

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

(Mark One)

(X) Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the fiscal year ended: December 31, 2000

() Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the transition period from: _____ to _____

XEROX CORPORATION

(Exact name of registrant as specified in its charter)

1-4471

(Commission file number)

New York

16-0468020

(State of incorporation)

(I.R.S. Employer Identification No.)

P.O. Box 1600, Stamford, Connecticut

06904

(Address of principal executive offices)

(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class -----	Name of Each Exchange on Which Registered -----
Common Stock, \$1 par value	New York Stock Exchange Chicago Stock Exchange

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

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)

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

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The aggregate market value of the voting stock of the registrant held by non-affiliates as of April 30, 2001 was: \$6,231,027,145.

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

Class -----	Outstanding at April 30, 2001 -----
Common Stock, \$1 Par Value	694,264,863 Shares

Documents Incorporated By Reference

Portions of the following documents are incorporated herein by reference:

Document -----	Part of 10-K in Which Incorporated -----
Xerox Corporation 2000 Annual Report to Shareholders	I & II

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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-K, 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 30% 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 are such as to effectively preclude its ready access to capital markets and the Registrant is currently funding its customer financing activity from 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 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.

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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.

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PART I

Item 1. Business

Overview

Xerox Corporation (Xerox or the Company) is The Document Company and a leader in the global document market, selling equipment and providing document solutions including hardware, services and software that enhance productivity and knowledge sharing. References herein to "us" or "our" refer to Xerox and consolidated subsidiaries unless the context specifically requires otherwise. We distribute our products in the Western Hemisphere through divisions and wholly-owned subsidiaries. In Europe, Africa, the Middle East, India and parts of Asia, we distribute through Xerox Limited and related companies (collectively Xerox Limited). Xerox had 92,500 employees at year-end 2000.

Fuji Xerox Co., Limited, an unconsolidated entity jointly owned by Xerox Limited and Fuji Photo Film Company Limited, develops, manufactures and distributes document processing products in Japan and other areas of the Pacific Rim, Australia and New Zealand. Japan represents approximately 80 percent of Fuji Xerox revenues, and Australia, New Zealand, Singapore, Malaysia, Korea, Thailand and the Philippines represent 10 percent. The remaining 10 percent of Fuji Xerox revenues are sales to Xerox. Fuji Xerox conducts business in other Asian Pacific Rim countries through joint ventures and distributors. In December 2000, as part of the asset disposition element of our turnaround plan, we completed the sale

of our China operations to Fuji Xerox for \$550 million cash and their assumption of \$118 million of debt. The sale included all of our manufacturing, sales and service functions in China and Hong Kong, including ownership of Xerox (China) Limited and Xerox (Hong Kong) Limited. The sale strengthened our liquidity and produced a \$119 million after tax gain. In March 2001 we sold half our ownership interest in Fuji Xerox to Fuji Photo Film for \$1,283 million in cash. The Company retains significant rights as a minority Shareholder. All product and technology agreements between Xerox and Fuji Xerox will continue, ensuring that the two companies retain uninterrupted access to each other's portfolio of patents, technology and products.

Our activities encompass developing, manufacturing, marketing, servicing and financing a complete range of document processing products, solutions and services designed to make organizations around the world more productive. We believe that the document is a tool for productivity, and that documents - both electronic and paper - are at the heart of most business processes. Documents are the means for storing, managing and sharing business knowledge. Document technology is key to improving productivity through information sharing and knowledge management and we believe no one knows the document - paper to electronic and electronic to paper - better than we do.

The financing of Xerox equipment is primarily carried out by Xerox Credit Corporation (XCC) in the United States and internationally by foreign financing subsidiaries and divisions in most countries. As part of our turnaround program, we intend to transition equipment financing to third parties. As part of this program, in April 2001 we announced the sale of certain of our European Financing businesses to Resonia Leasing AB. This transition will significantly reduce indebtedness on our balance sheet and improve liquidity.

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. In May 2000, Paul A. Allaire, Chairman and CEO and Anne Mulcahy, President and

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COO, assumed their new responsibilities and began work stabilizing the business. After a thorough review, they announced a turnaround plan in October 2000. Implementation of the turnaround program focuses Xerox on its core business and prioritizes cash generation, improved liquidity and a return to profitability in 2001.

The program includes asset dispositions and equity partnerships designed to generate \$2 billion to \$4 billion. Asset sales include the sale of the Company's China operations to Fuji Xerox, which was completed in December 2000, and in March 2001 the sale of half of the company's interest in Fuji Xerox for approximately \$1.3 billion. We are in discussion to form a strategic alliance for our European paper business. We are actively engaged in discussions to sell certain other assets, including Xerox Engineering Systems and our interests in spin-off companies such as ContentGuard and InXight. We are seeking equity investors for our inkjet business and we are exploring a joint venture with non-competitive partners for certain of our research centers including the Palo Alto Research Center. Lastly, Xerox is also seeking to sell or outsource certain manufacturing operations. It is expected that in most cases asset sales will result in a gain.

A second element of the turnaround program includes cost reductions of at least \$1 billion annually. Headcount reductions of 2000 and 4,300 were implemented in the fourth quarter 2000, and the first quarter 2001 respectively.

A third element of the turnaround program includes transitioning equipment financing to third parties, a move that will significantly improve Xerox's balance sheet and is designed to avoid negatively impacting customers. In January 2001 we announced the receipt of \$435 million in financing from General

Electric Capital Corporation secured by the Xerox portfolio of lease receivables in the United Kingdom. In April 2001 we announced the sale of our leasing businesses in four European countries to Resonia Leasing AB for approximately \$370 million in cash. We are also discussing with several potential vendors plans for them to provide equipment financing for Xerox customers around the world.

In addition, the Board of Directors announced in October the decision to reduce the quarterly dividend to 5 cents per share, saving \$400 million a year.

The turnaround program being implemented by the Xerox management team will refocus the core strategy of the Company going forward - with a greater emphasis on high-end, high-growth printing supported by color, solutions and services across the board and serving the office market in new ways. For an additional discussion of the Company's turnaround program, refer to Note 3 of the consolidated financial statements included on pages 24 through 25 of the Company's 2000 Annual Report to Shareholders hereby incorporated by reference in this document in partial answer to this Item.

Core Strategy

We believe that documents represent the knowledge base of an organization and play a dynamic and central role in business, government, education and other organizations.

Our principle strategy is to focus our core businesses on the most profitable and highest growth segments of the document market, with a particular emphasis on color across our product lines and document services and solutions. As our customers increasingly move towards color documents, we have responded with our highly successful DocuColor 2000 series of digital color presses and the ongoing development of FutureColor, the next generation of color technology that we believe will dramatically expand the color print-on-demand market. Our January 2000 acquisition of the Color Printing and Imaging Division of Tektronix (CPID),

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and its award winning line of Phaser solid ink and laser color printers, has moved Xerox to a strong number two market share position in the fast growing network office color printing market. We are also taking significant steps to satisfy our customers' increasing demand for more advanced services and solutions. Our products, technology, services and solutions are geared to match the needs of rapidly growing markets such as high-end, Internet driven digital printing and custom publishing, graphic arts and on-demand printing and publishing. Our success is derived from our ability to understand our customers' needs and to provide true document management services and outsourcing capabilities. As we increasingly make use of our direct sales force to serve customers seeking more advanced capabilities and solutions, we will simultaneously expand our use of more cost-effective distribution channels such as dealers, agents and concessionaires.

The document industry is undergoing a fundamental transformation, with the continued transition from analog and offset to digital technology, the management of publishing and printing jobs over the Internet, the use of variable data to create customized documents, an increasing reliance on outsourcing and the rapid transition to color. Documents are increasingly created and stored in digital electronic form while the Internet is increasing the amount of information that can be accessed in the form of electronic documents. We believe that all of these trends play to the strengths of our products, technology and services, and that such trends represent opportunities for Xerox's future growth.

We create customer value by providing innovative document technologies, products, systems, services and solutions that allow our customers to:

- Move easily within and between the electronic and paper forms of documents.

- Scan, store, retrieve, view, revise and distribute documents electronically anywhere in the world.
- Print or publish documents on demand, at the point closest to the need, including those locations of our customers' customers.
- Integrate the currently separate modes of producing documents, such as the data center, production publishing and office environments into a seamless, user-friendly, enterprise-wide document systems network - with technology acting as an enabler.

We have formed alliances to bring together the diverse infrastructures that currently exist and to nurture the development of an open document services and solutions environment to support complementary products from our partners and customers. We are working with more than 100 companies and industry organizations to make office and production electronic printing an integrated, seamless part of today's digital work place.

Industry Segments

Our financial results by industry segment for 2000, 1999 and 1998, presented in Note 10 to the consolidated financial statements on pages 29 through 31 of the Company's 2000 Annual Report to Shareholders are hereby incorporated by reference in this document in partial answer to this Item.

Market Overview

We estimate the global document market that we serve, excluding Japan and the Pacific Rim countries served by Fuji Xerox, was approximately \$149 billion in

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1999 and will grow to about \$209 billion in 2003. To return to growth and profitability, we continue to shift our focus to, and invest in, the most profitable and highest growth segments of the document market, with an emphasis on color throughout our product lines, high-end document systems, services and solutions, outsourcing and the transition from light-lens to digital technology. We are focused on providing solutions to our customers, through our products, technology, document management services and outsourcing capabilities. To drive future growth, we have increased our R&D spending, concentrating on programs to develop hardware and value-added solutions to support high-end business and programs that extend color capabilities. We are also expanding the use of more cost effective indirect sales channels such as dealers, agents and concessionaires for less complex product offerings and for those customers whose main product acquisition criteria is price.

We continue to lead the transition in our industry from black and white to color capable devices, from box sales to services and solutions that enhance customer productivity and solve customer problems, from light-lens to digital technology and from standalone devices to network-connected systems. Xerox growth will be driven by the accelerating demand for color documents, on-demand high-end services and solutions, document outsourcing, the transition to digital copying and printing in the office and the transfer of document production from offset printing to digital publishing.

Revenues for our major product categories for the three years ending December 31, 2000 are as follows:

Year ended December 31 (in millions)	2000	1999	1998
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Black and white office and small office/home office(SOHO)	\$ 7,410	\$ 8,150	\$ 8,384
Black and white production	4,940	5,904	5,954
Color copying and printing	2,897	1,851	1,726
Other products and services	3,454	3,662	3,529

Total	\$18,701	\$19,567	\$19,593

Production Market

Through our direct sales and service organizations around the world, we provide products and services directly to Fortune 1000 Graphic Arts and government, education and public sector customers. The global production market is expected to grow to \$96 billion in 2003 from \$49 billion in 1999, an 18 percent compound annual growth rate. Growth in Production will be propelled by strong demand for digital color products (expected to grow industrywide at a 20 percent annual rate) and professional services (increasing 35 percent annually).

Xerox products in this market include monochrome production publishing (DocuTech), production printing, color printing and production light-lens devices at speeds over 90 pages per minute. To capture these opportunities, we have identified color and services as two corporate strategic growth platforms. As discussed below, during 2000 we strengthened our market leadership with the introduction of the advanced DocuTech 2000 and DocuColor 2000 suite of products that combine industry-leading Web capabilities with fast, efficient color and monochrome printing.

Black and White Production Publishing (DocuTech)

 Since we launched the era of Production publishing with the introduction of our DocuTech Production Publishing family in 1990, we have installed more than 25,000 DocuTech systems worldwide.

Digital production publishing technology is increasingly replacing traditional short-run offset printing as customers seek improved productivity and cost savings, faster turnaround of document preparation, and the ability to print and customize documents "on demand." The market is substantial, as digital production publishing has less than 20 percent of the available page volume that could be converted to this technology. We offer the widest range of solutions available in the marketplace - from dial-up lines through the Internet to state-of-the-art networks - and we are committed to expanding these print-on-demand solutions as new technology and applications are developed.

The DocuTech family of digital production publishers scans hard copy and converts it into digital documents, or accepts digital documents directly from networked personal computers or workstations. DocuTech prints high-resolution (600 dots per inch) pages at speeds ranging from 65 to 180 impressions per minute and is supported by a full line of accessory products and options. Xerox is alone in offering a complete family of production publishing systems from 65 to 180 impressions per minute.

In 2000, we introduced an 155 page per minute and an 115 page per minute DocuTech. The DocuTech 6115 provides a clear migration path into the digital world by offering features for print on demand, 1:1 marketing and distribute then print. We also introduced an enhanced version of our DigiPath Production Software, a major productivity tool, which allows a printer's customers to use the Internet to streamline print job submission and subsequent archiving, preparation, proofing, and reprinting. This version adds more than 50 new features, including enhanced Internet connectivity. In February 2001, we announced a new streamlined version of DigiPath to offer an easy, low-cost way for print providers to enter the market.

Production Printing

Xerox pioneered and continues to be a worldwide leader in computer laser printing, which combines computer, laser, communications and xerographic technologies. We market a broad line of robust printers with speeds up to the industry's fastest cut-sheet printer at 180 pages per minute, and continuous-feed production printers at speeds up to 500 images per minute. Many of these printers have simultaneous interfaces that can be connected to multiple host computers as well as local area networks. Our goal is to integrate office, production and data-center computer printing into a single, seamless, user-friendly family of production class printers.

We introduced two new DocuPrint high-end printing systems and additional solutions and services in 2000 and early 2001. The new black-and-white printing systems, the DocuPrint 115 and DocuPrint 155 Enterprise Printing Systems operate at speeds of 115 and 155 pages per minute, respectively. They offer large customers, such as data centers and in-plant print shops, higher print speeds, advanced system integration and printing capabilities across the enterprise, from the mainframe to the network.

Breakthrough technology in our highlight color printers including the DocuPrint 4850 and DocuPrint 92C allows printing in an industry exclusive single pass of black-and-white plus one customer-changeable color (as well as shades, tints, textures and mixtures of each) at production speeds up to 90 pages per minute.

Production Color Printing

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Digital color is one of the fastest growing segments of the Production market. The DocuColor 40, introduced in 1996, copies and prints at 40 full-color pages per minute and has been the industry's fastest and most affordable digital color document production system. Since then we have expanded the line into networked and 30 page per minute versions.

DocuColor 12, introduced in 1999, was selected as "Product of the Year" for 2000 among PrintImage International's membership of quick and small commercial printers. DocuColor 12, designed for professionals in graphic arts environments such as quick printers, commercial printers and in-plant corporate reprographics departments, produces 12.5 full-color pages and 50 black-and-white pages per minute.

In February 2000, we introduced the DocuColor 2000 Series developed to provide high-volume on-demand printing, personalized printing, and printing and publishing for e-commerce and Internet delivery. The DocuColor 2045 prints at 45 pages per minute. DocuColor 2060, which produces 60 full-color prints per minute, is the industry's fastest cut-sheet color reproduction machine, and both products establish an industry standard by producing near-offset quality, full-color prints at an unprecedented operating cost of less than 10 cents per page, depending on monthly volumes. The 1,900 DocuColor units sold in 2000 exceeded company projections by 25 percent.

In May 2000 at Drupa 2000, a major industry trade show, we demonstrated our Futurecolor technology which is an advanced next-generation digital printing press with modular components which work together as a sophisticated print shop. Utilizing patented imaging technology enabling photographic quality output indistinguishable from offset, this breakthrough technology will produce one million pages/month at breakthrough operating costs. We expect initial customer engagement to begin in late 2001 and initial revenue producing installations beginning in the second half of 2002.

Production Light-Lens Copying

Revenues from black and white light-lens production copiers continued to decline, as expected, as customers transition to new digital products and amid

increasing price pressures.

Office Market

The Office market is comprised of global, national and mid-size commercial customers as well as government, education and other public sector customers. The global office market is forecast to increase at a modest one percent annual rate, to \$43 billion in 2003 from \$41 billion in 1999. Our strategy in the office is to offer our customers the "best tool for the job" including color everywhere. As part of our Turnaround Program we are outsourcing manufacturing and moving more of our sales and service from direct to indirect channels. Our products and services include multi-function devices, networked and standalone work group copiers, printers, and fax products sold through a variety of direct sales and indirect channels. Indirect channels include sales agents and concessionaires, retail and resellers, Internet sales and telebusiness offerings.

Black and White Digital Multifunction Products

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Our primary product line in this market is the Document Centre family of modular, black and white digital multifunction products at speeds ranging from 20 to 75 pages per minute that are better quality, more reliable, and more feature rich than light-lens copiers and priced at a modest premium over comparable light-lens copiers. This family was first introduced in 1997 and has been continually upgraded including six new models in the Document Centre 400 series in 2000. The network and fax options have compelling economics versus the alternative of purchasing comparable printers and faxes since the print engine, output mechanics and most of the software required are part of the base digital copier. All of our Document Centre products have IP (Internet Protocol) addresses, which permits them to be accessed via the Internet from anywhere in the world.

The proportion of Document Centre devices installed with network connectivity continued to grow, to over 50 percent installed with network connectivity during 2000. As a result, approximately 45 percent of the total installed population of Document Centre products have network capability. We believe that enabling network connectivity and training our customers to optimize the power of these products will lead ultimately to incremental page growth.

Color Copying and Printing

The use of color originals in the office is accelerating. While total office page volume is expected to grow a modest 2 percent, color pages are expected to grow at a compound rate of approximately 40 percent through 2003. Color is expected to represent 4 percent of total office pages and 19 percent of office page revenue by 2003.

We've had numerous recent color product introductions for the general office. In 1998, we introduced the DocuColor Office 6, a networked color copier/printer for the office that operates at twice the speed of most desktop color laser printers at the price of a mid-volume black and white copier. In 1999 we introduced the Document Centre Series 50, the first color-enabled Document Centre that produces 12.5 full-color pages and 50 black-and-white pages per minute and includes a Xerox network controller built into every machine. The Document Centre Color Series 50 combines the advantages of a relatively low equipment price, the production of color pages at operating costs significantly lower than other color copier/printers in this class, and, unlike other color products, the operating cost of producing black and white prints is similar to that of monochrome digital products.

Our strong number-two market share position in the networked office color market reflects the January 2000 acquisition of the Color Printing and Imaging Division

of Tektronix (CPID). This division manufactures and markets Phaser workgroup color printers that use either color laser or solid ink printing technology and markets a complete line of ink and related products and supplies. In January 2000, we introduced the Phaser 850 solid ink color printer, which prints truer colors and livelier images than any color laser printer in its class, and at 14 pages per minute, is more than three times faster than similarly priced competitive models. We have launched nine award-winning Phaser products since acquiring Tektronix's color printing and imaging business in January 2000. Most recently, on March 20, 2001 we launched the breakthrough 21 page per minute Phaser 2135 that is 3 times faster than the competition and more cost effective.

Light-lens Copying

The decline in light-lens copier revenues reflects customer

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transition to new digital black-and-white products and increasing price pressures. We believe that the trend over the past few years will continue and that light-lens product revenues will represent a declining share of total revenues. We expect that light-lens copiers will increasingly be replaced by digital copiers. However, some portions of the market will continue to use light-lens copiers, such as customers who care principally about price or whose work processes do not require digital products.

Black and White Laser Printers

Our DocuPrint family of monochrome network laser printers was originally launched in 1997 and currently includes models ranging from 8 to 45 pages per minute. These laser printers are faster, more advanced and less expensive than competitive models, offering "copier-like" features such as multiple-set printing, stapling and collating. The Tektronix CPID acquisition accelerated our objective of increasing the number of resellers who market our black and white laser printers. The acquisition more than doubled the number of channel partners and nearly doubled the distribution capacity and channel coverage to more than 16,000 resellers and dealers worldwide.

SOHO (Small Office/Home Office) Market

The SOHO market is expected to increase to \$46 billion in 2003 from \$41 billion in 1999, representing a 3 percent compound annual growth rate. We service this market with personal and networked products sold through expanded, indirect distribution channels such as Office Depot, OfficeMax, Staples, Micro Center, Fry's and J& R in the United States and Carrefour, Media Market and Merisel in Europe. The fastest growing segment of the SOHO market is color inkjet.

