payment, such awards and any related stock options shall be cancelled.

(2) The amount of cash to be paid shall be determined by multiplying the number of such awards, as the case may be, by: (i) in the case of stock awards, the CIC Price; (ii) in the case of SARs, the difference between the exercise price of the related option per share and the CIC Price; (iii) in the case of cash awards where the award period, if any, has not been completed upon the occurrence of a Change in Control, the maximum value of such awards as determined by the Committee at the time of grant, without regard to the performance criteria, if any, applicable to such award; and (iv) in the case of cash awards where the award period, if any, has been completed on or prior to the occurrence of a Change in Control: (aa) where the cash award is payable in cash, the value of such award as determined in accordance with the award agreement, and (bb) where the cash award is payable in shares of Common Stock, the CIC Price.

(c) Option Surrender Rights.

(1) All stock options granted under the Plan shall be accompanied by option surrender rights ("OSRs"). OSRs shall be evidenced by OSR agreements in such form and not inconsistent with the Plan as the Committee shall approve from time to time. Upon the occurrence of an event constituting a Change in Control, all OSRs, to the extent that the CIC Price exceeds the exercise price of the related stock options, shall be paid in cash as soon as may be practicable. Upon such payment, such rights and any related stock options shall be cancelled.

(2) The amount of cash payable in respect of an OSR shall be determined by multiplying the number of unexercised shares as to which the right then relates by the difference between the option price of such shares and the CIC Price.

(3) Upon the grant of SARs, with respect to the same shares covered by then outstanding OSRs the OSRs relating to such shares shall be automatically cancelled.

(d) Notwithstanding the foregoing subsections (a), (b) and (c), SARs, OSRs and any stock-based award held by an officer or director subject to Section 16 of the 1934 Act which have been outstanding less than six months (or such other period as may be required by the 1934 Act) upon the occurrence of an event constituting a Change in Control shall not be paid in cash until the expiration of such period, if any, as shall be required pursuant to such Section, and the amount to be paid shall be determined by multiplying the number of SARs, OSRs or stock awards by the CIC Price determined as though the event constituting the Change in Control had occurred on the first day following the end of such period.

23. Certain Provisions Applicable to Awards to Covered Employees

Performance-based awards made to Covered Employees shall be made by the Committee within the time period required under Section 162(m) for the establishment of performance goals and shall specify, among other things, the performance period(s) for such award (which shall be not less than one year), the performance criteria and the performance targets. The performance criteria shall be any one or more of the following as determined by the Committee and may differ as to type of award and from one performance period to another: earnings per share, total shareholder return, return on shareholders' equity, economic value added measures, return on assets, revenue, profit before tax, profit after tax, stock price and return on sales. Payment or vesting of awards to Covered Employees shall be contingent upon satisfaction of the performance criteria and targets as certified by the Committee by resolution of the Committee. To the extent provided at the time of an award, the Committee may in its sole discretion reduce any award to any Covered Employee to any amount, including zero.

EXHIBIT 10 (t)

THE DOCUMENT COMPANY
XEROX

FORM OF SALARY CONTINUANCE AGREEMENT

The following information summarizes the arrangements for your retirement from Xerox Corporation (the Company).

Last day of active employment:	To be determined by the Chief Executive Officer
Salary Continuance:	12 [24] months
Salary Continuance Amount:	$xxxxxxx per month or, if greater, monthly salary rate on last day of employment
Retirement Date:	Day following end of Salary Continuance

Notwithstanding anything else contained in this letter if you engage in Detrimental Activity as defined in the attached Exhibit the consequences set forth therein shall apply.

Summarized below are the relevant provisions that apply to your long-term incentive awards, profit sharing and savings accounts, pension benefits, life insurance benefits and other benefits arrangements. In case of inconsistencies between this summary and the relevant plan, the terms of the plan will govern.

STOCK AWARDS

Stock grants (including stock options) awarded to you prior to the commencement of salary continuance shall continue to vest and/or remain exercisable per the terms of the awards and the relevant plans. You will not be eligible for additional stock awards during salary continuation.

PROFIT SHARING AND SAVINGS ACCOUNT

As you know, under relevant plan provisions, you have choices available regarding the continued investment of your account balances and the time and form of distribution. Please refer to You and Xerox: Wealthwise for a description. A calculation of your account balances will be completed at the end of your salary continuance period at which time you will have the opportunity to elect how and when the proceeds will be distributed.