The Xerox M Series, which includes the DocuPrint M750 and M760 Color Inkjet Printers, are the first inkjet products to result from our SOHO Printing Alliance with Sharp Corporation and Fuji Xerox, which we announced in March 2000. The alliance with Fuji Xerox and Sharp leverages our strong brand and inkjet patent portfolio with Sharp's product development and manufacturing expertise and Fuji Xerox' technological know-how. As part of our turnaround plan, we are aggressively seeking equity partners for our inkjet business.

Other Products

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We also sell cut-sheet paper to our customers for use in their document processing products. The market for cut-sheet paper is highly competitive and revenue growth is significantly affected by pricing. Our strategy is to charge a spread over mill wholesale prices to cover our costs and value added as a distributor. In June 2000, we sold the U.S. and Canadian commodity paper business, including an exclusive license for the Xerox brand, to Georgia Pacific

Corporation. In addition to the proceeds from the sale of the business, the Company will receive royalty payments on future sales of Xerox branded commodity paper by Georgia Pacific and will earn commissions on Xerox originated sales of commodity paper as an agent for Georgia Pacific. As part of our turnaround plan, we have announced that we are in discussions to form a strategic alliance for our European paper business.

We also offer other document processing products including devices designed to reproduce large engineering and architectural drawings up to 3 feet by 4 feet in size developed and sold through Xerox Engineering Systems (XES). We have announced our intent to sell XES as part of our turnaround plan.

Xerox Competitive Advantages

Research and Development

Investment in research and development (R&D) is critical to drive future growth, and to this end Xerox R&D is directed toward the development of superior new products and capabilities in support of our document processing strategy. The goal of Xerox R&D is to continue to create disruptive technologies that will expand current and future markets. Our research scientists are deeply involved in the formulation of corporate strategy and key business decisions. They regularly meet with customers and have dialogues with our business divisions to ensure they understand customer requirements and are focused on products and solutions that can be commercialized.

In 2000, R&D expense was \$1,044 million compared with \$992 million in 1999 and \$1,035 million in 1998. 2000 R&D spending was focused primarily on programs to develop high-end business and on programs that extend our color capabilities. We continue to invest in technological development to maintain our premier position in the rapidly changing document processing market with a heightened focus on increasing our R&D investment in rapid market growth areas such as color and high-end services and solutions, as well as time to market. FutureColor, an advanced next-generation digital printing press set for initial customer engagement in late 2001 that produces photographic quality indistinguishable from offset, is an example of the type of breakthrough technologies developed by Xerox R&D that will drive our future growth. Xerox R&D is strategically coordinated with Fuji Xerox, which invested \$615 million in R&D in 2000 for a combined total of \$1.7 billion; adequate to remain technologically competitive.

Marketing and Distribution

Xerox document processing products are principally sold directly to customers by our worldwide sales force, a source of competitive advantage, totaling approximately 15,000 employees, and through a network of independent agents, dealers, retail chains, value-added resellers and systems integrators. Our turnaround plan is focused on the expansion of cost-effective third party distribution channels for simple commodities, and the continued use of our direct sales force for our customers' more advanced product needs, capabilities and

solutions.

To market laser and inkjet printers, digital multi-function devices and digital copiers, we are significantly expanding our indirect distribution channels. For our laser printer family we have arrangements with office information technology (IT) industry channels primarily through distributors including Ingram Micro, Tech Data, CHS and Computer 2000. These distributors supply our products to a broad range of IT/IS-oriented Resellers, Dealers, Direct Marketers, VARs, Systems Integrators and E-Commerce Business-Oriented Resellers, such as CDW. We also sell directly to some of these IT/IS-oriented Resellers ('Resellers'). Furthermore, as a result of the acquisition of the Tektronix Computer Printing and Imaging Division, completed in January 2000, we have more than doubled the number of Reseller partners and thus nearly doubled the distribution capacity

and channel coverage to more than 16,000 resellers worldwide. In 2000, we also forged marketing and reselling relationships with personal computer leaders Compaq and Dell.

For our inkjet and low-end digital multi-function products we currently have arrangements with U.S. retail marketing channels including Office Depot, OfficeMax, Staples, Micro Center, Fry's and J&R, and non-U.S. retail marketing channels including Carrefour, Media Market and Merisel. Our products are now available in more than 7,000 storefronts worldwide. In addition to web sites of several of our retail marketing partners, we have arrangements with several e-commerce web sites, including Amazon.com and CDW, for the sale of our equipment and supplies. We have continued to market copiers, fax machines and multi-function products through a family of authorized office product dealers.

Service

We have a worldwide service force of approximately 21,000 employees and a network of independent service agents. As part of our turnaround plan, we intend to expand our use of cost-effective third party service providers for simple commodity service, while continuing to focus Xerox's own direct service force on production products and serving customers in need of more advanced value added services. In our opinion, this service force represents a significant competitive advantage: the service force is continually trained on our new products and its diagnostic equipment is state-of-the-art. 24-hour-a-day, seven-day-a-week service is available in major metropolitan areas around the world. As a result, we are able to guarantee a consistent and superior level of service nationwide and worldwide.

Customer Satisfaction

Our most important priority is customer satisfaction. Our research shows that the cost of selling a replacement product to a satisfied customer is far less than selling to a "new" customer. We regularly survey customers on their satisfaction, measure the results, analyze the root causes of dissatisfaction, and take steps to correct any problems. Our products, technology, services and solutions are designed with one goal in mind - to make our customers' businesses more productive.

Because of our emphasis on customer satisfaction, we offer a Total Satisfaction Guarantee, one of the simplest and most comprehensive offered in any industry: "If you are not satisfied with our equipment, we will replace it without charge with an identical model or a machine with comparable features and capabilities." This guarantee applies for at least three years to equipment acquired from and continuously maintained by Xerox or its authorized agents.

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International Operations

Our international operations account for 44 percent of revenues. Our largest interest outside the United States is Xerox Limited which operates predominately in Europe. Marketing and manufacturing in Latin America are conducted through subsidiaries or distributors in over 35 countries. Fuji Xerox develops, manufactures and distributes document processing products in Japan and other areas of the Pacific Rim, Australia and New Zealand and now China.

Our financial results by geographical area for 2000, 1999 and 1998, which are presented on page -- of the Company's 2000 Annual Report to Shareholders are hereby incorporated by reference in this document in partial answer to this item.

Item 2. Properties

The Company owns a total of fourteen principal manufacturing and engineering facilities and leases an additional such facility. The domestic facilities are located in California, New York, Oklahoma, and Oregon and the international

facilities are located in Brazil, Canada, England, Ireland, Holland, Mexico, and India. The Company also has four principal research facilities; two are owned facilities in New York and Canada, and two are leased facilities in California and France.

In addition, within the Company, there are numerous facilities, which encompass general offices, sales offices, service locations and distribution centers. The principal owned facilities are located in the United States, England, and Mexico. The principal leased facilities are located in the United States, Brazil, Canada, England, Mexico, France, Germany and Italy.

The Company's Corporate Headquarters facility, located in Connecticut, is leased; the related land is owned by the Company. In 2001 the Company announced its intention to move out of this facility and to dispose of the underlying land. The Company also leases a portion of a training facility, located in Virginia, which was previously owned by the Company.

In connection with our purchase of the Color Printing and Imaging division of Tektronix, Inc. (CPID), the Company acquired a number of facilities that encompass administration, manufacturing, distribution centers, general offices, sales offices and service locations. The principal administration and manufacturing facilities, which are owned, are located in the United States (Wilsonville, OR) and Malaysia (Penang). The principal distribution facilities are located in Wilsonville and the Netherlands (Heerenveen). The facility in the Netherlands is leased. The remaining facilities acquired are leased and are located primarily in the United States, England and Canada.

In the opinion of Xerox management, its properties have been well maintained, are in sound operating condition and contain all the necessary equipment and facilities to perform the Company's functions.

Item 3. Legal Proceedings

The information set forth under Note 16 "Litigation" on pages 40 through 43 of the Company's 2000 Annual Report to Shareholders is hereby incorporated by reference in this document in answer to this item.

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Item 4. Submission of Matters to a Vote of Security Holders

None.

PART II

Item 5. Market for the Registrant's Common Equity and Related Stockholder

Matters

Market Information, Holders and Dividends

The information set forth under the following captions on the indicated pages of the Company's 2000 Annual Report to Shareholders is hereby incorporated by reference in this document in answer to this Item:

Caption -----	Page No. -----
Stock Listed and Traded	53
Xerox Common Stock Prices and Dividends	53

Recent Sales of Unregistered Securities

During the quarter ended December 31, 2000, Registrant issued the following securities in transactions which were not registered under the Securities Act of

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1933, as amended (the Act):

(a) Securities Sold: On October 1, 2000, Registrant issued 21,843 shares of Common stock, par value \$1 per share.

(b) 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, P.F. Russo, M.R. Seger and T.C.Theobald.

(c) The shares were issued at a deemed purchase price of \$4.63 per share (aggregate price \$101,125), 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.

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

Item 6. Selected Financial Data

The following information, as of and for the five years ended December 31, 2000, as set forth and included under the caption "Five Years in Review" on page 50 of the Company's 2000 Annual Report to Shareholders, is hereby incorporated by reference in this document in answer to this Item:

Revenues
Income (loss) from continuing operations
Per-Share Data - Earnings (loss) from continuing operations
Total assets
Long-term debt
Preferred stock
Per-Share Data - Dividends declared

Item 7. Management's Discussion and Analysis of Financial Condition and

Results of Operations

The information set forth under the caption "Management's Discussion and Analysis of Results of Operations and Financial Condition" on pages 1 through 15 of the Company's 2000 Annual Report to Shareholders is hereby incorporated by reference in this document in answer to this Item.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

The information set forth under the caption "Risk Management" on pages 14 and 15 of the Company's 2000 Annual Report to Shareholders is hereby incorporated by reference in this document in answer to this Item.

Item 8. Financial Statements and Supplementary Data

The consolidated financial statements of Xerox Corporation and subsidiaries and

the notes thereto and the report thereon of KPMG LLP, independent auditors, which appear on pages 16 through 48 and page 49 of the Company's 2000 Annual Report to Shareholders, are hereby incorporated by reference in this document in answer to this Item. In addition, also included is the quarterly financial data included under the caption "Quarterly Results of Operations (Unaudited)" on page 48 of the Company's 2000 Annual Report to Shareholders.

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The financial statement schedule required herein is filed as "Financial Statement Schedules" pursuant to Item 14 of this Report on Form 10-K.

Item 9. Changes in and Disagreements with Accountants on Accounting and

 Financial Disclosure

Not applicable.

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PART III

The information contained in Exhibit 99 to this Form 10-K is hereby incorporated herein in response to this part.

Executive Officers of Xerox

The following is a list of the executive officers of Xerox, their current ages, their present positions and the year appointed to their present positions. Anne M. Mulcahy, President and Thomas J. Dolan, Senior Vice President, are sister and brother. There are no other family relationships between any of the executive officers named.

Each officer is elected to hold office until the meeting of the Board of Directors held on the day of the next annual meeting of shareholders, subject to the provisions of the By-Laws.

Name	Age	Present Position	Year Appointed to Present Position	Officer Since
-----	---	-----	-----	-----
Paul A. Allaire*	62	Chairman of the Board and Chief Executive Officer	1991	1983
Anne M. Mulcahy*	48	President and Chief Operating Officer	2000	1992
Barry D. Romeril*	57	Vice Chairman and Chief Financial Officer	1999	1993
Allan E. Dugan	60	Executive Vice President President, Worldwide Business	2000	1990

Services

Carlos Pascual	55	Executive Vice President President, Developing Markets Operations	2000	1994
Thomas J. Dolan	56	Senior Vice President President Global Solutions Group	2000	1997
James A. Firestone	46	Senior Vice President Corporate Strategy and Marketing Group	2000	1998
Herve J. Gallaire	56	Senior Vice President Xerox Research and Technology and Chief Technical Officer	2000	1997
Michael C. Mac Donald	46	Senior Vice President President, North American Solutions Group	2000	1997

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* Member of Xerox Board of Directors.

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Executive Officers of Xerox, Continued

Name	Age	Present Position	Year Appointed to Present Position	Officer Since
-----	---	-----	-----	-----
Hector J. Motroni	57	Senior Vice President and Chief Staff Officer	1999	1994
Christina E. Clayton	53	Vice President and General Counsel	2000	2000
Eunice M. Filter	60	Vice President, Treasurer and Secretary	1990	1984
Jean-Noel Machon	48	Vice President President, European Solutions Group	2000	2000
Gregory B. Tayler	43	Vice President and Controller	2000	2000

Each officer named above, with the exception of James A. Firestone, has been an officer or an executive of Xerox or its subsidiaries for at least the past five

years.

Prior to joining Xerox in 1998, Mr. Firestone had been with International Business Machines (IBM) where he was General Manager, Consumer Division from 1995 to 1998. He was President, Consumer Services at Ameritech Corporation from 1993 to 1995. Prior to this he was with American Express Company where he was President, Travelers Cheques in 1993, Executive Vice President, Small Business and Corporate Services from 1989 to 1993, President, Travel Related Services-Japan from 1984 to 1989, Vice President, Finance and Planning, Travel Related Services-Japan from 1982 to 1984 and he held various other positions at American Express in Japan and at their headquarters from 1978 to 1982.

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PART IV

Item 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K.

- (a) (1) and (2) The financial statements, independent auditors' reports and Item 8 financial statement schedules being filed herewith or incorporated herein by reference are set forth in the Index to Financial Statements and Schedule included herein.

(3) The exhibits filed herewith or incorporated herein by reference are set forth in the Index of Exhibits included herein.
- (b) Current Reports on Form 8-K dated October 2, 2000, October 9, 2000, October 24, 2000, October 31, 2000, November 3, 2000, December 1, 2000, December 14, 2000 and December 21, 2000 reporting Item 5 "Other Events" were filed during the last quarter of the period covered by this Report.
- (c) The management contracts or compensatory plans or arrangements listed in the Index of Exhibits that are applicable to the executive officers named in the Summary Compensation Table which appears in Registrant's 2000 Proxy Statement are preceded by an asterisk (*).

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

XEROX CORPORATION

By: /s/ Barry D. Romeril

Vice Chairman and
Chief Financial Officer

June 7, 2001

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

June 7, 2001

Signature

Title

Principal Executive Officer:

Paul A. Allaire

/s/ Paul A. Allaire

Chief Executive Officer and Director

Principal Financial Officer:

Barry D. Romeril

/s/ Barry D. Romeril

Vice Chairman and
Chief Financial Officer and Director

Principal Accounting Officer:

Gregory B. Tayler

/s/ Gregory B. Tayler

Vice President and Controller

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Directors:

/s/ Antonia Ax:son Johnson

Director

/s/ Vernon E. Jordan, Jr.

Director

/s/ Yotaro Kobayashi

Director

/s/ Hilmar Kopper

Director

/s/ Ralph S. Larsen

Director

/s/ George J. Mitchell

Director

/s/ Anne M. Mulcahy

Director

/s/ N. J. Nicholas, Jr.

Director

/s/ John E. Pepper

Director

/s/ Martha R. Seger

Director

/s/ Thomas C. Theobald

Director

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Report of Independent Auditors

To the Board of Directors of Xerox Corporation:

Under date of May 30, 2001, we reported on the consolidated balance sheets of Xerox Corporation and consolidated subsidiaries (the "Company") as of December 31, 2000 and December 31, 1999, and the related consolidated statements of operations, cash flows, and shareholder's equity for each of the years in the three year period ended December 31, 2000, which are included in the accompanying financial statements. In connection with our audits of the aforementioned consolidated financial statements, we also audited the related consolidated financial statement schedule listed in the accompanying index. This consolidated financial statement schedule is the responsibility of the Company's management. Our responsibility is to express an opinion on this consolidated financial statement schedule based on our audits.

Our audit report on the Company's consolidated financial statements referred to above indicates that the consolidated balance sheet as of December 31, 1999, and the related consolidated statements of operations, cash flows, and shareholder's equity for the years ended December 31, 1999, and December 31, 1998 have been restated.

Our audit report also indicates that the supplementary quarterly financial information included in the Company's consolidated financial statements contains information that we did not audit, and accordingly, we do not express an opinion on that information. We did not have an adequate basis to complete reviews of quarterly information in accordance with standards established by the American Institute of Certified Public Accountants due to matters related to the restatement issues as described in Note 2 to the consolidated financial statements.

In our opinion, such financial statement schedule, when considered in relation to the basic Consolidated Financial Statements as a whole, presents fairly in all material aspects the information set forth therein.

/s/ KPMG LLP

Stamford, Connecticut
May 30, 2001

Index to Financial Statements and Schedule

Financial Statements:

Consolidated statements of operations of Xerox Corporation and subsidiaries for each of the years in the three-year period ended December 31, 2000

Consolidated balance sheets of Xerox Corporation and subsidiaries as of December 31, 2000 and 1999

Consolidated statements of cash flows of Xerox Corporation and subsidiaries for each of the years in the three-year period ended December 31, 2000

Consolidated statements of shareholders' equity of Xerox Corporation and subsidiaries for each of the years in the three-year period ended December 31, 2000

Notes to consolidated financial statements

Report of Independent Auditors

Quarterly Results of Operations (unaudited)

Commercial and Industrial (Article 5) Schedule:

II - Valuation and qualifying accounts

All other schedules are omitted as they are not applicable, or the information required is included in the financial statements or notes thereto.

SCHEDULE II

Valuation and Qualifying Accounts
Year ended December 31, 2000, 1999 and 1998

(in millions)	Balance at beginning of period	Additions charged to costs and expenses	Deductions, net of recoveries of period	Balance at end of period

2000				

Allowance for Losses on:				
Accounts Receivable	\$137	\$291	\$146	\$282
Finance Receivables	423	356	329	450

	\$560	\$647	\$475	\$732
	=====			
1999				

Allowance for Losses on:				
Accounts Receivable	\$102	\$168	\$133	\$137
Finance Receivables	441	238	256	423

	\$543	\$406	\$389	\$560
	=====			
1998				

Allowance for Losses on:				
Accounts Receivable	\$ 92	\$ 78	\$ 68	\$102
Finance Receivables	389	225	173	441

	\$481	\$303	\$241	\$543
	=====			

-
- (3) (a) Restated Certificate of Incorporation of Registrant filed by the Department of State of New York on October 29, 1996, as amended by Certificate of Amendment of the Certificate of Incorporation of Registrant filed by the Department of State of New York on May 21, 1999.

Incorporated by reference to Exhibit 3(a) to Amendment No. 5 to Registrant's Form 8-A Registration Statement dated February 8, 2000.

- (b) By-Laws of Registrant, as amended through April 9, 2001.
- (4) (a) (1) Indenture dated as of December 1, 1991, between Registrant and Citibank, N.A., relating to unlimited amounts of debt securities which may be issued from time to time by Registrant when and as authorized by or pursuant to a resolution of Registrant's Board of Directors (the "December 1991 Indenture").

Incorporated by reference to Exhibit 4(a) to Registration Nos. 33-44597, 33-49177 and 33-54629.

- (2) Instrument of Resignation, Appointment and Acceptance dated as of February 1, 2001, among Registrant, Citibank, N.A., as resigning trustee, and Wilmington Trust Company, as successor trustee, relating to the December 1991 Indenture.
- (b) (1) Indenture dated as of September 20, 1996, between Registrant and Citibank, N.A., relating to unlimited amounts of debt securities which may be issued from time to time by Registrant when and as authorized by or pursuant to a resolution of Registrant's Board of Directors (the "September 1996 Indenture").

Incorporated by reference to Exhibit 4(a) to Registration Statement No. 333-13179.

- (2) Instrument of Resignation, Appointment and Acceptance dated as of February 1, 2001, among Registrant, Citibank, N.A., as resigning trustee, and Wilmington Trust Company, as successor trustee, relating to the September 1996 Indenture.
- (c) (1) Indenture dated as of January 29, 1997, between Registrant and Bank One, National Association (as successor by merger with The First National Bank of Chicago) ("Bank One"), (the "January 1997 Indenture"), relating to Registrant's Junior Subordinated Deferrable Interest Debentures ("Junior Subordinated Debentures").

Incorporated by reference to Exhibit 4.1 to Registration Statement No. 333-24193.

- (2) Form of Certificate of Exchange relating to Junior Subordinated Debentures.