EMPLOYEE STOCK OWNERSHIP PLAN (ESOP)

At separation, your ESOP account can be taken as cash, in stock, or rolled over to the Xerox 401(k) savings plan. A determination of your final plan benefit will be made at the end of salary continuance period.

PENSION BENEFITS

Effective on your retirement date, you will become a retiree of Xerox. As a retiree, you will receive pension benefits accrued in the Retirement Income Guarantee Plan (RIGP). In addition to your vested RIGP benefit, depending on your age on your retirement date, you may be eligible to receive a benefit under the Supplemental Executive Retirement Plan (SERP), which as you know, will allow you to begin to receive retirement income benefits unreduced for commencement prior to attainment of age 65 and will be offset by your RIGP benefits. If you are eligible, this benefit will commence on your retirement date, and will be paid in monthly installments reflecting your survivor election. This benefit is unfunded and is not tax qualified. This means you are an unsecured general creditor of the Company with respect to this benefit. A determination of your benefit will be made at retirement. We can prepare an estimate prior to that time if you so desire.

MEDICAL BENEFITS

As a retiree, you will receive medical coverage under Xerox Retiree Flex as it is in effect from time to time. This program will include, among other things, coordination of benefits if you are covered by more than one plan including Medicare. As you get closer to your retirement date, an information package will be sent to you from our medical insurance partner.

BONUS

You will be eligible to receive a cash bonus and/or other cash award earned for any year in which you are actively employed. If earned, any such cash awards will be prorated based on the number of months of active employment during the year.

LIFE INSURANCE

Your Contributory Life Insurance coverage of $xxxxxxx will continue during your salary continuance period. During this period, both you and the Company will continue to share in the cost of premiums according to the original plan agreement. In the event of your death during salary continuance, salary would cease and your beneficiaries will, subject to applicable plan provisions, receive the proceeds of your life insurance coverage. Upon termination, the Company will recover its cumulative premiums paid into the Contributory Life Insurance Plan, plus an amount for administrative expenses as stated in the Plan Agreement. At that time you will become sole owner of the policy along with any remaining cash value, with the option to continue the coverage at your own expense.

OTHER ARRANGEMENTS

You will relinquish your position as a Director and Officer of Xerox Corporation and as a director and officer of any subsidiary company when your active employment ends.

You will be paid for any accrued and unused vacation upon commencement of salary continuance. You will not accrue any further vacation during salary continuance.

Your company financial counseling and tax preparation programs will be continued through the end of the year in which your active employment ends.

You will not be entitled to any future Executive Expense Allowance payments while on salary continuance.

You will not be eligible to receive long-term incentive awards while on salary continuation. You will be eligible for your physical under the Executive Physical program for any year during which you are actively employed.

INDEMNITY

You will be entitled to be indemnified with respect to all periods of your service as a director or officer of the Company or any of its subsidiaries in accordance with 1) the provisions of Sections 721 through 725 of the Business Corporation Law of the State of New York and provisions of California Labor Code Section 2802 2) Section 2 of Article VIII of the by-laws of the Company as in effect on the date of commencement of salary continuance and 3) the Company directors and officers liability insurance policies with Federal Insurance Company, National Union Fire Insurance Company of Pittsburgh P.A., Reliance Insurance Company, Chubb Atlantic Ltd., Gulf Insurance Company and A.C.E. Insurance, Ltd., or any replacement or substitute thereof or any addition thereto.

RELEASE

This salary continuance payments provided for in this letter shall not become effective until you execute and deliver to the Company the release in the form attached immediately prior to the scheduled commencement thereof.

COOPERATION IN LITIGATION

You will cooperate fully with the Company and its counsel in any litigation that arises out of or is related to your service with the Company or any of its subsidiaries, or in which you are named as a party. That cooperation includes making yourself available for reasonable periods of time upon reasonable notice for consultation with the Company's counsel in any such litigation and to testify in such litigation.

At the appropriate time, a representative of Xerox Corporation will contact you regarding your resignation as a Corporate Officer.