Incorporated by reference to Exhibit A to Exhibit 4.1 to Registration Statement No. 333-24193.

- (3) Certificate of Trust of Xerox Capital Trust I executed as of January 23, 1997.

Incorporated by reference to Exhibit 4.3 to Registration Statement No. 333-24193.

- (4) Amended and Restated Declaration of Trust of Xerox Capital Trust I dated as of January 29, 1997.

Incorporated by reference to Exhibit 4.4 to Registration Statement No. 333-24193.

- (5) Form of Exchange Capital Security Certificate for Xerox Capital Trust I.

Incorporated by reference to Exhibit A-1 to Exhibit 4.4 to Registration Statement No. 333-24193.

- (6) Series A Capital Securities Guarantee Agreement of Registrant dated as of January 29, 1997, relating to Series A Capital Securities of Xerox Capital Trust I.

Incorporated by reference to Exhibit 4.6 to Registration Statement No. 333-24193.

- (7) Registration Rights Agreement dated January 29, 1997, among Registrant, Xerox Capital Trust I and the initial purchasers named therein.

Incorporated by reference to Exhibit 4.7 to Registration Statement No. 333-24193.

- (d) (1) Indenture dated as of October 1, 1997, among Registrant, Xerox Overseas Holding Limited (formerly Xerox Overseas Holding PLC), Xerox Capital (Europe) plc (formerly Rank Xerox Capital (Europe) plc) and Citibank, N.A., relating to unlimited amounts of debt securities which may be issued from time to time by Registrant and unlimited amounts of guaranteed debt securities which may be issued from time to time by the other issuers when and as authorized by or pursuant to a resolution or resolutions of the Board of Directors of Registrant or the other issuers, as applicable (the "October 1997 Indenture").

Incorporated by reference to Exhibit 4(b) to Registration Statement Nos. 333-34333, 333-34333-01 and 333-34333-02.

- (2) Instrument of Resignation, Appointment and Acceptance dated as of February 1, 2001, among Registrant, the other issuers under the October 1997 Indenture, Citibank, N.A., as resigning trustee, and Wilmington Trust Company, as successor trustee, relating to the October 1997 Indenture.

- (e) Indenture dated as of April 21, 1998, between Registrant and Bank One, relating to \$1,012,198,000 principal amount at

maturity of Registrant's Convertible Subordinated Debentures due 2018 (the "April 1998 Indenture").

Incorporated by reference to Exhibit 4(b) to Registration Statement No. 333-59355.

- (f) Indenture dated as of March 1, 1988, as supplemented by the First Supplemental Indenture dated as of July 1, 1988, between Xerox Credit Corporation ("XCC") and Bank One, relating to unlimited amounts of debt securities which may be issued from time to time by XCC when and as authorized by XCC's Board of Directors or the Executive Committee of the Board of Directors.

Incorporated by reference to Exhibit 4(a) to XCC's Registration Statement No. 33-20640 and to Exhibit 4(a)(2) to XCC's Current Report on Form 8-K dated July 13, 1988.

- (g) Indenture dated as of October 2, 1995, between XCC and State Street Bank and Trust Company ("State Street"), relating to unlimited amounts of debt securities which may be issued from

time to time by XCC when and as authorized by XCC's Board of Directors or Executive Committee of the Board of Directors.

Incorporated by reference to Exhibit 4(a) to XCC's Registration Statement Nos. 33-61481 and 333-29677.

- (h) (1) Indenture dated as of April 1, 1999, between XCC and Citibank, N.A., relating to unlimited amounts of debt securities which may be issued from time to time by XCC when and as authorized by XCC's Board of Directors or Executive Committee of the Board of Directors (the "April 1999 XCC Indenture").

Incorporated by reference to Exhibit 4(a) to XCC's Registration Statement No. 33-61481.

- (2) Instrument of Resignation, Appointment and Acceptance dated as of February 1, 2001, among XCC, Citibank, N.A., as resigning trustee, and Wilmington Trust Company, as successor trustee, relating to the April 1999 XCC Indenture.

- (i) \$7,000,000,000 Revolving Credit Agreement dated October 22, 1997, among Registrant, XCC and certain Overseas Borrowers, as Borrowers, various lenders and Morgan Guaranty Trust Company of New York, The Chase Manhattan Bank, Citibank, N.A. and Bank One, as Agents.

Incorporated by reference to Exhibit 4(h) to Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2000.

- (j) Instruments with respect to long-term debt where the total amount of securities authorized thereunder does not exceed 10% of the total assets of Registrant and its subsidiaries on a consolidated basis have not been filed. Registrant agrees to furnish to the Commission a copy of each such instrument upon

request.

- (10) The management contracts or compensatory plans or arrangements listed below that are applicable to the executive officers named in the Summary Compensation Table which appears in Registrant's 2001 Proxy Statement are preceded by an asterisk (*).

- * (a) Registrant's 1976 Executive Long-Term Incentive Plan, as amended through February 4, 1991.

Incorporated by reference to Exhibit (10) (a) to Registrant's Annual Report on Form 10-K for the Year Ended December 31, 1991.

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

- (c) Registrant's 1996 Non-Employee Director Stock Option Plan, as amended through May 20, 1999.

Incorporated by reference to Registrant's Notice of the 1999 Annual Meeting of Shareholders and Proxy Statement pursuant to Regulation 14A.

- * (d) Description of Registrant's Annual Performance Incentive Plan.

- * (e) 1997 Restatement of Registrant's Unfunded Retirement Income Guarantee Plan, as amended through October 9, 2000.

- * (f) 1997 Restatement of Registrant's Unfunded Supplemental Retirement Plan, as amended through October 9, 2000.

(g) Registrant's 1981 Deferred Compensation Plan, 1985 Restatement, as amended through April 2, 1990.

Incorporated by reference to Exhibit 10(h) to Registrant's Quarterly Report on Form 10-Q for the Quarter Ended March 31, 1990.

(h) 1996 Amendment and Restatement of Registrant's Restricted Stock Plan for Directors.

Incorporated by reference to Registrant's Notice of the 1996 Annual Meeting of Shareholders and Proxy Statement pursuant to Regulation 14A.

* (i) (1) Form of severance agreement entered into with various executive officers.

Incorporated by reference to Exhibit 10(j) to Registrant's Quarterly Report on Form 10-Q for the Quarter ended June 30, 1989.

* (2) Form of severance agreement entered into with various executive officers, effective October 15, 2000.

* (j) Registrant's Contributory Life Insurance Program, as amended as of January 1, 1999.

Incorporated by reference to Exhibit 10(j) to Registrant's Annual Report on Form 10-K for the year ended December 31, 1999.

(k) Registrant's Deferred Compensation Plan for Directors, 1997 Amendment and Restatement, as amended through October 9, 2000.

* (l) Registrant's Deferred Compensation Plan for Executives, 1997 Amendment and Restatement, as amended through October 9, 2000.

* (m) Executive Performance Incentive Plan.

Incorporated by reference to Registrant's Notice of the 1995 Annual Meeting of Shareholders and Proxy Statement pursuant to Regulation 14A.

* (n) Registrant's 1998 Employee Stock Option Plan, as amended through October 9, 2000.

* (o) Registrant's CEO Challenge Bonus Program.

* (p) Letter Agreement dated December 4, 2000 between Registrant and William F. Buehler, Vice Chairman of Registrant.

* (q) Separation Agreement dated May 11, 2000 between Registrant and G. Richard Thoman, former President and Chief Executive Officer of Registrant.

Incorporated by reference to Exhibit 10(p) to Registrant's Quarterly Report on Form 10-Q for the Quarter Ended June 30, 2000.

* (r) Letter Agreement dated June 4, 1997 between Registrant and G. Richard Thoman, former President and Chief Executive Officer of Registrant.

Incorporated by reference to Exhibit 10(m) to Registrant's Quarterly Report on Form 10-Q for the Quarter Ended June 30, 1997.

- * (s) Letter Agreement dated April 2, 2001 between Registrant and Carlos Pascual, Executive Vice President of Registrant.
- (11) Statement re computation of per share earnings.
- (12) Computation of Ratio of Earnings to Fixed charges.
- (13) Registrant's 2001 Annual Report to Shareholders.
- (21) Subsidiaries of Registrant.
- (23) Consent of KPMG LLP.
- (99) Directors and Officers Information.

BY-LAWS

of

XEROX CORPORATION

April 9, 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 or if the date of the applicable annual meeting has been changed by more than 30 days from the date contemplated at the time of the previous year's proxy statement, not less than 90 days before the date of the applicable annual meeting.

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 Chairmen 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. The Chairman of the Board 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 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 Chief Operating Officer of the Company. 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 deliver 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.

INSTRUMENT OF RESIGNATION, APPOINTMENT AND ACCEPTANCE

THIS INSTRUMENT OF RESIGNATION, APPOINTMENT AND ACCEPTANCE, ("Instrument"), dated and effective as of February 1, 2001 (the "Effective Date"), among XEROX CORPORATION, a corporation organized under the laws of the State of New York (the "Company"), CITIBANK, N.A., a national banking association organized under the laws of the United States of America (the "Resigning Trustee"), and WILMINGTON TRUST COMPANY, a banking corporation organized under the laws of the State of Delaware (the "Successor Trustee"). Capitalized terms not otherwise defined herein shall have the same meaning ascribed to such terms in the Indenture as referred to below.

RECITALS

WHEREAS, pursuant to an Indenture, dated as of December 1, 1991 (the "Indenture"), among the Company and the Resigning Trustee, the Company issued its \$200,000,000 8 1/8% Notes Due April 15, 2002 (Cusip 984121AT0), its \$200,000,000 7.15% Notes due August 1, 2004 (Cusip 984121AU7), its Medium Term Notes, Series B (Base Cusip 98412J), and its Medium Term Notes, Series C (Base Cusip 98412J) (collectively all such issued notes, the "Securities");

WHEREAS, the Company appointed the Resigning Trustee as the trustee under the Indenture of all Securities issued under the Indenture;

WHEREAS, there is presently issued and outstanding \$962,000,000 in aggregate principal amount of the Securities;

WHEREAS, the Indenture provides that the trustee may resign at any time with respect to any series of Securities and be discharged from the trusts created by the Indenture by notifying the Company in writing;

WHEREAS, the Indenture further provides that if the trustee resigns with respect to any series of Securities, the Company, by or pursuant to a Board Resolution, shall promptly appoint a successor Trustee with respect to such applicable series of Securities;

WHEREAS, the Resigning Trustee desires to resign as the trustee with respect to all Securities issued pursuant to the Indenture, and the Company desires to appoint the Successor Trustee as trustee to succeed the Resigning Trustee as the trustee with respect to the Securities; and

WHEREAS, the Successor Trustee is willing to accept the appointment as trustee under the Indenture.

NOW, THEREFORE, in consideration of the covenants set forth herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

1. Acceptance of Resignation of Resigning Trustee and Appointment of Successor Trustee. The Company having received written notice of the Resigning Trustee's request to resign as trustee pursuant to Section 8.07(b) of the

Indenture, hereby accepts the resignation of the Resigning Trustee as trustee under the Indenture. Pursuant to Section 8.07(e) of the Indenture, the Company acting pursuant to Board Resolution hereby appoints the Successor Trustee as trustee under the Indenture, and vests and confirms to the Successor Trustee all rights, powers, trusts, privileges, duties and obligations of the trustee under the Indenture.

2. Company's Representations and Warranties. The Company hereby represents and warrants to the Successor Trustee that:

a. It is duly organized and validly existing and in good standing under all applicable law, and, this Instrument has been duly authorized, executed and delivered on its behalf and constitutes its legal, valid, binding and enforceable obligation;

b. It has not entered into any amendment or supplement to the Indenture, and the Indenture is in full force and effect;

c. No Event of Default and no default exists under the Indenture;

d. No covenant or condition contained in the Indenture has been waived by the Holders of a percentage in aggregate principal amount of the Securities required by the Indenture to effect any such waiver;

e. The Indenture was validly executed and delivered by it, and the Securities are validly issued securities of the Company; and

f. The execution and delivery of this Instrument do not and will not conflict with, or result in a breach of, any of the terms or provisions of, or constitute a default under, any (i) contract, agreement, indenture or other instrument (including, without limitation, its certificate of incorporation, by-laws and/or any and all other applicable organizational documents) to which it is a party or by which it or its property is bound, or (ii) any judgment, decree or order of any court or governmental agency or regulatory body or law, rule or regulation applicable to it or its property.

3. Resigning Trustee's Representations and Warranties. The Resigning Trustee hereby represents and warrants to the Successor Trustee that:

a. It has not entered into any amendment or supplement to the Indenture and the Indenture is in full force and effect;

b. No covenant or condition contained in the Indenture has been waived by the Resigning Trustee or by the Holders of a percentage in aggregate principal amount of the Securities required by the Indenture to effect any such waiver;

c. There is no action, suit or proceeding pending or threatened against the Resigning Trustee of which it has actual knowledge before any court or governmental authority arising out of any action or omission by the Resigning Trustee as trustee under the Indenture;

d. It has made, or promptly will make, available to the Successor Trustee originals, if available, or copies in its possession, of all documents relating to the trusts created by the Indenture (the "Trusts") and all information in the possession of its corporate trust administration department relating to the administration and status of the Trusts and shall do such other things as the Successor Trustee may reasonably request to more fully vest and confirm in the Successor Trustee all the rights, powers, trusts, privileges, duties and obligations assigned and transferred hereby to the Successor Trustee;

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e. It has lawfully discharged its duties as trustee under the Indenture;

f. Pursuant to Section 3.03 of the Indenture, it duly authenticated and delivered the Securities in an aggregate principal face amount of \$962,000,000 and there is currently issued and outstanding \$962,000,000 in aggregate principal amount of the Securities;

g. As of the Effective Date, it holds no property or money in its capacity as trustee under the Indenture; and

h. This Instrument has been duly authorized, executed and delivered on behalf of the Resigning Trustee and constitutes its legal, valid, binding and enforceable obligation.

4. Successor Trustee's Representations and Warranties. The Successor Trustee represents and warrants to the Resigning Trustee and the Company that:

a. It is qualified and eligible to serve as trustee under the Indenture and the Trust Indenture Act of 1939, as amended (the "Act"); and

b. This Instrument has been duly authorized, executed and delivered on behalf of the Successor Trustee and constitutes its legal, valid, binding and enforceable obligation.

5. Acceptance by Successor Trustee. The Successor Trustee hereby accepts its appointment, as of the Effective Date, as successor trustee under the Indenture, and assumes, as of the Effective Date, all rights, powers, trusts, privileges, duties and obligations of the trustee thereunder, subject to the terms and conditions therein.

6. Notice to Holders. Promptly after the Effective Date of this Instrument, the Company shall give notice in accordance with Section 8.07(f) of the Indenture of the resignation of the Resigning Trustee and the appointment of the Successor Trustee.

7. Assignment by Resigning Trustee. The Resigning Trustee hereby confirms, assigns, transfers, delivers and conveys, as of the Effective Date, to the Successor Trustee, as successor trustee under the Indenture, upon the Trusts expressed in the Indenture, all rights, powers, trusts, privileges, duties and obligations, which the Resigning Trustee, as trustee now holds under and by virtue of the Indenture, and shall pay over to the Successor Trustee, any and all property and moneys held by the Resigning Trustee under and by virtue of the Indenture, subject to the lien provided by Section 8.05 of the Indenture, which lien the Resigning Trustee expressly reserves to the fullest extent necessary to secure the Company's obligations under said section to the Resigning Trustee, which lien shall also secure the Company's obligations under said section to the Successor Trustee. Notwithstanding any other provision in this Instrument, the Successor Trustee assumes none of the obligations or duties of the Paying Agent or Registrar in the Indenture.

8. Indemnification

a. The parties to this Instrument agree that this Instrument does not constitute an assumption by the Successor Trustee of any liability of the Resigning Trustee arising out of any breach by the Resigning Trustee in the performance of its duties as trustee under the Indenture.

b. The Company agrees to pay or indemnify, as applicable, the Successor Trustee and save the Successor Trustee harmless from and against any and all

costs, claims, liabilities, losses or damages whatsoever (including the reasonable fees, expenses and disbursements of the Successor Trustee's legal counsel and other advisors) arising out of the actual, alleged or adjudicated actions or omissions of the Resigning Trustee that the Successor Trustee may suffer or incur as a result of the Successor Trustee accepting this appointment and acting as successor trustee under the Indenture. The Successor Trustee will furnish to the Company, promptly upon receipt, all documents with respect to any action the outcome of which would make the indemnity provided for in this paragraph operative. The Successor Trustee shall notify the Company in writing of any claim for which it may seek indemnity.

c. As security for the performance of the obligations of the Company under

this Section 8 and under Section 8.05 of the Indenture, the Successor Trustee shall have a lien prior to the Securities upon all property and funds held or collected by the Trustee as such.

9. Further Assurances. The Company and the Resigning Trustee, for the purposes of more fully and certainly vesting in and confirming to the Successor Trustee, as successor trustee under the Indenture, said rights, powers, trusts, privileges, duties and obligations, agree upon reasonable request of the Successor Trustee, to execute, acknowledge and deliver such further instruments of conveyance and further assurance and to do such other things as may reasonably be required for more fully and certainly vesting and confirming to the Successor Trustee all rights, powers, trusts, privileges, duties and obligations which the Resigning Trustee now holds under and by virtue of the Indenture.

10. Survival of Certain Obligations of the Company. Notwithstanding the resignation of the Resigning Trustee, the Company shall remain obligated under the Indenture to compensate, reimburse and indemnify the Resigning Trustee in connection with its trusteeship under the Indenture, and nothing contained in this Instrument shall in any way abrogate the obligations of the Company to the Resigning Trustee under the Indenture or any lien created in favor of the Resigning Trustee thereunder.

11. Corporate Trust Office. Reference in the Indenture to the "Corporate Trust Office" of the Resigning Trustee or other similar terms shall be deemed to refer to the Corporate Trust Office of the Successor Trustee at Rodney Square North, 1100 North Market Street, Wilmington, Delaware 19890 or any other office of the Successor Trustee at which, at any particular time, its corporate trust business shall be principally administered.

12. Notices. All notices, whether faxed or mailed will be deemed received when sent pursuant to the following instructions:

TO THE SUCCESSOR TRUSTEE:
WILMINGTON TRUST COMPANY
Attn: Corporate Trust Administration
Rodney Square North
1100 North Market Street
Wilmington, Delaware 19890
TELEPHONE: (302) 651-1343
TELECOPIER: (302) 651-8882

TO THE RESIGNING TRUSTEE:
CITIBANK, N.A.
111Wall Street, 14th Floor
New York, New York 10005
TELEPHONE: (212) 657-7805
TELECOPIER: (212) 657-4009

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TO THE COMPANY:
XEROX CORPORATION
800 Long Ridge Road
Stamford, Connecticut 06904
Attn: Assistant Treasurer
TELEPHONE: (203) 968-4653
TELECOPIER: (203) 968-3972

13. Effective Date. This Instrument and the resignation, appointment and acceptance effected hereunder shall be effective as of the close of business on the Effective Date.

14. Governing Law. This Instrument shall be governed by and construed in accordance with the laws of the State of New York.

15. Counterparts. This Instrument may be executed in any number of counterparts, each of which shall be an original, but such counterparts shall together constitute one and the same instrument.

[SIGNATURE PAGE FOLLOWS]

IN WITNESS WHEREOF, the parties have executed this Instrument to be effective as of the day and year first above written.

WILMINGTON TRUST COMPANY,
Successor Trustee

By: _____
Name:
Title:

CITIBANK, N.A.,
Resigning Trustee

By: _____
Name:
Title:

XEROX CORPORATION,
Company

By: _____
Name:
Title:

INSTRUMENT OF RESIGNATION, APPOINTMENT AND ACCEPTANCE

THIS INSTRUMENT OF RESIGNATION, APPOINTMENT AND ACCEPTANCE, ("instrument"), dated and effective as of February 1, 2001 (the "Effective Date"), among XEROX CORPORATION, a corporation organized under the laws of the State of New York (the "Company"), CITIBANK, N.A., a national banking association organized under the laws of the United States of America (the "Resigning Trustee"), and WILMINGTON TRUST COMPANY, a banking corporation organized under the laws of the State of Delaware (the "Successor Trustee"). Capitalized terms not otherwise defined herein shall have the same meaning ascribed to such terms in the Indenture as referred to below.

RECITALS

WHEREAS, pursuant to an Indenture, dated as of September 20, 1996 (the "Indenture"), between the Company and the Resigning Trustee, the Company issued its Medium Term Notes, Series D (Base Cusip 98412J) (the "Securities");

WHEREAS, the Company appointed the Resigning Trustee as the trustee under the Indenture and in its capacity as the paying agent and registrar (in each such capacity, the "Paying Agent") of all Securities issued under the Indenture;

WHEREAS, there is presently issued and outstanding \$420,774,000 in aggregate principal amount of the Securities;

WHEREAS, the Indenture provides that the trustee may resign at any time with respect to any series of Securities and be discharged from the trusts created by the Indenture by notifying the Company in writing;

WHEREAS, the Indenture further provides that if the trustee resigns with respect to any series of Securities, the Company, by or pursuant to a Board Resolution, shall promptly appoint a successor Trustee with respect to such applicable series of Securities;

WHEREAS, the Resigning Trustee desires to resign as the trustee with respect to all Securities issued pursuant to the Indenture, and the Company desires to appoint the Successor Trustee as trustee to succeed the Resigning Trustee as the trustee with respect to the Securities;

WHEREAS, the Resigning Trustee will remain Paying Agent with respect to the Securities; and

WHEREAS, the Successor Trustee is willing to accept the appointment as trustee under the Indenture.

NOW, THEREFORE, in consideration of the covenants set forth herein and

other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

1. Acceptance of Resignation of Resigning Trustee and Appointment of Successor Trustee. The Company having received written notice of the Resigning Trustee's request to resign as trustee pursuant to Section 8.07(b) of the Indenture, hereby accepts the resignation of the Resigning Trustee as trustee under the Indenture. Pursuant to Section 8.07(e) of the Indenture, the Company acting pursuant to Board Resolution hereby appoints the Successor Trustee as trustee under the Indenture, and vests and confirms to the Successor Trustee all rights, powers, trusts, privileges, duties and

obligations of the trustee under the Indenture.

2. Company's Representations and Warranties. The Company hereby represents and warrants to the Successor Trustee that:

- a. It is duly organized and validly existing and in good standing under all applicable law, and, this Instrument has been duly authorized, executed and delivered on its behalf and constitutes its legal, valid, binding and enforceable obligation;
- b. It has not entered into any amendment or supplement to the Indenture, and the Indenture is in full force and effect;
- c. No Event of Default and no default exists under the Indenture;
- d. No covenant or condition contained in the Indenture has been waived by the Holders of a percentage in aggregate principal amount of the Securities required by the Indenture to effect any such waiver;
- e. The Indenture was validly executed and delivered by it, and the Securities are validly issued securities of the Company; and
- f. The execution and delivery of this Instrument do not and will not conflict with, or result in a breach of, any of the terms or provisions of, or constitute a default under, any (i) contract, agreement, indenture or other instrument (including, without limitation, its certificate of incorporation, by-laws and/or any and all other applicable organizational documents) to which it is a party or by which it or its property is bound, or (ii) any judgment, decree or order of any court or governmental agency or regulatory body or law, rule or regulation applicable to it or its property.

3. Resigning Trustee's Representations and Warranties. The Resigning Trustee hereby represents and warrants to the Successor Trustee that:

- a. It has not entered into any amendment or supplement to the Indenture and the Indenture is in full force and effect;
- b. No covenant or condition contained in the Indenture has been waived by the Resigning Trustee or by the Holders of a percentage in aggregate

principal amount of the Securities required by the Indenture to effect any such waiver;

- c. There is no action, suit or proceeding pending or threatened against the Resigning Trustee of which it has actual knowledge before any court or governmental authority arising out of any action or omission by the Resigning Trustee as trustee under the Indenture;
- d. It has made, or promptly will make, available to the Successor Trustee originals, if available, or copies in its possession, of all documents relating to the trusts created by the Indenture (the "trusts") and all information in the possession of its corporate trust administration department relating to the administration and status of the Trusts and shall do such other things as the Successor Trustee may reasonably request to more fully vest and confirm in the Successor Trustee all the rights, powers, trusts, privileges, duties and obligations assigned and transferred hereby to the Successor Trustee;
- e. It has lawfully discharged its duties as trustee under the Indenture;
- f. Pursuant to Section 3.03 of the Indenture, it duly authenticated and delivered the Securities in an aggregate principal face amount of \$950,000,000 and there is currently issued and outstanding \$420,774,000 in aggregate principal amount of the Securities;

g. As of the Effective Date, it holds no property or money in its capacity as trustee under the Indenture; and

h. This Instrument has been duly authorized, executed and delivered on behalf of the Resigning Trustee and constitutes its legal, valid, binding and enforceable obligation.

4. Successor Trustee's Representations and Warranties. The Successor Trustee represents and warrants to the Resigning Trustee and the Company that:

a. It is qualified and eligible to serve as trustee under the Indenture and the Trust Indenture Act of 1939, as amended (the "Act"); and

b. This Instrument has been duly authorized, executed and delivered on behalf of the Successor Trustee and constitutes its legal, valid, binding and enforceable obligation.

5. Acceptance by Successor Trustee. The Successor Trustee hereby accepts its appointment, as of the Effective Date, as successor trustee under the Indenture, and assumes, as of the Effective Date, all rights, powers, trusts, privileges, duties and obligations of the trustee thereunder, subject to the terms and conditions therein.

6. Notice to Holders. Promptly after the Effective Date of this Instrument, the Company shall give notice in accordance with Section 8.07(f) of the Indenture of the resignation of the Resigning Trustee and the

appointment of the Successor Trustee.

7. Assignment by Resigning Trustee. The Resigning Trustee hereby confirms, assigns, transfers, delivers and conveys, as of the Effective Date, to the Successor Trustee, as successor trustee under the Indenture, upon the Trusts expressed in the Indenture, all rights, powers, trusts, privileges, duties and obligations, which the Resigning Trustee, as trustee now holds under and by virtue of the Indenture, and shall pay over to the Successor Trustee, any and all property and moneys held by the Resigning Trustee under and by virtue of the Indenture, subject to the lien provided by Section 8.05 of the Indenture, which lien the Resigning Trustee expressly reserves to the fullest extent necessary to secure the Company's obligations under said section to the Resigning Trustee, which lien shall also secure the Company's obligations under said section to the Successor Trustee. Notwithstanding any other provision in this Instrument, the Resigning Trustee shall continue to act as Paying Agent under the Indenture to the extent that the Resigning Trustee acts as Paying Agent under any series of Securities, and the Successor Trustee assumes none of the obligations or duties of the Paying Agent in the Indenture.

8. Indemnification

a. The parties to this Instrument agree that this Instrument does not constitute an assumption by the Successor Trustee of any liability of the Resigning Trustee arising out of any breach by the Resigning Trustee in the performance of its duties as trustee under the Indenture.

b. The Company agrees to pay or indemnify, as applicable, the Successor Trustee and save the Successor Trustee harmless from and against any and all costs, claims, liabilities, losses or damages whatsoever (including the reasonable fees, expenses and disbursements of the Successor Trustee's legal counsel and other advisors) arising out of the actual, alleged or adjudicated actions or omissions of the Resigning Trustee that the Successor Trustee may suffer or incur as a result of the Successor Trustee accepting this appointment and acting as successor trustee under the Indenture. The Successor Trustee will furnish to the Company, promptly upon receipt, all documents with respect to any action the outcome of which would make the indemnity provided for in this paragraph operative. The Successor Trustee shall notify the Company in writing of

any claim for which it may seek indemnity.

c. As security for the performance of the obligations of the Company under this Section 8 and under Section 8.05 of the Indenture, the Successor Trustee shall have a lien prior to the Securities upon all property and funds held or collected by the Trustee as such.

9. Further Assurances. The Company and the Resigning Trustee, for the purposes of more fully and certainly vesting in and confirming to the Successor Trustee, as successor trustee under the Indenture, said rights, powers, trusts, privileges, duties and obligations, agree upon reasonable request of the Successor Trustee, to execute, acknowledge and deliver such

further instruments of conveyance and further assurance and to do such other things as may reasonably be required for more fully and certainly vesting and confirming to the Successor Trustee all rights, powers, trusts, privileges, duties and obligations which the Resigning Trustee now holds under and by virtue of the Indenture.

10. Survival of Certain Obligations of the Company. Notwithstanding the resignation of the Resigning Trustee, the Company shall remain obligated under the Indenture to compensate, reimburse and indemnify the Resigning Trustee in connection with its trusteeship under the Indenture, and nothing contained in this Instrument shall in any way abrogate the obligations of the Company to the Resigning Trustee under the Indenture or any lien created in favor of the Resigning Trustee thereunder.

11. Corporate Trust Office. Reference in the Indenture to the "Corporate Trust Office" of the Resigning Trustee or other similar terms shall be deemed to refer to the Corporate Trust Office of the Successor Trustee at Rodney Square North, 1100 North Market Street, Wilmington, Delaware 19890 or any other office of the Successor Trustee at which, at any particular time, its corporate trust business shall be principally administered.

12. Notices. All notices, whether faxed or mailed will be deemed received when sent pursuant to the following instructions:

TO THE SUCCESSOR TRUSTEE:

WILMINGTON TRUST COMPANY
Attn: Corporate Trust Administration
Rodney Square North
1100 North Market Street
Wilmington, Delaware 19890
TELEPHONE: (302) 651-1343
TELECOPIER: (302) 651-8882

TO THE RESIGNING TRUSTEE:

CITIBANK, N.A.
111 Wall Street, 14th Floor
New York, New York 10005
TELEPHONE: (212) 657-7805
TELECOPIER: (212) 657-4009

TO THE COMPANY:

XEROX CORPORATION
800 Long Ridge Road
Stamford, Connecticut 06904
Attn: Assistant Treasurer
TELEPHONE: (203) 968-4653
TELECOPIER: (203) 968-3972

13. Effective Date. This Instrument and the resignation, appointment and acceptance effected hereunder shall be effective as of the close of business on the Effective Date.

14. Governing Law. This Instrument shall be governed by and construed in accordance with the laws of the State of New York.

15. Counterparts. This Instrument may be executed in any number of counterparts, each of which shall be an original, but such counterparts shall together constitute one and the same instrument.

[SIGNATURE PAGE FOLLOWS]

IN WITNESS WHEREOF, the parties have executed this Instrument to be effective as of the day and year first above written.

WILMINGTON TRUST COMPANY,
Successor Trustee

By:
Name:
Title:

CITIBANK, N.A.,
Resigning Trustee

By:
Name:
Title:

XEROX CORPORATION,
Company

By:
Name:
Title:

INSTRUMENT OF RESIGNATION, APPOINTMENT AND ACCEPTANCE

THIS INSTRUMENT OF RESIGNATION, APPOINTMENT AND ACCEPTANCE, ("Instrument"), dated and effective as of February 1, 2001 (the "Effective Date"), among XEROX CORPORATION, a corporation organized under the laws of the State of New York (the "Company," and in its capacity as guarantor under the Indenture referred to below, the "Guarantor"), XEROX OVERSEAS HOLDINGS LIMITED, formerly known as Xerox Overseas Holdings PLC, a limited liability company organized under the laws of England and Wales ("Xerox Overseas"), XEROX CAPITAL (EUROPE) PLC, formerly known as Rank Xerox Capital (Europe) PLC, a public limited company organized under the laws of England and Wales ("Xerox Capital," and together with Xerox Overseas, the "Subsidiary Issuers," and each a "Subsidiary Issuer"), CITIBANK, N.A., a national banking association organized under the laws of the United States of America (the "Resigning Trustee"), and WILMINGTON TRUST COMPANY, a banking corporation organized under the laws of the State of Delaware (the "Successor Trustee"). The Company together with the Subsidiary Issuers, each in its capacity as an issuer of securities under the Indenture referred to below, are referred to herein as an "Issuer," and collectively the "Issuers." Capitalized terms not otherwise defined herein shall have the same meaning ascribed to such terms in the Indenture as referred to below.

RECITALS

WHEREAS, pursuant to an Indenture, dated as of October 21, 1997 (the "Indenture"), among the Issuers, the Guarantor and the Resigning Trustee, Xerox Capital issued its \$500,000,000 5.75% Notes Due May 15, 2002 (Cusip 98411MAB4), its \$500,000,000 5.875% Notes due May 15, 2004 (Cusip 98411MAA6) and its \$25,000,000 Medium Term Notes, Series E due April 24, 2008 (Cusip 98411PAA9); and Xerox issued its \$600,000,000 5.5% Notes due November 15, 2003 (Cusip 984121AW3), its Medium Term Notes, Series E (Base Cusip 98412J) and its Medium Term Notes, Series F (Base Cusip 98412J) (collectively all such issued notes, the "Securities");

WHEREAS, the Issuers appointed the Resigning Trustee as the trustee under the Indenture and in its capacity as the paying agent and registrar (in each such capacity, the "Paying Agent") of all Securities issued under the Indenture;

WHEREAS, there is presently issued and outstanding \$2,400,000,000 in aggregate principal amount of the Securities;

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WHEREAS, the Indenture provides that the trustee may resign at any time with respect to any series of Securities and be discharged from the trusts created by the Indenture by notifying the Issuer of any and all such Securities and the Guarantor in writing;

WHEREAS, the Indenture further provides that if the trustee resigns with respect to any Securities, the Issuer of the applicable series of Securities and the Guarantor, by or pursuant to a Board Resolution, shall promptly appoint a successor Trustee with respect to such applicable series of Securities;

WHEREAS, the Resigning Trustee desires to resign as the trustee with respect to all Securities issued pursuant to the Indenture, and the Issuers and the Guarantor desire to appoint the Successor Trustee as trustee to succeed the Resigning Trustee as the trustee with respect to the Securities;

WHEREAS, the Resigning Trustee will remain Paying Agent with respect to the Securities; the Calculation Agent pursuant to the Interest Calculation Agency Agreement, dated as of October 21, 1997, among the Issuers and the Resigning Trustee; and the Exchange Agent pursuant to the Exchange Rate Agent Agreement, dated as of October 21, 1997, among the Issuers and the Resigning Trustee; and

WHEREAS, the Successor Trustee is willing to accept the appointment as trustee under the Indenture.

NOW, THEREFORE, in consideration of the covenants set forth herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

1. Acceptance of Resignation of Resigning Trustee and Appointment of Successor Trustee. The Issuers and Guarantor having received written notice of the Resigning Trustee's request to resign as trustee pursuant to Section 8.07(b) of the Indenture, hereby accept the resignation of the Resigning Trustee as trustee under the Indenture. Pursuant to Section 8.07(e) of the Indenture, the Issuers and Guarantor acting pursuant to Board Resolution hereby appoint the Successor Trustee as trustee under the Indenture, and vest and confirm to the Successor Trustee all rights, powers, trusts, privileges, duties and obligations of the trustee under the Indenture.

2. Issuers' and Guarantor's Representations and Warranties. Each Issuer and the Guarantor, as applicable, hereby represent and warrant to the Successor Trustee that:

a. It is duly organized and validly existing and in good standing under all applicable law, and, this Instrument has been duly authorized, executed and delivered on its behalf and constitutes its legal, valid, binding and enforceable obligation;

b. It has not entered into any amendment or supplement to the Indenture, and the Indenture is in full force and effect;

c. No Event of Default and no default exists under the Indenture;

d. No covenant or condition contained in the Indenture has been waived by the Holders of a percentage in aggregate principal amount of the Securities required by the Indenture to effect any such waiver;

e. The Indenture was validly executed and delivered by it, and the Securities are validly issued securities of the Issuer; and

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f. The execution and delivery of this Instrument do not and will not conflict with, or result in a breach of, any of the terms or provisions of, or constitute a default under, any (i) contract, agreement, indenture or other instrument (including, without limitation, its certificate of incorporation, by-laws and/or any and all other applicable organizational documents) to which it is a party or by which it or its property is bound, or (ii) any judgment, decree or order of any court or governmental agency or regulatory body or law, rule or regulation applicable to it or its property.

3. Resigning Trustee's Representations and Warranties. The Resigning Trustee hereby represents and warrants to the Successor Trustee that:

a. It has not entered into any amendment or supplement to the Indenture and the Indenture is in full force and effect;

b. No covenant or condition contained in the Indenture has been waived by the Resigning Trustee or by the Holders of a percentage in aggregate principal amount of the Securities required by the Indenture to effect any such waiver;

c. There is no action, suit or proceeding pending or threatened against the Resigning Trustee of which it has actual knowledge before any court or governmental authority arising out of any action or omission by the Resigning Trustee as trustee under the Indenture;

d. It has made, or promptly will make, available to the Successor Trustee originals, if available, or copies in its possession, of all documents relating to the trusts created by the Indenture (the "Trusts") and all information in the possession of its corporate trust administration department relating to the administration and status of the Trusts and shall do such other things as the Successor Trustee may reasonably request to more fully vest and confirm in the Successor Trustee all the rights, powers, trusts, privileges, duties and obligations assigned and transferred hereby to the Successor Trustee;

e. It has lawfully discharged its duties as trustee under the Indenture;

f. Pursuant to Section 3.03 of the Indenture, it duly authenticated and delivered the Securities in an aggregate principal face amount of \$2,400,000,000 and there is currently issued and outstanding \$2,400,000,000 in aggregate principal amount of the Securities;

g. As of the Effective Date, it holds no property or money in its capacity as trustee under the Indenture; and

h. This Instrument has been duly authorized, executed and delivered on behalf of the Resigning Trustee and constitutes its legal, valid, binding and enforceable obligation.

4. Successor Trustee's Representations and Warranties. The Successor Trustee represents and warrants to the Resigning Trustee, the Issuers and the Guarantor that:

a. It is qualified and eligible to serve as trustee under the Indenture and the Trust Indenture Act of 1939, as amended (the "Act"); and

b. This Instrument has been duly authorized, executed and delivered on behalf of the Successor Trustee and constitutes its legal, valid, binding and enforceable obligation.

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5. Acceptance by Successor Trustee. The Successor Trustee hereby accepts its appointment, as of the Effective Date, as successor trustee under the Indenture, and assumes, as of the Effective Date, all rights, powers, trusts, privileges, duties and obligations of the trustee thereunder, subject to the terms and conditions therein.

6. Notice to Holders. Promptly after the Effective Date of this Instrument, the applicable Issuer shall give notice in accordance with Section 8.07(f) of the Indenture of the resignation of the Resigning Trustee and the appointment of the Successor Trustee.

7. Assignment by Resigning Trustee. The Resigning Trustee hereby confirms, assigns, transfers, delivers and conveys, as of the Effective Date, to the Successor Trustee, as successor trustee under the Indenture, upon the Trusts expressed in the Indenture, all rights, powers, trusts, privileges, duties and obligations, which the Resigning Trustee, as trustee now holds under and by virtue of the Indenture, and shall pay over to the Successor Trustee, any and all property and moneys held by the Resigning Trustee under and by virtue of the Indenture, subject to the lien provided by Section 8.05 of the Indenture, which lien the Resigning Trustee expressly reserves to the fullest extent necessary to secure the Issuers' and the Guarantor's obligations under said section to the Resigning Trustee, which lien shall also secure the Issuers' and the Guarantor's

obligations under said section to the Successor Trustee. Notwithstanding any other provision in this Instrument, the Resigning Trustee shall continue to act as Paying Agent under the Indenture to the extent that the Resigning Trustee acts as Paying Agent under any series of Securities, and the Successor Trustee assumes none of the obligations or duties of the Paying Agent in the Indenture.