Sincerely,

____

[Chief Executive Officer]

AGREED AND ACCEPTED

____

[Employee Name]

Date:

Exhibit to Letter Agreement

Engagement in Detrimental Activity

Definition of Detrimental Activity

"Detrimental Activity" shall mean:

(1) Employment as an employee of, or services provided as a consultant to, another firm or corporation (other than the Company or an affiliate) that is a direct competitor of the Company in any business in which the Company is presently engaged or in which the Company as of the date of the letter to which this Exhibit is attached ("Letter Agreement") may reasonably be expected to engage in the future, or is or may become such a competitor indirectly through a partnership, joint venture or other business arrangement with, or as a supplier or consultant to, such a direct competitor ("Competitor"), unless the Company has previously advised in writing that in its reasonable judgment such other firm or corporation is not a Competitor (the Company will provide notice upon request as to the competitive nature of a prospective employer); or

(2) Disclosure of confidential or proprietary business information of the Company;

(3) The making of any derogatory or disparaging statements about the Company, its management or its business;

(4) Violation of any rules, policies, procedures or guidelines of the Company, including but not limited to the Company's Business Ethics Policy;

(5) Any attempt directly or indirectly to induce any employee of the Company to be employed or perform services elsewhere or any attempt directly or indirectly to solicit the trade or business of any current or prospective customer, supplier or partner of the Company;

(6) Conviction of, or entry of a guilty plea with respect to, a crime, whether or not connected with the Company; or

(7) Engagement in any other conduct or act determined by the Company to be injurious, detrimental or prejudicial to any interest of the Company and, therefore, to constitute an act of disloyalty towards the Company.

Consequences of Engagement in Detrimental Activity

If the executive who is a party to the Letter Agreement engages in any Detrimental Activity any salary continuance provided for therein shall not become payable or shall immediately terminate if payments have started, employment with the Company will terminate and any benefits described in the Letter Agreement, or otherwise, that are dependent upon continued employment, including without limitation, continued vesting of benefits and determination of years of service will also terminate.

If the executive who is a party to the Letter Agreement engages in Detrimental Activity, that in the Company's sole discretion constitutes an act of disloyalty towards the Company either before becoming entitled to salary continuance or after commencement of salary continuance payments, as the case may be, in accordance with the Letter Agreement, the following additional consequences shall apply:

(a) Any outstanding award under the 1991 Long-term Incentive Plan (including LEEP awards), the 1998 Employee Stock Option Plan, or pursuant to any bonus or retention plans or programs ("Awards") shall be cancelled and be of no further force or effect;

(b) Any payment of salary continuance or exercise, payment or delivery of an Award within six months prior to such Detrimental Activity may be rescinded at the sole discretion of the Company. In the event of any such rescission, the executive shall pay to the Company the amount of any gain realized or payment received as a result of the rescinded exercise, payment or delivery, in such manner and on such terms and conditions as may be required amount owed to you by the Company; and

(c) Any unfunded retirement benefits including, without limitation, under the Unfunded Retirement Income Guarantee Plan and the Supplementary Executive

Retirement Plan, shall be forfeited.

THE DOCUMENT COMPANY
XEROX

GENERAL RELEASE

(1) In consideration of Xerox's agreement to provide salary continuance and other benefits as set forth in the letter agreement dated June 13, 2001, attached hereto and incorporated herein, and other good and valuable consideration the adequacy and receipt of which are hereby acknowledged, I, [Employee Name] release Xerox and its employees, directors, officers, agents, stockholders, subsidiaries, affiliates, successors and assigns, and the Xerox employee benefits plans in which I am now or have been a participant and their trustees, administrators, successors, assigns, agents and, employees (the "Releasees"), from any and all claims of any kind, known or unknown, which I now have or may have against the Releasees by reason of facts which have occurred prior to the date of this Release. Such released claims include, without limitation, any and all claims of age discrimination under the Age Discrimination in Employment Act of 1967, the Older Workers' Benefits Protection Act of 1990, any claims under Title VII of the Civil Rights Act of 1964, the Civil Rights Acts of 1866, 1870, 1871 and 1991, the Americans with Disabilities Act of 1990, the Rehabilitation Act of 1973, the Family and Medical Leave Act of 1993, the Equal Pay Act of 1963, the Fair Labor Standards Act of 1938, the Employee Retirement Income Security Act of 1974, the Worker Adjustment and Retraining Notification Act of 1989, the Uniformed Services Reemployment Rights Act of 1994, and the Vietnam Era Veteran's Readjustment Assistance Act of 1974 (all as amended), and the laws of the state(s) where I am employed and reside, including by example and not limitation the state fair employment practices law(s) or any other federal, state or local statute or regulation regarding employment or discrimination in employment, as well as any and all claims arising out of, based upon or relating to the hire, offer of employment by Releasees, employment contract, if any, between myself and Releasees, any representations or commitments made by the Releasees regarding future employment, remuneration, promotion, discipline, termination from employment, or benefits payable by Releasees to me including but not limited to any and all claims under State contract or tort law such as breach of the implied covenant of good faith and fair dealing, negligent or intentional infliction of emotional distress and defamation, all claims for punitive or compensatory damages, costs or attorneys fees, and any and all claims I have, against Xerox based upon its employee relocation policy.