8. Indemnification

a. The parties to this Instrument agree that this Instrument does not constitute an assumption by the Successor Trustee of any liability of the Resigning Trustee arising out of any breach by the Resigning Trustee in the performance of its duties as trustee under the Indenture.

b. The Company, Xerox Capital and Xerox Overseas agree jointly and severally to pay or indemnify, as applicable, the Successor Trustee and save the Successor Trustee harmless from and against any and all costs, claims, liabilities, losses or damages whatsoever (including the reasonable fees, expenses and disbursements of the Successor Trustee's legal counsel and other advisors) arising out of the actual, alleged or adjudicated actions or omissions of the Resigning Trustee that the Successor Trustee may suffer or incur as a result of the Successor Trustee accepting this appointment and acting as successor trustee under the Indenture. The Successor Trustee will furnish to the Company, promptly upon receipt, all documents with respect to any action the outcome of which would make the indemnity provided for in this paragraph operative. The Successor Trustee shall notify the Company in writing of any claim for which it may seek indemnity.

c. As security for the performance of the obligations of the Issuers and the Guarantor under this Section 8 and under Section 8.05 of the Indenture, the Successor Trustee shall have a lien prior to the Securities of such Issuer upon all property and funds held or collected in respect of such Securities of such Issuer by the Trustee as such.

9. Further Assurances. The Issuers, the Guarantor and the Resigning Trustee, for the purposes of more fully and certainly vesting in and confirming to the Successor Trustee, as successor trustee under the Indenture, said rights, powers, trusts, privileges, duties and obligations agrees, upon reasonable

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request of the Successor Trustee, to execute, acknowledge and deliver such further instruments of conveyance and further assurance and to do such other things as may reasonably be required for more fully and certainly vesting and confirming to the Successor Trustee all rights, powers, trusts, privileges, duties and obligations which the Resigning Trustee now holds under and by virtue of the Indenture.

10. Survival of Certain Obligations of the Company. Notwithstanding the resignation of the Resigning Trustee, the Issuers and the Guarantor shall remain obligated under the Indenture to compensate, reimburse and indemnify the Resigning Trustee in connection with its trusteeship under the Indenture, and nothing contained in this Instrument shall in any way abrogate the obligations of the Issuers or the Guarantor to the Resigning Trustee under the Indenture or any lien created in favor of the Resigning Trustee thereunder.

11. Corporate Trust Office. Reference in the Indenture to the "Corporate Trust Office" of the Resigning Trustee or other similar terms shall be deemed to refer to the Corporate Trust Office of the Successor Trustee at Rodney Square North, 1100 North Market Street, Wilmington, Delaware 19890 or any other office of the Successor Trustee at which, at any particular time, its corporate trust business shall be principally administered.

12. Notices. All notices, whether faxed or mailed will be deemed received when sent pursuant to the following instructions:

TO THE SUCCESSOR TRUSTEE:
WILMINGTON TRUST COMPANY
Attn: Corporate Trust Administration
Rodney Square North
1100 North Market Street
Wilmington, Delaware 19890
TELEPHONE: (302) 651-1343
TELECOPIER: (302) 651-8882

TO THE RESIGNING TRUSTEE:
CITIBANK, N.A.
111Wall Street, 14th Floor
New York, New York 10005
TELEPHONE: (212) 657-7805
TELECOPIER: (212) 657-4009

TO THE COMPANY:
XEROX CORPORATION
800 Long Ridge Road
Stamford, Connecticut 06904
Attn: Assistant Treasurer
TELEPHONE: (203) 968-4653
TELECOPIER: (203) 968-3972

TO XEROX OVERSEAS:
XEROX OVERSEAS HOLDINGS LIMITED
Bridge House, Oxford Road
Uxbridge, Middlesex UB8 1HS,
United Kingdom
TELEPHONE: 011 44(0) 1895 251133
TELECOPIER: 011 44(0) 1895 845472

(with a copy to the Company)

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TO XEROX CAPITAL:
XEROX CAPITAL (EUROPE) PLC
Bridge House, Oxford Road
Uxbridge, Middlesex UB8 1HS,
United Kingdom
TELEPHONE: 011 44(0) 1895 251133
TELECOPIER: 011 44(0) 1895 845472

(with a copy to the Company)

13. Effective Date. This Instrument and the resignation, appointment and acceptance effected hereunder shall be effective as of the close of business on the Effective Date.

14. Governing Law. This Instrument shall be governed by and construed in accordance with the laws of the State of New York.

15. Counterparts. This Instrument may be executed in any number of counterparts, each of which shall be an original, but such counterparts shall together constitute one and the same instrument.

IN WITNESS WHEREOF, the parties have executed this Instrument to be effective as of the day and year first above written.

WILMINGTON TRUST COMPANY,
Successor Trustee

By: _____
Name:
Title:

CITIBANK, N.A.,
Resigning Trustee

By: _____
Name:
Title:

XEROX CORPORATION,
Company

By: _____
Name:
Title:

XEROX OVERSEAS HOLDINGS LIMITED,
Issuer

By: _____
Name:
Title:

XEROX (CAPITAL) EUROPE PLC,
Issuer

By: _____
Name:
Title:

INSTRUMENT OF RESIGNATION, APPOINTMENT AND ACCEPTANCE

THIS INSTRUMENT OF RESIGNATION, APPOINTMENT AND ACCEPTANCE, ("instrument"), dated and effective as of February 1, 2001 (the "Effective Date"), among XEROX CREDIT CORPORATION, a corporation organized under the laws of the State of Delaware (the "Company"), CITIBANK, N.A., a national banking association organized under the laws of the United States of America (the "Resigning Trustee"), and WILMINGTON TRUST COMPANY, a banking corporation organized under the laws of the State of Delaware (the "Successor Trustee"). Capitalized terms not otherwise defined herein shall have the same meaning ascribed to such terms in the Indenture as referred to below.

RECITALS

WHEREAS, pursuant to an Indenture, dated as of April 1, 1999 (the "Indenture"), between the Company and the Resigning Trustee, the Company issued its \$300,000,000 Medium Term Notes, Series G due November 1, 2001 (Cusip 983917BT1) (the "Securities");

WHEREAS, the Company appointed the Resigning Trustee as the trustee under the Indenture and in its capacity as the paying agent and registrar (in each such capacity, the "Paying Agent") of all Securities issued under the Indenture;

WHEREAS, there is presently issued and outstanding \$300,000,000 in aggregate principal amount of the Securities;

WHEREAS, the Indenture provides that the trustee may resign at any time with respect to any series of Securities and be discharged from the trusts created by the Indenture by notifying the Company in writing;

WHEREAS, the Indenture further provides that if the trustee resigns with respect to any series of Securities, the Company, by or pursuant to a Board Resolution, shall promptly appoint a successor Trustee with respect to such applicable series of Securities;

WHEREAS, the Resigning Trustee desires to resign as the trustee with respect to all Securities issued pursuant to the Indenture, and the Company desires to appoint the Successor Trustee as trustee to succeed the Resigning Trustee as the trustee with respect to the Securities;

WHEREAS, the Resigning Trustee will remain Paying Agent with respect to the Securities; and

WHEREAS, the Successor Trustee is willing to accept the appointment as trustee under the Indenture.

NOW, THEREFORE, in consideration of the covenants set forth herein and

other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

1. Acceptance of Resignation of Resigning Trustee and Appointment of Successor Trustee. The Company having received written notice of the Resigning Trustee's request to resign as trustee pursuant to Section 8.07(b) of the Indenture, hereby accepts the resignation of the Resigning Trustee as trustee under the Indenture. Pursuant to Section 8.07(e) of the Indenture, the Company acting pursuant to Board Resolution hereby appoints the Successor Trustee as trustee under the Indenture, and vests and confirms to the Successor Trustee all rights, powers, trusts, privileges, duties and obligations of the trustee under the Indenture.

2. Company's Representations and Warranties. The Company hereby represents and warrants to the Successor Trustee that:

- a. It is duly organized and validly existing and in good standing under all applicable law, and, this Instrument has been duly authorized, executed and delivered on its behalf and constitutes its legal, valid, binding and enforceable obligation;
- b. It has not entered into any amendment or supplement to the Indenture, and the Indenture is in full force and effect;
- c. No Event of Default and no default exists under the Indenture;
- d. No covenant or condition contained in the Indenture has been waived by the Holders of a percentage in aggregate principal amount of the Securities required by the Indenture to effect any such waiver;
- e. The Indenture was validly executed and delivered by it, and the Securities are validly issued securities of the Company; and
- f. The execution and delivery of this Instrument do not and will not conflict with, or result in a breach of, any of the terms or provisions of, or constitute a default under, any (i) contract, agreement, indenture or other instrument (including, without limitation, its certificate of incorporation, by-laws and/or any and all other applicable organizational documents) to which it is a party or by which it or its property is bound, or (ii) any judgment, decree or order of any court or governmental agency or regulatory body or law, rule or regulation applicable to it or its property.

3. Resigning Trustee's Representations and Warranties. The Resigning Trustee hereby represents and warrants to the Successor Trustee that:

- a. It has not entered into any amendment or supplement to the Indenture and the Indenture is in full force and effect;
- b. No covenant or condition contained in the Indenture has been waived by the Resigning Trustee or by the Holders of a percentage in aggregate principal amount of the Securities required by the Indenture to effect any such waiver;
- c. There is no action, suit or proceeding pending or threatened against the Resigning Trustee of which it has actual knowledge before any court or governmental authority arising out of any action or omission by the

Resigning Trustee as trustee under the Indenture;

- d. It has made, or promptly will make, available to the Successor Trustee originals, if available, or copies in its possession, of all documents relating to the trusts created by the Indenture (the "Trusts") and all information in the possession of its corporate trust administration department relating to the administration and status of the Trusts and shall do such other things as the Successor Trustee may reasonably request to more fully vest and confirm in the Successor Trustee all the rights, powers, trusts, privileges, duties and obligations assigned and transferred hereby to the Successor Trustee;
- e. It has lawfully discharged its duties as trustee under the Indenture;
- f. Pursuant to Section 3.03 of the Indenture, it duly authenticated and delivered the Securities in an aggregate principal face amount of \$300,000,000 and there is currently issued and outstanding \$300,000,000 in aggregate principal amount of the Securities;
- g. As of the Effective Date, it holds no property or money in its capacity

as trustee under the Indenture; and

h. This Instrument has been duly authorized, executed and delivered on behalf of the Resigning Trustee and constitutes its legal, valid, binding and enforceable obligation.

4. Successor Trustee's Representations and Warranties. The Successor Trustee represents and warrants to the Resigning Trustee and the Company that:

a. It is qualified and eligible to serve as trustee under the Indenture and the Trust Indenture Act of 1939, as amended (the "Act"); and

b. This Instrument has been duly authorized, executed and delivered on behalf of the Successor Trustee and constitutes its legal, valid, binding and enforceable obligation.

5. Acceptance by Successor Trustee. The Successor Trustee hereby accepts its appointment, as of the Effective Date, as successor trustee under the Indenture, and assumes, as of the Effective Date, all rights, powers, trusts, privileges, duties and obligations of the trustee thereunder, subject to the terms and conditions therein.

6. Notice to Holders. Promptly after the Effective Date of this Instrument, the Company shall give notice in accordance with Section 8.07(f) of the Indenture of the resignation of the Resigning Trustee and the appointment of the Successor Trustee.

7. Assignment by Resigning Trustee. The Resigning Trustee hereby confirms, assigns, transfers, delivers and conveys, as of the Effective Date, to the Successor Trustee, as successor trustee under the Indenture, upon the Trusts expressed in the Indenture, all rights, powers, trusts, privileges, duties and obligations, which the Resigning Trustee, as trustee now holds under and by virtue of the Indenture, and shall pay over to the Successor Trustee, any and all property and moneys held by the Resigning Trustee under and by virtue of the Indenture, subject to the lien provided by Section 8.05 of the Indenture, which lien the Resigning Trustee expressly reserves to the fullest extent necessary to secure the Company's obligations under said

section to the Resigning Trustee, which lien shall also secure the Company's obligations under said section to the Successor Trustee. Notwithstanding any other provision in this Instrument, the Resigning Trustee shall continue to act as Paying Agent under the Indenture to the extent that the Resigning Trustee acts as Paying Agent under any series of Securities, and the Successor Trustee assumes none of the obligations or duties of the Paying Agent in the Indenture.

8. Indemnification

a. The parties to this Instrument agree that this Instrument does not constitute an assumption by the Successor Trustee of any liability of the Resigning Trustee arising out of any breach by the Resigning Trustee in the performance of its duties as trustee under the Indenture.

b. The Company agrees to pay or indemnify, as applicable, the Successor Trustee and save the Successor Trustee harmless from and against any and all costs, claims, liabilities, losses or damages whatsoever (including the reasonable fees, expenses and disbursements of the Successor Trustee's legal counsel and other advisors) arising out of the actual, alleged or adjudicated actions or omissions of the Resigning Trustee that the Successor Trustee may suffer or incur as a result of the Successor Trustee accepting this appointment and acting as successor trustee under the Indenture. The Successor Trustee will furnish to the Company, promptly upon receipt, all documents with respect to any action the outcome of which would make the indemnity provided for in this paragraph operative. The Successor Trustee shall notify the Company in writing of any claim for which it may seek indemnity.

c. As security for the performance of the obligations of the Company under this Section 8 and under Section 8.05 of the Indenture, the Successor Trustee shall have a lien prior to the Securities upon all property and funds held or collected by the Trustee as such.

9. Further Assurances. The Company and the Resigning Trustee, for the purposes of more fully and certainly vesting in and confirming to the Successor Trustee, as successor trustee under the Indenture, said rights, powers, trusts, privileges, duties and obligations, agree upon reasonable request of the Successor Trustee, to execute, acknowledge and deliver such further instruments of conveyance and further assurance and to do such other things as may reasonably be required for more fully and certainly vesting and confirming to the Successor Trustee all rights, powers, trusts, privileges, duties and obligations which the Resigning Trustee now holds under and by virtue of the Indenture.

10. Survival of Certain Obligations of the Company. Notwithstanding the resignation of the Resigning Trustee, the Company shall remain obligated under the Indenture to compensate, reimburse and indemnify the Resigning Trustee in connection with its trusteeship under the Indenture, and nothing contained in this Instrument shall in any way abrogate the obligations of the Company to the Resigning Trustee under the Indenture or any lien created in favor of the Resigning Trustee thereunder.

11. Corporate Trust Office. Reference in the Indenture to the "Corporate Trust Office" of the Resigning Trustee or other similar terms shall be deemed to refer to the Corporate Trust Office of the Successor Trustee at Rodney Square North, 1100 North Market Street, Wilmington, Delaware 19890 or

any other office of the Successor Trustee at which, at any particular time, its corporate trust business shall be principally administered.

12. Notices. All notices, whether faxed or mailed will be deemed received when sent pursuant to the following instructions:

TO THE SUCCESSOR TRUSTEE:

WILMINGTON TRUST COMPANY
Attn: Corporate Trust Administration
Rodney Square North
1100 North Market Street
Wilmington, Delaware 19890
TELEPHONE: (302) 651-1343
TELECOPIER: (302) 651-8882

TO THE RESIGNING TRUSTEE:

CITIBANK, N.A.
111 Wall Street, 14th Floor
New York, New York 10005
TELEPHONE: (212) 657-7805
TELECOPIER: (212) 657-4009

TO THE COMPANY:

XEROX CREDIT CORPORATION
800 Long Ridge Road
Stamford, Connecticut 06904
Attn: Assistant Treasurer
TELEPHONE: (203) 968-4653
TELECOPIER: (203) 968-3972

13. Effective Date. This Instrument and the resignation, appointment and acceptance effected hereunder shall be effective as of the close of business on the Effective Date.

14. Governing Law. This Instrument shall be governed by and construed in accordance with the laws of the State of New York.

15. Counterparts. This Instrument may be executed in any number of counterparts, each of which shall be an original, but such counterparts shall together constitute one and the same instrument.

[SIGNATURE PAGE FOLLOWS]

IN WITNESS WHEREOF, the parties have executed this Instrument to be effective as of the day and year first above written.

WILMINGTON TRUST COMPANY,
Successor Trustee

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. In addition, (a) any shares of Common Stock which as of the effective date of the Plan are reserved for issuance under the company's 1976 Executive Long-Term Incentive Plan the "1976 Plan" and which are not thereafter issued and (b) any shares of Common Stock available for issuance under the Plan in previous years but not actually issued, shall be added to the aggregate number of shares of common Stock available for issuance in that calendar year 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) fifteen million (15,000,000) shares of Common Stock be available for issuance pursuant to the exercise of incentive stock options ("ISOs") awarded under the Plan(1); (b) thirteen million seven hundred ninety six thousand one hundred eighty-one (13,796,181) shares of Common Stock shall be available for issuance pursuant to stock awards granted under Section 7(c) of the Plan(1) ;and (c) five million (5,000,000) 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 May 23, 1996

(2) Effective May 15, 1997

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 is 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.

Annual Performance Incentive Plan

Under the Annual Performance Incentive Plan (APIP), executive officers of the Company may be entitled to receive performance related cash payments provided that performance thresholds, established annually by the Executive Compensation and Benefits Committee, are met. At the beginning of the year, the Committee approves for each officer not participating in the Executive Performance Incentive Plan, an annual incentive target and maximum opportunity expressed as a percentage of annual base salary. The Committee also establishes overall threshold, target and maximum measures of performance and associated payment schedules. For 2000, the performance measures were earnings per share (35%), revenue growth (25%), cash conversion cycle (20%) and customer satisfaction (20%). Additional goals are also established for each officer that include business unit specific and/or individual performance goals and objectives. The weights associated with each business unit specific or individual performance goal and objective used vary and range from 20 percent to 50 percent of the total. Actual performance payments to corporate officers are subject to approval by the Committee following the end of the year. As a result of the Company's performance during 2000, no cash bonuses under APIP were paid to officers with respect to 2000 performance.

As amended by Board of Directors through 10/9/00

1997 Restatement

of

XEROX CORPORATION

UNFUNDED RETIREMENT INCOME GUARANTEE PLAN

XEROX CORPORATION, a New York corporation having its principal executive office in the City of Stamford, County of Fairfield and State of Connecticut, hereby adopts the XEROX CORPORATION UNFUNDED RETIREMENT INCOME GUARANTEE PLAN effective on the Effective Date as follows:

Restatement October 13, 1997

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XEROX CORPORATION

UNFUNDED RETIREMENT INCOME GUARANTEE PLAN

ARTICLE 1

Definitions

When used herein, the words and phrases defined hereinafter shall have the following meaning unless a different meaning is clearly required by the context of the Plan. Terms used herein which are defined in Article 1 of the Funded Plan shall have the meanings assigned to them in the Funded Plan.

Section 1.1. Administrator. The Administrator appointed by the Vice President, Human Resources of the Company

Section 1.2. Average Monthly Compensation. Shall be determined under Article 1 of the Funded Plan, without regard to the dollar limitation contained therein; and, notwithstanding the above, shall also include any compensation provided under the Xerox Corporation CEO Challenge Bonus Program.

Section 1.3. Board. The Board of Directors of the Company.

Section 1.4. Code. The Internal Revenue Code of 1986 as amended, or as it may be amended from time to time.

Section 1.5. Company. Xerox Corporation.

Section 1.6. Effective Date. The original effective date of the Plan was July 1, 1977. This Restatement is effective as of October 13, 1997.

Section 1.7. Employee. A Member in the Funded Plan.

Section 1.8. Funded Plan. The Xerox Corporation Retirement Income Guarantee Plan.

Section 1.9. Plan. The "Xerox Corporation Unfunded Retirement Income Guarantee Plan", as set forth herein or in any amendment hereto.

ARTICLE 2

Purpose of Plan

Section 2.1. Purpose. The Plan is designed to provide retirement benefits payable out of the general assets of the Company as provided in Section 4.1.

ARTICLE 3

Eligibility

Section 3.1. Eligibility. All Employees and beneficiaries of Employees eligible to receive benefits from the Funded Plan shall be eligible to receive benefits under this Plan in accordance with Section 4.1 regardless of when the Employees may have retired.

ARTICLE 4

Benefits

Section 4.1. Amount of Benefits. The amount of the benefit payable under the Plan shall be equal to the monthly benefit which would be payable to or on behalf of an Employee under the Funded Plan as a Life Annuity if Section 9.5 of the Funded Plan were inapplicable and if the amount of any compensation deferred by the Employee was included in the calculation of Average Monthly Compensation (except the increase in compensation which became payable under the Company's policy of increasing compensation by the amount which cannot be added to an Employee's accounts under the Profit Sharing Plan by reason of the limitation contained in Section 415 of the Code), less the following:

(a) The monthly benefit actually payable as a Life Annuity to or on behalf of the Employee under the Funded Plan other than the RIGP Plus Benefit payable under Article 17 thereof.