(2) I acknowledge and agree that the consideration set forth in this Release is in addition to anything of value to which I am otherwise entitled by law and Xerox policy.

(3) I understand and agree that this Release and Releasees' agreement to provide consideration as set forth above are not intended and should not be construed, in any way, as an admission by Releasees of wrongdoing or liability.

(4) I agree that I will not file or pursue any charge, claim or action with any government agency or any court against the Releasees based upon any event or occurrence which took place prior to the date of this Release. However, I understand that nothing set forth in this Release shall be construed as a condition precedent, penalty or other limitation of my right to file a charge or complaint with, or participate in an investigation or proceeding conducted by, the EEOC or any comparable state agency.

(5) I agree that if I act contrary to the representations and obligations set forth in this Release, I shall repay to Xerox upon demand any and all moneys paid to me by Xerox in consideration of this release. Moreover, if I act contrary to paragraph 4 of this Release, I agree to pay all costs and expenses of defending the charge, claim or action incurred by Releasees, including reasonable attorneys fees.

(6) Should any provision of this Release, with the exception of paragraph I, be declared or be determined by any court to be illegal or invalid, the validity of the remaining parts, terms or provisions shall not be affected thereby and said illegal or invalid part, term, or provision shall be deemed not to be a part of this Agreement. Should paragraph I be declared or be determined by any court to be illegal or invalid, the purpose of this entire Agreement shall be deemed to have failed and I shall return all consideration paid by Xerox hereunder.

(7) I agree to treat the existence and substance of this Release as Confidential and shall not disclose it to other persons within or outside the

Releasees except as required by law.

(8) I understand and acknowledge that for a period of one year following my separation from service with Xerox, I will not be eligible for rehire as an employee, or retention as a contract worker or consultant.

(9) The undersigned and the Company agree that this release shall not release the payments, benefits and other provisions contained in the attached letter agreement between the undersigned and the Company.

(10) I acknowledge that I have been advised by Xerox as follows:

- -- TO CONSULT WITH AN ATTORNEY OF MY CHOOSING TO COUNSEL ME AS TO MY RIGHTS BEFORE I SIGN THIS RELEASE;
- -- TO TAKE SUFFICIENT TIME TO DECIDE WHETHER TO SIGN THIS RELEASE. I HAVE 21 DAYS FROM THE DATE THIS RELEASE IS PROVIDED TO ME TO CONSIDER IT BEFORE I SIGN AND RETURN IT TO XEROX;
- -- THAT EVEN AFTER I SIGN AND RETURN THIS RELEASE TO XEROX, I WILL HAVE 7 DAYS THEREAFTER TO CHANGE MY MIND AND REVOKE MY RELEASE BY ASKING XEROX FOR ITS RETURN.

(11) I understand and agree that this release waives all claims I may have at the time I sign it, including claims I do not then know about or suspect. I further understand and acknowledge that California Civil Code, Section 1542 provides: "A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HIS FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH IF KNOWN BY HIM MUST HAVE MATERIALLY AFFECTED HIS SETTLEMENT WITH THE DEBTOR." I hereby expressly waive any rights I may have under that Code section, if applicable, or any other similar state or federal statute or common law principle of similar effect.