(b) The monthly benefit which could be purchased as a Life Annuity with the balance, if any, in the Employee's deferred compensation account under the Xerox Corporation Deferred Compensation Plan For Executives arising from the Retirement Account portion of the Profit Sharing Adjustment under Section 4 thereof.

(c) Any amount paid to the Employee from which FICA taxes are withheld related to nonqualified retirement benefits from a plan sponsored by the Company which have not been previously withheld (or deemed to be withheld because the

maximum tax had already been paid) and are payable upon retirement but cannot be withheld from any single sum payment of compensation or other nonqualified plan benefits translated to an annuity (single life or joint and survivor as appropriate) payable commencing on the date of retirement.

(d) The amount of that certain provisional supplement provided to certain high-paid Employees in RIGP effective in 1989 when the RIGP benefit was modified payable to Employees in a lump sum translated to an annuity (single life or joint and survivor as appropriate) payable commencing on the date of retirement.

Section 4.1A Additional Benefit. In addition to the benefit provided by the foregoing provisions of Section 4.1, there shall be an additional benefit equal to the excess of (a) over (b) where (a) is the RIGP Plus Benefit which would be payable under Article 17 of the Funded Plan as if "Annual Pay", as defined in Article 17 of the Funded Plan, had been calculated without regard

to the applicable limitations of the "Code" as defined in the Funded Plan and to include deferred compensation to the extent not already included and (b) is the RIGP Plus Benefit calculated under Article 17 of the Funded Plan subject to such Code limitations. Notwithstanding any provision of this Plan to the contrary, the benefit under this Section 4.1A shall be payable in cash in a lump sum. Such benefit shall be paid at the time specified in Section 4.4. If payment is not made at or about termination of employment, the Administrator may, in his or her discretion, determine to increase the amount of the additional benefit at the CBRA interest rate (within the meaning of the Funded Plan) for the period between termination and payout hereunder.

Section 4.2. Form of Benefit Payments. The forms of benefit available under the Plan shall be for single Employees a 10-Year certain and life annuity or a life annuity and for married Employees a 50% or 100% joint and survivor annuity option, all as shall have been elected by Employee on forms provided by the Administrator. The benefit payable to a single Employee who has failed to make such an election shall be a life annuity and for any such married Employee a 50% joint and survivor annuity. The 10-year certain and life annuity is the actuarial equivalent of the life annuity and the 100% joint and survivor annuity is the actuarial equivalent of the 50% joint and survivor annuity. Except as otherwise provided in Section 5.1 in no event is the benefit payable in a lump sum.

Notwithstanding the above, the lump sum actuarial equivalent of any benefit otherwise payable as a monthly amount of one hundred dollars (\$100.00) or less, shall be distributed in accordance with Section 4.3. The interest rate used in computing the lump sum actuarial equivalent amount shall be the interest rate described in the section entitled "Optional Forms of Benefit Payment" of the Funded Plan.

Section 4.3 Death Prior to Benefit Commencement. The spouse of a Participant who dies before commencement of benefits under the Plan shall be entitled to a survivor benefit calculated in accordance with Article 7 of the Funded Plan in an amount equal to the amount determined under (a) or (b) below.

(a) In the case of a Participant who is eligible to retire under the Funded Plan on the date of his or her death, one-half of the retirement benefit to which the Participant would have been entitled under the Plan if he or she had retired on the last day of the month coincident with or next following the date of the Participant's death; or

(b) In the case of a Participant who is not eligible to retire under the Funded Plan on the date of his or her death, one-half of the retirement benefit to which the Participant would have been entitled under the Plan if he or she had terminated on his or her date of death and survived to the date of payment of benefits as determined under Section 4.4 below.

Section 4.4. Time of Benefit Payments. Benefits due under the Plan shall be paid coincident with the payment date of benefits under the Funded Plan or at such other time or times as the Administrator in his discretion determines.

Section 4.5. Employee's Rights Unsecured. The benefits payable under this Plan shall be unfunded. Consequently, no assets shall be segregated for purposes of this Plan and placed beyond the reach of the Company's general creditors. The right of any Employee to receive benefits under the provisions

of the Plan shall be an unsecured claim against the general assets of the Company.

ARTICLE 5

Change in Control

Section 5.1. Change In Control. Notwithstanding anything to the contrary in this Plan, in the event of a change in control of the Company, as hereinafter defined, each Employee, including retired Employees, shall be entitled to a benefit hereunder without regard to his or her age or Years of Service at the time of such change in control. Upon the occurrence of a change in control of the Company, the benefit of each Employee shall be payable in a lump sum within 30 days of such change in control equal in amount to the then present value of a benefit expressed in the form provided in Section 4.1 hereof, commencing on the later of (i) the date of such change in control and (ii) the date the Employee would be eligible for a benefit under the Funded Plan, and based upon such Employee's Average Monthly Compensation and Years of Participation as of the date of such change in control. A "change in control of the Company" shall have the meaning set forth in the Xerox Corporation Retirement Income Guarantee Plan, as may be amended or restated from time to time.

Section 5.2. Termination of Employment Following Change in Control. Upon the termination of employment of a Employee following a change in control of the Company, such Employee, if he or she has otherwise satisfied the requirements of the Funded Plan for a benefit, shall be entitled to a benefit equal to the benefit to which he or she would have been entitled without application of Section 5.1, reduced (but not below zero) to reflect the value of the benefit he or she received pursuant to Section 5.1.

Section 5.3. Calculation of Present Value. For purposes of Section 5.1 hereof, the present value of a benefit shall be calculated based upon the interest rate which would be used by the Pension Benefit Guaranty Corporation for purposes of determining lump sums for benefits payable as immediate annuities with respect to plans terminating on the date on which the change in control of the Company occurs and the 1983 GAM mortality table, provided, however, that effective upon the date that the applicable interest rate as specified in Section 417(e)(3)(A) of the Code is adopted for use in the Funded Plan, the present value hereunder shall thereafter be determined under such applicable interest rate and the applicable mortality table as defined in Section 417(e)(3)(A)(ii)(1) of the Code. For purposes of the Funded Plan, each Employee shall be treated as if they terminated employment upon the change in control and had their benefits determined as if they were to begin receiving benefits on the commencement date used in developing the present value of the benefit in Section 5.1.

ARTICLE 6

Administration

Section 6.1. Duties of Administrator. The Plan shall be administered by the Administrator in accordance with its terms and purposes. The Administrator shall determine the amount and manner of payment of the benefits due to or on behalf of each Employee from the Plan and shall cause them to be paid by the Company accordingly.

Section 6.2. Finality of Decisions. The decisions made by and the actions taken by the Administrator in the administration of the Plan shall be final and

conclusive on all persons, and the Administrator shall not be subject to individual liability with respect to the Plan.

ARTICLE 7

Amendment and Termination

Section 7.1. Amendment and Termination. It is the intention of the Company to continue the Plan indefinitely. The Company expressly reserves the right to amend the Plan at any time and in any particular manner, provided that any such amendment shall be made in accordance with ERISA. Such amendments, other than amendments relating to termination of the Plan or relating to benefit levels under Section 4.1 of the Plan, may be effected by (i) the Board of Directors, (ii) a duly constituted committee of the Board of Directors, or (iii) the Vice President of the Company responsible for human resources or a representative thereof. In the event such office is vacant at the time the amendment is to be made, the Chief Executive Officer of the Company shall approve such amendment or appoint a representative. Amendments relating to termination of the Plan or relating to benefit levels under Section 4.1 of the Plan shall be effected pursuant to a resolution duly adopted by the Board of Directors of the Company, or a duly constituted committee of the Board of Directors of the Company, in accordance with the Business Corporation Law of the State of New York.

Any amendment, alteration, modification or suspension under subsection (iii) of the preceding paragraph shall be set forth in a written instrument executed by any Vice President of the Company and by the Secretary or an Assistant Secretary of the Company

Section 7.2. Contractual Obligation. Notwithstanding Section 7.1, the Company hereby makes a contractual commitment to pay the benefits accrued under the Plan to the extent it is financially capable of meeting such obligations.

ARTICLE 8

Miscellaneous

Section 8.1. No Employment Rights. Nothing contained in the Plan shall be construed as a contract of employment between the Company and an Employee, or as a right of any Employee to be continued in the employment of the Company, or as a limitation of the right of the Company to discharge any of its Employees, with or without cause.

Section 8.2. Assignment. The benefits payable under this Plan may not be assigned or alienated except as may otherwise be required by law or pursuant to the terms of a domestic relations order that has been approved by the Plan Administrator.

Section 8.3. Law Applicable. This Plan shall be governed by the laws of the State of New York.

As amended by the Board of
Directors through 10/9/00

1997 Restatement

of

XEROX CORPORATION

UNFUNDED SUPPLEMENTAL RETIREMENT PLAN

XEROX CORPORATION, a New York corporation having its principal executive office in the City of Stamford, County of Fairfield and State of Connecticut, hereby adopts the XEROX CORPORATION UNFUNDED SUPPLEMENTAL RETIREMENT PLAN effective on the Effective Date as follows:

Restatement October 13, 1997

XEROX CORPORATION

UNFUNDED SUPPLEMENTAL RETIREMENT PLAN

Section 1. Plan Name

The plan name is the Xerox Corporation Unfunded Supplemental Retirement Plan (the "Plan").

Section 2. Effective Date

The original effective date of the Plan is June 30, 1982. The Plan was restated on three previous occasions, effective February 4, 1985, January 1, 1990, December 6, 1993 and December 9, 1996. This Restatement is effective as of October 13, 1997.

Section 3. Purpose of the Plan

The Plan is designed to address special circumstances involved in the retirement of executives.

Section 4. Covered Employees

The following employees of Xerox Corporation (the "Company") are covered by the Plan:

A. All employees who were corporate officers of the Company at grade level 25 and above on the original effective date of the Plan (the "Grandfathered Officers").

B. All employees who were corporate officers at grades 23 or 24 on the original effective date of the Plan or who first become corporate officers of the Company at grade level 23 and above after the original effective date of the Plan and do not fall within categories D through G below (the "Officers").

C. Certain employees who received a letter dated September 2, 1982 from David T. Kearns regarding Executive Retirement Guidelines (the "Guideline Employees").

D. All employees who are corporate officers of the Company on the date of

this 1996 Restatement who first commenced employment with the Company on or after attainment of age 40 and whose names appear on Schedule A ("Schedule A") presented at the meeting of the Executive Compensation and Benefits Committee held December 9, 1996 and made part of the records of that meeting which Schedule is incorporated herein by reference and made a part of the Plan ("Grandfathered Mid-Career Officers").

E. All employees who after the date of the 1996 Restatement first commence employment with the Company on or after attainment of age 40 who are elected corporate officers and whose names are added to Schedule A upon selection by the Chief Executive Officer of the Company as maintained with records of the Executive Compensation department of the Company which Schedule as so modified from time to time is incorporated herein by reference and made a part hereof ("Mid-Career Officer Hires").

F. All employees who are in payroll Band A of the Company on the date of the 1996 Restatement who first commenced employment with the Company on or after attainment of age 40 and whose names are set forth on Schedule B ("Schedule B") which has been approved by the Vice President responsible for Human Resources and placed with the records of the Executive Compensation department of the Company which Schedule is incorporated herein by reference and made a part of the Plan ("Grandfathered Mid-Career Band A Employees").

G. All employees who after the date of the 1996 Restatement first commence employment with the Company on or after attainment of age 40 who are hired into payroll Band A selected by the Vice President of the Company responsible for Human Resources, or his or her designee, such selection to be evidenced by the placement of the employee's name on Schedule C to be maintained from time to time by such Vice President or his or her designee, which Schedule is incorporated herein by reference and made a part of the Plan ("Mid-Career Band A Hires")

H. Grandfathered Mid-Career Officers, Mid-Career Officer Hires, Grandfathered Mid-Career Band A Employees and Mid-Career Band A Hires are sometimes together referred to as "Mid-Career Executives".

I. The employees referred to in paragraphs A through G above are together referred to herein as "Participants".

Section 5. Eligibility for Benefits

Participants must have attained the following age and completed the following Years of Service to be eligible for benefits under the Plan:

A. Grandfathered Officers and Guideline Employees -- age 55, Years of Service -- 5.

B. Officers -- age 60, Years of Service -- 10.

C. Grandfathered Mid-Career Officers -- the age set forth opposite their respective names on Schedule A, Years of Service -- 5.

D. Mid-Career Officer Hires -- the age determined by the Chief Executive Officer of the Company as reflected in Schedule A, Years of Service -- 5.

E. Grandfathered Mid-Career Band A Employees -- the age set forth opposite their respective names on the Schedule B, Years of Service -- 5.

F. Mid-Career Band A Hires -- the age determined by the Vice President responsible for Human Resources or his or her delegate as set forth on Schedule C referred to above, Years of Service 5.

Section 6. Supplemental Retirement Benefit

A. The benefit payable under the Plan shall be a monthly retirement

benefit equal to:

One and two-thirds percent of Average Monthly Compensation of the Participant multiplied by the number of full and fractional Years of Participation up to thirty less

(a) One and two-thirds percent of the Social Security Benefit multiplied by the number of full and fractional Years of Participation up to thirty; and

(b) The monthly retirement benefit payable under the Company's Retirement Income Guarantee Plan ("RIGP") (stated as a Life Annuity)* as it is in effect as of and from time to time after January 1, 1990 other than the RIGP Plus Benefit payable under Article 17 thereof; subject to the "Adjustments" set forth in subsections B through F below.

"Average Monthly Compensation" shall be determined under RIGP without regard to the dollar limitation contained in the Plan as required by Section 401(a)(17) of the Internal Revenue Code of 1986, as amended, or any successor thereto; and, notwithstanding the above, shall also include any compensation provided under the Xerox Corporation CEO Challenge Bonus Program.

"Social Security Benefit" shall mean the monthly benefit which a retired Participant or a terminated Participant receives or would be entitled to receive at the age at which unreduced retirement benefits are then paid under the U.S. Social Security Act (or at his sixty-second birthday, in the case of a retired Participant who has at least thirty Years of Service or who, on such Participant's retirement, is the pilot of an airplane operated by the

Company), as a primary insurance amount under the U.S. Social Security Act, as amended, whether he or she applies for such benefit or not, and even though he or she may lose part or all of such benefit for any reason.

The amount of such Social Security Benefit to which the retired or terminated Participant is or would be entitled shall be computed by the Administrator for the purposes of the Plan as of the January 1 of the calendar year of retirement or termination. In computing such amount, the Administrator shall use estimated benefit tables developed by the Plan's actuary, the five-year average compensation of the Participant and the assumption that the Participant's compensation prior to the fifth year preceding the year of termination grew in accordance with average national wages.

B. Grandfathered Officers -- Adjustments shall be

1. The monthly benefit and the Social Security Benefit shall be calculated at the rate of 3 1/3% of Average Monthly Compensation and of the Social Security Benefit, respectively, for each full or fractional Year of Participation up to a maximum of 15 Years of Participation.

2. There shall be no reduction in the benefit payable upon retirement on or after attainment of age 55 on account of payment commencing prior to attainment of age 65.

3. Amounts included in the Participant's Executive Expense Allowance shall be included in determining Average Monthly Compensation.

C. Officers -- Adjustments shall be that there shall be no reduction in the benefit payable upon retirement on or after attainment of age 60 on account of payment commencing prior to attainment of age 65 and no part of the Executive Expense Allowance shall be included in determining Average Monthly Compensation.

D. Guideline Employees -- An adjustment shall be that there shall be no reduction in the benefit payable upon retirement on or after attainment of age 55.

* Defined terms in RIGP shall have the same meanings in the Plan, except as

otherwise noted herein.

E. Mid-Career Executives -- Adjustments shall be

1. The monthly benefit and the Social Security Benefit shall be calculated at the rate of 2.5% of the Average Monthly Compensation and of the Social Security Benefit, respectively, for each full or fractional Year of Participation up to a maximum of 20 Years of Participation.

2. There shall be no reduction in the benefit payable upon retirement on or after attainment of age 60 on account of payment commencing prior to attainment of age 65 and no part of the Executive Expense Allowance, if any, shall be included in determining Average Monthly Compensation.

F. All Participants -- Adjustments shall be

1. Average Monthly Compensation shall be calculated including any

compensation deferred by the Participant during the period used in calculating Average Monthly Compensation (except that there shall not be included any increase in Participant's compensation which became payable under the Company's policy of increasing compensation by the amount which cannot be added to the Participant's accounts under the Company's Profit Sharing and Savings Plan ("Profit Sharing Plan") by reason of the limitation contained in Section 415 of the Internal Revenue Code of 1986, as amended, hereinafter the "Code").

2. The following additional amounts shall be deducted from the hypothetical monthly benefit:

(a) The value of the portion of the Participant's Account under the Company's Deferred Compensation Plan For Executives, if any, resulting from the Retirement Account portion of the Profit Sharing Adjustment (as defined in such Deferred Compensation Plan) translated into an annuity (single life or joint and survivor, as appropriate) payable commencing on the date of retirement.

(b) The benefit payable under the Company's Unfunded Retirement Income Guarantee Plan ("Unfunded RIGP") other than the additional benefit payable under Section 4.1A thereof.

(c) Any amount paid to the participant from which FICA taxes are withheld related to nonqualified retirement benefits from a plan sponsored by the Company which have not been previously withheld (or deemed to have been withheld because the maximum tax had already been paid) and are payable upon retirement but cannot be withheld from any single sum payment of compensation or other nonqualified plan benefits translated to an annuity (single or joint and survivor as appropriate) payable commencing on the date of retirement.

(d) The amount of that certain supplement provided to certain high-paid participants in RIGP effective in 1989 when the RIGP benefit was modified payable to the Participant in a lump sum translated to an annuity (single life or joint and survivor as appropriate) payable commencing on the date of retirement.

(e) The amount of any pension, retirement or other post-retirement income benefits paid or payable to a Participant under plans or arrangements provided by the Company or any subsidiary of the Company, whether incorporated or organized in the United States or in any other country of the world.

Section 7. Change In Control.

A. Notwithstanding anything to the contrary in this Plan, in the event of a change in control of the Company, as hereinafter defined, each Participant, including retired Participants, shall be entitled to a benefit hereunder without regard to his or her age or Years of Service at the time of such change in control (including, without limitation, the benefit provided under Section 8 hereof, if applicable). Upon the occurrence of a change in control of the

Company, the benefit of each Participant shall be payable in a lump sum within five days of such change in control equal in amount to the then present value of a benefit expressed in the form provided in Section 10 hereof, commencing on the later of (i) the date of such change in control, (ii) the date Guideline Employee or Grandfathered Officer attains age 55, (iii) the date the Officers attain age 60 or (iv) in the case of a Mid-Career Executive, the date such Participant attains the age specified in Schedule A,

B or C, and based upon such Participant's Average Monthly Compensation and Years of Participation as of the date of such change in control. A "change in control of the Company" shall have the meaning set forth in the Xerox Corporation Retirement Income Guarantee Plan, as may be amended or restated from time to time.

B. Upon the termination of employment of a Participant following a change in control of the Company, such Participant, if he or she has otherwise satisfied the requirements of Section 5 hereof, shall be entitled to a benefit equal to the benefit to which he or she would have been entitled without application of Section 7A, reduced (but not below zero) to reflect the value of the benefit he or she received pursuant to Section 7A.

C. For purposes of Section 7A hereof, the present value of a benefit shall be calculated based upon the interest rate which would be used by the Pension Benefit Guaranty Corporation for purposes of determining lump sums for benefits payable as immediate annuities with respect to plans terminating on the date on which the change in control of the Company occurs and the 1983 GAM mortality table, provided, however, that effective upon the date that the applicable interest rate as specified in Section 417(e)(3)(A) of the Code is adopted for use in RIGP, the present value hereunder shall thereafter be determined under the applicable interest rate and mortality table as defined in Section 417(e)(3)(A)(ii)(1) of the Code. For purposes of RIGP, each Participant shall be treated as if he or she terminated employment upon the change in control and had his or her benefits determined as if he or she were to begin receiving benefits on the commencement date used in developing the present value of the benefit in Section 7.A.

Section 8. Minimum Benefit

In no event shall the monthly retirement benefit payable to any Participant other than Mid-Career Executives under the Plan be less than an amount which, when added to the benefits payable under RIGP, 25% of the amount of the Social Security Benefit and the amounts described in Section 6F2 above, is equal to 25% of such Participant's Average Monthly Compensation as adjusted in Section 6F1 for Participants and Section 6B3 for Grandfathered Officers.

Section 9. Pre-Retirement Spouse's Benefit

The spouse of a Participant who dies after completing the appropriate age and number of Years of Service pursuant to Section 5 (but in no case less than 10) while still employed by the Company shall be entitled to a survivor benefit, commencing on the death of the Participant, in an amount equal to one-half of the retirement benefit to which the Participant would have been entitled under the Plan if the Participant had retired on the last day of the month coincident with or next following the date of the Participant's death.

Section 10. Form of Benefit

The forms of benefit available under the Plan shall be for single Participants a 10-Year certain and life annuity or life annuity and for married Participants a 50% or 100% joint and survivor annuity option, all as shall have been elected by Participant on forms provided by the Administrator. The benefit payable to single Participant who has failed to make such an election shall be a life annuity and for a married Participant a 50% joint and survivor annuity. The 10 year certain and life annuity is the actuarial equivalent of the life annuity and the 100% joint and survivor annuity is the

actuarial equivalent of the 50% joint and survivor annuity. Except as otherwise provided in Section 7A in no event is the benefit payable in a lump sum.

Section 11. Participant's Rights Unsecured

The benefits payable under this Plan shall be unfunded. Consequently, no assets shall be segregated for purposes of the Plan and placed beyond the reach of the Company's general creditors. The right of any Participant to receive benefits under the provisions of the Plan shall be an unsecured claim against the general assets of the Company.

Section 12. Other Plan Provisions

Other Plan provisions necessary to determine any benefit under the Plan shall be the same as those described in RIGP.

Section 13. Duties of Administrator

The Plan shall be administered by the Administrator in accordance with its terms and purposes. The Administrator shall determine the amount and manner of payment of the benefits due to or on behalf of each Participant from the Plan and shall cause them to be paid by the Company accordingly. The Administrator shall be appointed by the Vice President, Human Resources of the Company.

Section 14. Finality of Decisions

The decisions made by and the actions taken by the Administrator in the administration of the Plan shall be final and conclusive on all persons, and the Administrator shall not be subject to individual liability with respect to the Plan.

Section 15. Amendment and Termination

It is the intention of the Company to continue the Plan indefinitely. The Company expressly reserves the right to amend the Plan at any time and in any particular manner, provided that any such amendment shall be made in accordance with ERISA. Such amendments, other than amendments relating to termination of the Plan or relating to benefit levels under Section 6 of the Plan, may be effected by (i) the Board of Directors, (ii) a duly constituted committee of the Board of Directors, or (iii) the Vice President of the Company responsible for Human Resources or a representative thereof. In the event such office is vacant at the time the amendment is to be made, the Chief Executive Officer of the Company shall approve such amendment or appoint a representative. Amendments relating to termination of the Plan or relating to benefit levels under Section 6 of the Plan shall be effected pursuant to a resolution duly adopted by the Board of Directors of the Company, or a duly constituted committee of the Board of Directors of the Company, in accordance with the Business Corporation Law of the State of New York.

Any amendment, alteration, modification or suspension under subsection (iii) of the preceding paragraph shall be set forth in a written instrument executed by any Vice President of the Company and by the Secretary or an Assistant Secretary of the Company.

Section 16. No Employment Rights

Nothing contained in the Plan shall be construed as a contract of employment between the Company and a Participant, or as a right of any Participant to be continued in the employment of the Company, or as a limitation of the right of the Company to discharge any of its employees, with or without cause.

Section 17. Assignment

The benefits payable under this Plan may not be assigned or alienated

except as may otherwise be required by law or pursuant to the terms of a domestic relations order that has been approved by the Plan Administrator.

Section 18. Law Applicable

This Plan shall be governed by the laws of the State of New York.

Restatement adopted and approved as of October 13, 1997.

XEROX CORPORATION
800 Long Ridge Road
Stamford, CT 06904

October 15, 2000

Dear :

Xerox Corporation (the "Company") considers it essential to the best interests of its shareholders to foster the continuous employment of key management personnel. In this connection, the Board of Directors of the Company (the "Board") recognizes that, as is the case with many publicly held corporations, the possibility of a Change in Control may exist and that such possibility, and the uncertainty and questions which it may raise among management, may result in the departure or distraction of management personnel to the detriment of the Company and its shareholders.

The Board has determined that appropriate steps should be taken to reinforce and encourage the continued attention and dedication of members of the Company's management, including yourself, to their assigned duties without distraction in the face of potentially disturbing circumstances arising from the possibility of a Change in Control of the Company, although no such change is now contemplated.

In order to induce you to remain in the employ of the Company and in consideration of your agreement set forth in Section 2(ii) hereof, the Company agrees that you shall receive the severance benefits set forth in this letter agreement in the event your employment with the Company is terminated subsequent to a "Change in Control of the Company" (as defined in Section 2 hereof) under the circumstances described below.

1. Term of Agreement. This Agreement shall commence on October 15, 2000 and shall continue in effect through December 31, 2001; provided, however, that commencing on January 1, 2002, and each January 1 thereafter, the term of this Agreement shall automatically be extended for one additional year unless not later than September 30 of the preceding year, the Company shall have given notice that it does not wish to extend this Agreement (provided that no such notice may be given during the pendency of a potential Change in Control of the Company, as defined in Section 2); provided, further, that notwithstanding any such notice by the Company not to extend, if a Change in Control of the Company, as defined in Section 2 hereof, shall have occurred while this Agreement is in effect, this Agreement shall continue in effect until the last day of the 24th month following the month in which occurs such Change in Control of the Company.

2. Change in Control.

(i) No benefits shall be payable hereunder unless there shall have been a Change in Control of the Company, as set forth below, and your employment by the Company shall thereafter have been terminated in accordance with Section 3 below. For purposes of this Agreement, a "Change in Control of the Company" shall be deemed to have occurred if (A) any "person" (as such term is used in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended (the "Exchange 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 Exchange 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% or more of the combined voting power of the Company's then outstanding securities; (B) the following individuals cease for any reason to constitute a majority of the directors then serving: individuals who, on the date hereof 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 the date hereof 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..

(ii) For purposes of this Agreement, a "Potential Change in Control of the Company" shall be deemed to have occurred if (A) the Company enters into an agreement, the consummation of which would result in the occurrence of a Change in Control of the Company, (B) any person (including the Company) publicly announces an intention to take or to consider taking actions which if consummated would constitute a Change in Control of the Company; (C) any person, other than a trustee or other fiduciary holding securities under an employee benefit plan of the Company (or a company owned, directly or

indirectly, by the shareholders of the Company in substantially the same proportions as their ownership of stock of the Company), 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 10% or more of the combined voting power of the Company's then outstanding securities; or (D) the Board of Directors adopts a resolution to the effect that a Potential Change in Control of the Company for purposes of this Agreement has occurred. You agree that, subject to the terms and conditions of this Agreement, in the event of a Potential Change in Control of the Company, you will remain in the employ of the Company until the earliest of (i) the expiration of nine (9) months from the occurrence of such Potential Change in Control of the Company, (ii) the termination by you of your employment by reason of Disability, or (iii) the date on which you first become entitled under this Agreement to receive the benefits provided in Section 4(iii) below. For purposes of this Agreement, "Disability" shall mean a physical or mental incapacity which is incurred subsequent to a Potential Change in Control of the Company which would allow you to receive benefits under the Company's Long-Term Disability Income Plan (or any substitute plans adopted prior to a Change in Control of the Company).

3. Termination Following Change in Control. If any of the events described in Section 2 hereof constituting a Change in Control of the Company shall have occurred, you shall be entitled to the benefits provided in Section 4 hereof upon the subsequent termination of your employment during the term of

this Agreement unless such termination is (A) because of your death, (B) by the Company for Cause or Disability or (C) by you other than for Good Reason. For purposes of this Agreement, your employment shall be deemed to have been terminated following a Change in Control by the Company without Cause or by you with Good Reason, if (i) your employment is terminated by the Company without Cause prior to a Change in Control (whether or not a Change in Control ever occurs) and such termination was at the request or direction of a person who has entered into an agreement with the Company the consummation of which would constitute a Change in Control, (ii) you terminate your employment for Good Reason prior to a Change in Control (whether or not a Change in Control ever occurs) and the circumstance or event which constitutes Good Reason occurs at the request or direction of such person, or (iii) your employment is terminated by the Company without Cause prior to a Change in Control (whether or not a Change in Control ever occurs) and you reasonably demonstrate that such termination was otherwise in connection with or in anticipation of a Change in Control.

(i) Disability. If, as a result of your incapacity due to physical or mental illness, you shall have been receiving payments under the Company's Long-Term Disability Income Plan, or any substitute plans adopted prior to the Change in Control, for a period of twelve (12) consecutive months, and within thirty (30) days after written notice of termination is given you shall not have returned to the full-time performance of your duties, the Company may terminate your employment for "Disability".

(ii) Cause. Termination by the Company of your employment for "Cause" shall mean termination upon (A) the willful and continued failure by you to substantially perform your duties with the Company (other than any such failure resulting from your incapacity due to physical or mental illness or any such actual or anticipated failure after the issuance of a Notice of Termination by you for Good Reason), after a written demand for substantial performance is delivered to you by the Board which specifically identifies

the manner in which the Board believes that you have not substantially performed your duties, (B) the willful engaging by you in conduct which is demonstrably and materially injurious to the Company, monetarily or otherwise, or (C) the conviction of any crime (whether or not involving the Company) which constitutes a felony. For purposes of this Subsection, no act, or failure to act, on your part shall be considered "willful" unless done, or omitted to be done, by you not in good faith and without reasonable belief that your action or omission was in the best interest of the Company. Notwithstanding the foregoing, you shall not be deemed to have been terminated for Cause unless and until there shall have been delivered to you a copy of a resolution duly adopted by the affirmative vote of not less than three-quarters of the entire membership of the Board at a meeting of the Board called and held for the purpose (after reasonable notice to you and an opportunity for you, together with your counsel, to be heard before the Board), finding that in the good faith opinion of the Board you were guilty of conduct set forth above in clauses (A), (B) or (C) of the first sentence of this Subsection and specifying the particulars thereof in detail.

(iii) Good Reason. You shall be entitled to terminate your employment for Good Reason. For purposes of this Agreement, "Good Reason" shall mean, without your express written consent, the occurrence after a Change in Control of the Company and during the term of this Agreement of any of the following circumstances:

A. the assignment to you of any duties inconsistent with your status as a senior executive of the Company or a substantial adverse alteration in the nature or status of your responsibilities from those in effect immediately prior to a Change in Control of the Company (including, without limitation, if you are an executive officer of the Company prior to a Change in Control, ceasing to be an executive officer of a public company);

B. (i) a reduction in your annual base salary and/or annual target bonus as in effect on the date hereof or as the same may be increased

from time to time, (ii) a failure by the Company to increase your annual base salary following a Change in Control of the Company at such periodic intervals consistent with the Company's practice prior thereto by at least a percentage equal to the average of the percentage increases in your base salary for the three merit pay periods immediately preceding such Change in Control or (iii) the failure to increase your salary as the same may be increased from time to time for similarly situated senior executives, except that this subparagraph (B) shall not apply to across-the-board salary reductions similarly affecting all executives of the Company and all executives of any person in control of the Company;

C. the Company's requiring you to be based anywhere other than in the metropolitan area in which you were based immediately prior to the Change in Control, except for required travel on the Company's business to an extent substantially consistent with your present business travel obligations;

D. the failure by the Company to continue in effect any compensation plan in which you participate immediately prior to the Change in Control of the Company, including but not limited to the Company's Unfunded Supplemental Retirement Plan, Unfunded Retirement Income Guarantee Plan, the 1976 Executive Long-Term Incentive Plan and 1991 Long-Term Incentive Plan or any substitute plans adopted prior to such Change in Control (except to the extent such plans terminate in accordance with their respective terms),

unless an equitable arrangement (embodied in an ongoing substitute or alternative plan) has been made with respect to such plan in connection with the Change in Control of the Company, or the failure by the Company to continue your participation therein (or in such substitute or alternative plan) on a basis not materially less favorable, both in terms of the amount of benefits provided and the level of your participation relative to other participants, than existed at the time of the Change in Control of the Company;

E. the failure by the Company to continue to provide you with benefits substantially similar to those enjoyed by you under any of the Company's pension, retirement, life insurance, medical, health and accident, or disability plans in which you were participating at the time of a Change in Control of the Company, the taking of any action by the Company which would directly or indirectly materially reduce any of such benefits or deprive you of any material fringe benefit enjoyed by you at the time of the Change in Control of the Company, or the failure by the Company to provide you with the number of paid vacation days to which you are entitled on the basis of years of service with the Company in accordance with the Company's normal vacation policy in effect at the time of the Change in Control;

F. the failure of the Company to obtain a satisfactory agreement from any successor to assume and agree to perform this Agreement, as contemplated in Section 5 hereof; or

G. any purported termination of your employment which is not effected pursuant to a Notice of Termination satisfying the requirements of Subsection (iv) below (and, if applicable, Subsection (ii) above); and for purposes of this Agreement, no such purported termination shall be effective.

Your right to terminate your employment pursuant to this Subsection shall not be affected by your incapacity due to physical or mental illness. Your continued employment shall not constitute consent to, or a waiver of rights with respect to, any circumstance constituting Good Reason hereunder.

(iv) Notice of Termination. Any purported termination by the Company or by you shall be communicated by written Notice of Termination to the other party hereto in accordance with Section 6 hereof. For purposes of this Agreement, a "Notice of Termination" shall mean a notice which shall indicate the specific termination provision in this Agreement relied upon and shall set forth in reasonable detail the facts and circumstances claimed to provide a basis for termination of your employment under the provision so indicated.

(v) Date of Termination, Etc. "Date of Termination" shall mean (A) if your employment is terminated for Disability, thirty (30) days after Notice of Termination is given (provided that you shall not have returned to the performance of your duties on a full-time basis during such thirty (30) day period), and (B) if your employment is otherwise terminated pursuant to Subsection (ii) or (iii) above or for any other reason, the date specified in the Notice of Termination (which, in the case of a termination pursuant to Subsection (ii) above shall not be less than thirty (30) days, and in the case of a termination pursuant to Subsection (iii) above shall not be less than fifteen (15) days nor more than sixty (60) days, respectively, from the date such Notice of Termination is given); provided that, if within thirty (30) days after any Notice of Termination is given the party receiving such Notice of Termination notifies the other party that a dispute exists

concerning the termination, the Date of Termination shall be the date on which the dispute is finally determined, either by mutual written agreement of the parties, by a binding arbitration award, or by a final judgment, order or decree of court of competent jurisdiction (the time for appeal therefrom having expired and no appeal having been perfected); and provided, further, that the Date of Termination shall be extended by a notice of dispute only if such notice is given in good faith and the party giving such notice pursues the resolution of such dispute with reasonable diligence. Notwithstanding the pendency of any such dispute, the Company will continue to pay you your full compensation in effect when the notice giving rise to the dispute was given (including, but not limited to, base salary) and continue you as a participant in all compensation, benefit and insurance plans in which you were participating when the notice giving rise to the dispute was given, until the dispute is finally resolved in accordance with this Section. Amounts paid under this Subsection (v) are in addition to all other amounts due under this Agreement and shall not be offset against or reduce any other amounts due under this Agreement and shall not be reduced by any compensation earned by you as the result of employment by another employer.

4. Compensation Upon Termination or During Incapacity. Following a Change in Control of the Company, you shall be entitled to the following benefits during a period of incapacity, or upon termination of your employment, as the case may be, provided that such period or termination occurs during the term of this Agreement:

(i) During any period that you fail to perform your duties as a result of incapacity due to physical or mental illness, you shall continue to receive your full base salary at the rate then in effect, your bonus and all compensation, including under the 1991 Long-Term Incentive Plan, paid during the period until this Agreement is terminated pursuant to Section 3(i) hereof. Your benefits shall thereafter be determined in accordance with the Company's welfare benefit programs then in effect, and the Company's Retirement Income Guarantee Plan, Unfunded Retirement Income Guarantee Plan and Unfunded Supplemental Retirement Plan (the "Pension Plans") and Profit Sharing Retirement and Savings Plan (the "Profit Sharing Plan").

(ii) If your employment shall be terminated by the Company (a) for Cause or Disability or (b) by you other than for Good Reason, the Company shall pay you your full base salary through the Date of Termination at the rate in effect at the time Notice of Termination is given plus all other amounts to which you are entitled under any compensation plan of the Company at the time such payments are due, and the Company shall have no further obligations to you under this Agreement.

(iii) If your employment by the Company shall be terminated (a) by the Company other than for Cause or Disability or (b) by you for Good Reason, then you shall be entitled to the benefits provided below:

A. The Company shall pay you your full base salary through the Date of Termination at the rate in effect at the time Notice of Termination is given plus all other amounts to which you are entitled under any compensation plan of the Company, at the time such payments are due;

B. In lieu of any further salary payments to you for periods subsequent to the Date of Termination, the Company shall pay as severance pay to you, not later than the fifth day following the Date of Termination, a lump sum severance payment (the "Severance Payment") equal to [three] [two]

[(3)] [2] times the sum of (i) the greater of (1) your annual rate of base salary in effect on the date Notice of Termination is given and (2) your annual rate of base salary in effect immediately prior to the Change in Control of the Company and (ii) the greater of (1) the annual target bonus applicable to you for the year in which Notice of Termination is given and (2) the annual target bonus applicable to you for the year in which the Change in Control of the Company occurs.

C. In addition to all other amounts payable to you under this Subsection 4(iii), you shall be entitled to receive all benefits payable under the Pension Plans, the Profit Sharing Plan and any other plan or agreement relating to retirement benefits or to compensation previously earned and not yet paid, in accordance with the respective terms of such plans or agreements.

D. For the [36][24]-month period immediately following the Date of Termination, the Company shall arrange to provide you and your dependents life, disability, accident and health insurance benefits substantially similar to those provided to you and your dependents immediately prior to the Date of Termination or, if more favorable to you, those provided to you and your dependents immediately prior to the occurrence of a Change in Control, at no greater cost to you than the cost to you immediately prior to such date or occurrence. Benefits otherwise receivable by you pursuant to this Section 4(iii)(D) shall be reduced to the extent benefits of the same type are received by or made available at no greater cost to you by a subsequent employer during the [36][24]-month period following the Date of Termination (and any such benefits received by or made available to you shall be reported by you to the Company).

(iv) You shall not be required to mitigate the amount of any payment provided for in this Section 4 by seeking other employment or otherwise, nor shall the amount of any payment or benefit provided for in this Section 4 be reduced by any compensation earned by you as the result of employment by another employer or by retirement benefits after the Date of Termination, or otherwise (other than under Subsection (iii)(D) of this Section 4..

Notwithstanding the foregoing, if you become entitled to the Severance Payment, you shall not be entitled to receive severance pay under any severance pay plan, policy or arrangement maintained by the Company or any of its subsidiaries. If the Company is obligated by law or by contract to pay severance pay, a termination indemnity, notice pay, or the like, or if the Company is obligated by law or by contract to provide advance notice of separation ("Notice Period"), then the Severance Payment shall be reduced, but not below zero, by the amount of any such severance pay, termination indemnity, notice pay or the like, as applicable, and by the amount of any compensation received by you during any Notice Period.