Date release provided to employee:

Date Signed and Returned to Xerox: ____________________, _____
(To be filled in by employee)

By: _______________________
(Employee Signature)

XEROX CORPORATION

By: ____________________
[Title]

Exhibit 11

Xerox Corporation

Computation of Net Income (Loss) Per Common Share
(Dollars in millions, except per-share data; shares in thousands)

	Three months ended June 30, 2001	Three months ended June 30, 2000	Six months ended June 30, 2001	Six months ended June 30, 2000
I. Basic Net Income (Loss) Per Common Share				
Net Income (Loss)	$(281)	$ 202	$ (79)	$ (47)
Accrued dividends on ESOP preferred stock, net	-	(7)	(12)	(17)
Adjusted net income (loss)	$(281)	$ 195	$ (91)	$ (64)
Average common shares outstanding during the period	699,657	666,360	688,478	666,031
Common shares issuable with respect to exchangeable shares	834	920	859	921
Adjusted average shares outstanding for the period	700,491	667,280	689,337	666,952
Basic earnings (loss) per share	$(0.40)	$0.29	$(0.13)	$(0.10)
II. Diluted Net Income (Loss) Per Common Share				
Net Income (Loss)	$(281)	$ 202	$ (79)	$ (47)
ESOP expense adjustment, net of tax	-	(7)	(12)	(17)
Interest on convertible debt, net of tax	-	1	-	-
Adjusted net income (loss)	$(281)	$ 196	$ (91)	$ (64)
Average common shares outstanding during the period	699,657	666,360	688,478	666,031
Stock options, incentive and exchangeable shares	834	6,147	859	921
Convertible debt	-	5,287	-	-
ESOP preferred stock	-	51,004	-	-
Adjusted average shares outstanding for the period	700,491	728,798	689,337	666,952
Diluted earnings (loss) per share	$(0.40)	$ 0.27	$(0.13)	$(0.10)

Exhibit 12

Xerox Corporation
Computation of Ratio of Earnings to Fixed Charges

(In millions)	Six months ended June 30, 2001	Six months ended June 30, 2000	Year ended December 31, 2000	1999	1998	1997	1996
Fixed charges:							
Interest expense	$ 551	$ 474	$ 1,031	$ 803	$ 749	$ 617	$ 592
Rental expense	56	57	115	132	145	140	140
Total fixed charges before capitalized interest and preferred stock dividends of subsidiaries	607	531	1,146	935	894	757	732
Preferred stock dividends of subsidiaries	27	27	55	55	55	50	-
Capitalized interest	-	7	3	8	-	-	-
Total fixed charges	$ 634	$ 565	$ 1,204	$ 998	$ 949	$ 807	$ 732
Earnings available for fixed charges:							
Earnings(3)	$ 144	$ (64)	$ (323)	$1,976	$ 653	$2,132	$2,045
Adjustment to reflect undistributed income from minority owned companies	(1)	(11)	(20)	(68)	(27)	(84)	(84)
Add fixed charges before capitalized interest and preferred stock dividends of subsidiaries	607	531	1,146	935	894	757	732
Total earnings available for fixed charges	$ 750	$ 456	$ 803	$2,843	$1,520	$2,805	$2,693
Ratio of earnings to fixed charges (1)(2)	1.18	*	**	2.85	1.60	3.48	3.68

(1) The ratio of earnings to fixed charges has been computed based on the Company's continuing operations by dividing total earnings available for fixed charges, excluding capitalized interest and preferred stock dividends of subsidiaries, by total fixed charges. Fixed charges consist of interest, including capitalized interest and preferred stock dividends of subsidiaries, and one-third of rent expense as representative of the interest portion of rentals.

(2) The Company's ratio of earnings to fixed charges includes the effect of the Company's finance subsidiaries, which primarily finance Xerox equipment. Financing businesses are more highly leveraged and, therefore, tend to operate at lower earnings to fixed charges ratio levels than do non-financial businesses.

(3) Sum of "Income (Loss) before Income Taxes (Benefits), Equity Income and Minorities' Interests" and "Equity in Net Income of Unconsolidated Affiliates."

* Earnings for the six months ended June 30, 2000 were inadequate to cover fixed charges. The coverage deficiency was $109 million.

** Earnings for the year ended December 31, 2000 were inadequate to cover fixed charges. The coverage deficiency was $401 million.