(v) (A) Whether or not you become entitled to the Severance Payments, if any of the payments or benefits received or to be received by you in connection with a Change in Control or your termination of employment (whether pursuant to the terms of this Agreement or any other plan, arrangement or agreement with the Company, any person whose actions result in a Change in Control or any person affiliated with the Company or such person) (all such payments and benefits, excluding the Gross-Up Payment, being hereinafter referred to as the "Total Payments") will be subject to the excise tax (the "Excise Tax") imposed under section 4999 of the Internal

Revenue Code of 1986, as amended (the "Code"), the Company shall pay to you an additional amount (the "Gross-Up Payment"), not later than the later of (1) the fifth day following the Date of Termination and (2) the tenth day following the

date of initial determination of the amount of the Gross-Up Payment (as set forth in subparagraph (B) below), such that the net amount retained by you, after deduction of required withholding taxes (required to be withheld at the time of payment of the Gross-Up Payment) plus any amounts payable with your personal federal, state and local income tax returns for any Excise Tax on the Total Payments and any federal, state and local income and employment taxes and Excise Tax upon the Gross-Up Payment, shall be equal to the Total Payments.

(B) An initial determination of the amount of the Gross-Up Payment (if any) shall be made by Tax Counsel (as hereinafter defined) not later than ten days following the Date of Termination. For purposes of determining whether any of the Total Payments will be subject to the Excise Tax and the amount of such Excise Tax, (i) all of the Total Payments shall be treated as "parachute payments" (within the meaning of section 280G(b)(2) of the Code) unless, in the opinion of tax counsel ("Tax Counsel") reasonably acceptable to you and the Company and selected by the accounting firm which was, immediately prior to the Change in Control, the Company's independent auditor (the "Auditor"), such payments or benefits (in whole or in part) do not constitute parachute payments, including by reason of section 280G(b)(4)(A) of the Code, (ii) all "excess parachute payments" within the meaning of section 280G(b)(1) of the Code shall be treated as subject to the Excise Tax unless, in the opinion of Tax Counsel, such excess parachute payments (in whole or in part) represent reasonable compensation for services actually rendered (within the meaning of section 280G(b)(4)(B) of the Code) in excess of the base amount allocable to such reasonable compensation, or are otherwise not subject to the Excise Tax, and (iii) the value of any noncash benefits or any deferred payment or benefit shall be determined by the Auditor in accordance with the principles of sections 280G(d)(3) and (4) of the Code. For purposes of determining the amount of the Gross-Up Payment, you shall be deemed to pay federal income tax (taking into account your filing status for the year(s) the Gross-Up Payment(s) are made) at the highest marginal rate of federal income taxation in the calendar year(s) in which the Gross-Up Payment(s) are to be made and state and local income taxes at the highest marginal rate of taxation in the state and locality of your residence on the Date of Termination (or if there is no Date of Termination, then the date on which the Gross-Up Payment is calculated for purposes of this Section 4(v)), net of the maximum reduction in federal income taxes which could be obtained from deduction of such state and local taxes.

(C) In the event that the Excise Tax is finally determined by the Internal Revenue Service to be less than the amount taken into account hereunder in calculating the Gross-Up Payment, you shall repay to the Company, within five business days following the time that the amount of such reduction in the Excise Tax is finally determined, the portion of the Gross-Up Payment attributable to such reduction (plus that portion of the Gross-Up Payment attributable to the Excise Tax and federal, state and local income and employment taxes imposed on the Gross-Up Payment being repaid by you), to the extent that such repayment results in a reduction in the Excise Tax and a dollar-for-dollar reduction in your taxable income and wages for purposes of federal, state and local income and employment taxes, plus interest on the amount of such repayment at 120% of the rate provided in section 1274(b)(2)(B) of the Code. In the event that the Excise Tax is finally determined by the Internal Revenue Service to exceed the amount taken into

account hereunder in calculating the Gross-Up Payment (including by reason of any payment the existence or amount of which cannot be determined at the time of the Gross-Up Payment), the Company shall make an additional Gross-Up Payment in respect of such excess (plus any interest, penalties or additions payable by you with respect to such excess) within five business days following the time that the amount of such excess is finally determined. The Company and you shall each cooperate with the other in connection with any administrative or judicial proceedings concerning the existence or amount of liability for Excise Tax with respect to the Total Payments. For purposes of the foregoing sentence, cooperation shall include (but not be limited to) providing to the Company and/or Tax Counsel copies of your Forms W-2 issued by the Company, together with your federal, state and local income tax returns, for the five calendar years immediately preceding the calendar year in which the Change in Control occurs

(excluding any such year, if at no point during such year were you employed by the Company),

(vi) The Company also shall pay to you all legal fees and expenses incurred by you with respect to the initial determination by Tax Counsel (as set forth in subsection 4(v)(B) above) of the amount of the Gross-Up Payment (if any), as well as in disputing in good faith any issue hereunder relating to the termination of your employment, in seeking in good faith to obtain or enforce any benefit or right provided by this Agreement or in connection with any tax audit or proceeding to the extent attributable to the application of section 4999 of the Code to any payment or benefit provided hereunder. Such payments shall be made within five business days after delivery of your written request for payment accompanied with such evidence of fees and expenses incurred as the Company reasonably may require.

5. Successors; Binding Agreement. (i) The Company will require any successor (whether direct or indirect, by purchase, merger, consolidation or otherwise) to all or substantially all of the business and/or assets of the Company to expressly assume and agree to perform this Agreement in the same manner and to the same extent that the Company would be required to perform it if no succession had taken place. Failure of the Company to obtain such assumption and agreement prior to the effectiveness of any such succession shall be a breach of this Agreement and shall entitle you to compensation from the Company in the same amount and on the same terms as you would be entitled hereunder if you terminated your employment for Good Reason following a Change in Control of the Company, except that for purposes of implementing the foregoing, the date on which any such succession becomes effective shall be deemed the Date of Termination. As used in this Agreement, "Company" shall mean the Company as hereinbefore defined and any successor to its business and/or assets as aforesaid which assumes and agrees to perform this Agreement by operation of law or otherwise.

(ii) This Agreement shall inure to the benefit of and be enforceable by your personal or legal representatives, executors, administrators, successors, heirs, distributees, devisees and legatees. If you should die while any amount would still be payable to you hereunder if you had continued to live, all such amounts, unless otherwise provided herein, shall be paid in accordance with the terms of this Agreement to your devisee, legatee or other designee or if no such designee, to your estate.

6. Notice. For the purposes of this Agreement, notices and all other communications provided for in the Agreement shall be in writing and shall be deemed to have been duly given when delivered or mailed by United States registered mail, return receipt requested, postage prepaid, addressed to

the respective addresses set forth on the first page of this Agreement, provided that all notices to the Company shall be directed to the attention of the Board with a copy to the Secretary of the Company, or to such other address as either party may have furnished to the other in writing in accordance herewith, except that notice of change of address shall be effective only upon receipt.

7. Miscellaneous. No provision of this Agreement may be modified, waived or discharged unless such waiver, modification or discharge is agreed to in writing and signed by you and such officer as may be specifically designated by the Board. No waiver by either party hereto at any time of any breach by the other party hereto of, or compliance with, any condition or provision of this Agreement to be performed by such other party shall be deemed a waiver of similar or dissimilar provisions or conditions at the same or at any prior or subsequent time. No agreements or representations, oral or otherwise, express or implied, with respect to the subject matter hereof have been made by either party which are not expressly set forth in this Agreement. The validity, interpretation, construction and performance of this Agreement shall be governed by the laws of the State of New York without regard to its conflicts of law principles. All references to sections of the Exchange Act or the Code shall be deemed also to refer to any successor provisions to such sections. Any payments provided for hereunder shall be paid net of any applicable withholding required

under federal, state or local law. The obligations of the Company under Section 4 shall survive the expiration of the term of this Agreement. This Agreement shall not be construed as creating an express or implied contract of employment and, except as otherwise agreed in writing between you and the Company, you shall not have any right to be retained in the employ of the Company.

8. Validity. The invalidity or unenforceability of any provision of this Agreement shall not affect the validity or enforceability of any other provision of this Agreement, which shall remain in full force and effect.

9. Counterparts. This Agreement may be executed in several counterparts, each of which shall be deemed to be an original but all of which together will constitute one and the same instrument.

10. Entire Agreement. This Agreement sets forth the entire agreement of the parties hereto in respect of the subject matter contained herein and during the term of the Agreement supersedes the provisions of all prior agreements, promises, covenants, arrangements, communications, representations or warranties, whether oral or written, by any officer, employee or representative of any party hereto with respect to the subject matter hereof (including, without limitation, the Severance Agreement previously entered into between you and the Company as thereafter amended and/or extended).

11. Effective Date. This Agreement shall become effective as of the date set forth above. If this letter correctly sets forth our agreement on the subject matter hereof, kindly sign and return to the Company the enclosed copy of this letter which will then constitute our agreement on this subject.

Sincerely,

XEROX CORPORATION

By

Name:

Title:

Agreed to as of the day
of October 15, 2000

As amended through October 9, 2000

XEROX CORPORATION
DEFERRED COMPENSATION PLAN FOR DIRECTORS
(Formerly 1989 Deferred Compensation Plan For Directors)

1997 AMENDMENT AND RESTATEMENT

Preamble. This Plan is a private unfunded nonqualified deferred compensation arrangement for Directors and all rights shall be governed by and construed in accordance with the laws of New York, except where preempted by federal law. It is intended to provide a vehicle for setting aside funds for retirement.

Section 1. Effective Date. The original effective date of the Plan is January 1, 1989. The effective date of this amendment and restatement is October 9, 2000.

Section 2. Eligibility. Any Director of Xerox Corporation (the "Company") who is not an officer or employee of the Company or a subsidiary of the Company is eligible to participate in the Plan (a Director who has so elected to participate is hereinafter referred to as a "Participant"). A Participant who terminates an election to defer receipt of compensation is not eligible to participate again in the Plan until twelve months after the effective date of such termination.

Section 3. Deferred Compensation Accounts. There shall be established for each Participant one or more deferred compensation Accounts (as hereinafter defined).

Section 4. Amount of Deferral.

(a) A Participant may elect to defer receipt of all or a specified part, expressed as a percentage of the cash compensation otherwise payable to the Participant for serving on the Company's Board of Directors or committees of the Board of Directors. Any amount deferred is credited to the Participant's Accounts on the date such amount is otherwise payable.

(b) In addition to the foregoing, there shall be credited to the deferred compensation accounts of each person who is serving as a Director on May 17, 1996 a sum computed by the Company as the present value of his or her accrued benefit under the Company's Retirement Income Plan For Directors, if any, as of such date and each such Director shall be given notice of such amount. The amount so computed shall be final and binding on the Company and each such Director. Within 30 days of the giving of such notice, each such Director shall make an election on a form provided by the Company as to the hypothetical investment of such amount and the payment methods as permitted under Sections 6 and 8 hereof as in effect on such date under the administrative rules adopted by the Administrator.

Section 5. Time of Election to Defer. The election to defer will be made prior to the individual's commencement of services as a Director for amounts to be earned for the remainder of the calendar year. In the case of an individual currently serving as a Director, the election to defer must be made prior to December 31, of any year for amounts to be earned in a subsequent calendar year or years. An election to totally terminate deferrals may be made at any time prior to the relevant payment date.

Section 6. Hypothetical Investment. Deferred compensation is assumed to be invested, without charge, in the (a) Balanced Fund, Income Fund, U.S. Stock

Fund, International Stock Fund, Small Company Stock Fund or Xerox Stock Fund (or the successors thereto) (the "Funds") established from time to time

under the Xerox Corporation Profit Sharing and Savings Plan (the "Profit Sharing Plan") (b) a fund with a variable fixed rate of return based upon the prime or base rate charged by one or more banks ("Prime Rate Investment") and (c) such other fixed income return investments ("Fixed Return Investment"), all as shall be made available from time to time by the Administrator in his or her administrative discretion ("Investments") as elected by the participant

It is anticipated that the Administrator will substitute the Prime Rate Investment for the Income Fund effective January 1, 1998. Amounts deferred prior to January 1, 1998 shall have a rate of return at the Income Fund or the Prime Rate Investment as elected by Participants on forms provided by the Administrator in connection with the implementation of the Prime Investment Rate.

Elections to make hypothetical investments in any one or more of the Investments shall be subject to administrative rules adopted by the Administrator from time to time.

No shares of Xerox stock will ever actually be issued to a Participant under the Plan.

Section 7. Value of Deferred Compensation Accounts and Installment Payments. The value of each Participant's Accounts shall reflect all amounts deferred, gains, losses and rates of return from the Investments, and shall be determined at the close of business on each day on which securities are traded on the New York Stock Exchange. Hypothetical investments in the Profit Sharing Plan shall be valued on each business day based upon the value of such hypothetical investment as determined under such Plan on the valuation date under such Plan coincident with or last preceding such business day. The value of Investments not made under the Profit Sharing Plan shall be determined from such available source or sources as the Administrator in his or her sole discretion shall from time to time determine. The date as of which investments are valued pursuant to the foregoing sentences are referred to herein as a Valuation Date.

Section 8. Manner of Electing Deferral. A Participant may elect to defer compensation by giving written notice to the Administrator on a form provided by the Company, which notice shall include (1) the percentage to be deferred; (2) if more than one is offered under the Plan, the hypothetical investment applicable to the amount deferred; and (3) the payment method that will apply to the deferred compensation. A Participant may elect to a maximum of four separate payment methods during his or her participation in the Plan ("Accounts"). Such payment methods once made may never be changed. Each election to defer compensation under the Plan shall specify an Account from which payment will be made. The Accounts available under the Plan shall be:

Account 1 which shall be payable beginning the July 15 of a calendar year that follows the calendar year of retirement by the number of years elected by the Participant (0, 1, 2, 3, 4, or 5 years). The last payment shall be on the July 15 of the year in which the Participant attains a certain age elected by the Participant.

Account 2 which shall be payable beginning the July 15 of a calendar year that follows the calendar year of retirement by the number of years elected by the Participant (0, 1, 2, 3, 4, or 5 years) and is payable on each subsequent July 15 until the number of payments elected by the Participant have been made.

Account 3 which shall be payable on the July 15 of a calendar year that follows the calendar year of retirement by the number of years elected by the Participant (0, 1, 2, 3, 4, or 5 years) and is payable as a single sum.

Account 4 shall be available with respect to amounts deferred during 1998 and later years. This account is payable beginning on the July 15 of a specified year whether before or after retirement. In addition to this payment date, the Participant must elect the number of payments that are to commence on this date. The payment(s) from this account can be as a single sum or payable in up to four annual installments. Once Account 4 is established (an election is made to defer and the payment date is defined), deferrals to Account 4 shall cease for any calendar year in which a payment is scheduled to be made from this Account. The full account balance shall be distributed by the end of the installment period. Once the final payment is made from this Account, the Participant may elect to create a new Account 4. The initial election or any subsequent election to use this Account must be made by December 31 of the year preceding the calendar year in which deferrals will be allocated to this Account. The first payment date that can be elected is the July 15 of the calendar year that follows the calendar year of election (calendar year containing the December 31 due date for election) by three years.

Not later than December 31, 1997, Participants who are currently serving as Directors of the Company may change their payment elections previously made under the Plan which specified payment dates relating to termination, retirement, death, or disability, by selecting payments pursuant to the methods described in Accounts 1 through 3 above. Such change shall be effected by the Participant filing with the Administrator a change of election on a form or forms established by the Administrator for such purpose. Such change shall be effective only with respect to payments in 1999 or later for Participants who are serving on the Company's Board of Directors as of December 31, 1998.

The Administrator may adopt rules of general applicability for administration of payments under the Plan which may be elected by Participants, including without limitation, fixing the maximum age selected for payments to terminate and the maximum number of payments.

Section 9. Payment of Deferred Compensation.

(a) No withdrawal may be made from the Participant's Account, except as provided under this Section and Sections 10 and 11.

(b) Payments from a Participant's Account are made in cash in accordance with the elections made under Section 8 of the Plan based on the value of the Participant's deferred compensation Accounts as of the Valuation Date immediately preceding the date of payment.

(c) Unless otherwise elected by a Participant with the written approval of the Administrator, payments of deferred compensation shall be made pursuant to the following formula: the amount of the first payment shall be a fraction of the value of the Participant's deferred compensation account on the preceding Valuation Date, the numerator of which is one and the denominator of which is the total number of installments elected, and the amount of each subsequent payment shall be a fraction of the value on the Valuation Date preceding each subsequent payment date, the numerator of which is one and the

denominator of which is the total number of installments elected minus the number of installments previously paid. Any other payment method selected with the written approval of the Administrator must in all events provide for payments in substantially equal installments.

(d) Upon termination of service on the Board of Directors, other than termination resulting from death, prior to retirement, the total value of the Participant's Accounts under the Plan shall be paid to the Participant as soon as administratively possible after his or her date of termination.

(e) Upon the death of a Participant either before or after retirement the total value of the Participant's Accounts under the Plan shall be paid in accordance with an election made by such Participant in a lump sum or in installments, as appropriate, from the Accounts established under Section 8 to the beneficiary(ies) designated by the Participant.

(f) If a Participant dies either before or after retirement without having made such an election, the total value of his or her Accounts under the Plan shall be paid in a single payment to the Participant's estate as soon as administratively possible after notice of his or her date of death has been received by the Administrator.

Section 10. Acceleration of Payment for Hardship.

(a) For Hardship. Upon written approval from the Board of Directors (with the Participant requesting the withdrawal not participating) a Participant may be permitted to receive all or part of his accumulated benefits if, in the discretion of such Board of Directors, it is determined that an emergency event beyond the Participant's control exists and which would cause such Participant severe financial hardship if the payment of his benefits were not approved. Any such distribution for hardship shall be limited to the amount needed to meet such emergency. A Participant who makes a hardship withdrawal cannot reenter the Plan for twelve months after the date of withdrawal.

(b) Upon a Change in Control. Within 5 days following the occurrence of a change in control of the Company (as hereinafter defined), each Participant shall receive a lump sum payment equal to the value of his or her Account. For purposes hereof, a "change in control of the Company" shall be deemed to have occurred if (A) any "person" (as such term is used in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended (the "Exchange 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 Exchange 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% or more of the combined voting power of the Company's then outstanding 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.

Section 11. Other Penalized Withdrawals. Notwithstanding the provisions of Sections 9 and 10, a Participant may be permitted to receive all or part of his accumulated benefits at any time provided that (A) the Administrator approves such distribution in his or her sole discretion, and (B) the Participant forfeits a portion of his account balance equal to a percentage of the amount distributed. The percentage reduction shall be the greater of (A) six percent, or (B) a percentage equal to one-half of the prime interest rate, as determined by the Administrator.

Section 12. Time Of Investment. Amounts deferred under the Plan shall begin to be credited with gains, losses and rates of return from Investments commencing on the date credited to the Participant's Accounts.

Section 13. Participant's Rights Unsecured. The benefits payable under this Plan shall be unfunded. Consequently, no assets shall be segregated for purposes of this Plan and placed beyond the reach of the Company's general creditors. The right of any Participant to receive future installments under the provisions of the Plan shall be an unsecured claim against the general assets of the Company.

Section 14. Statement of Account. Statements will be sent to each Participant by February and August and more frequently if the Administrator so determines as to the value of their deferred compensation accounts as of the end of December and June, respectively.

Section 15. Assignability. No right to receive payments hereunder shall be transferable or assignable by a Participant, except by will or by the laws of descent and distribution or except as provided under Section 9.

Section 16. Business Days. In the event any date specified herein falls on a Saturday, Sunday or legal holiday, such date shall be deemed to refer to the next business day thereafter.

Section 17. Administration. The Plan shall be administered by the Vice President of the Company having responsibility for human resources (the "Administrator"). The Administrator shall have the authority to adopt rules and regulations for carrying out the plan, and interpret, construe and implement the provisions of the Plan.

Section 18. Amendment. The Company expressly reserves the right to amend the Plan at any time and in any particular manner. Such amendments, other than amendments relating to termination of the Plan or relating to Investments under Section 6 of the Plan, may be effected by (i) the Board of Directors, (ii) a duly constituted committee of the Board of Directors ("Committee"), or (iii) the Vice President of the Company responsible for human resources or a representative thereof. In the event such office is vacant at the time the amendment is to be made, the Chief Executive Officer of the Company shall approve such amendment or appoint a representative. Amendments relating to termination of the Plan or relating to Investments under Section 6 of the Plan shall be effected pursuant to a resolution duly adopted by the Board of Directors of the Company, or a duly constituted committee of the Board of Directors of the Company, in accordance with the Business Corporation Law of the State of New York.

Any amendment, alteration, modification or suspension under subsection (iii) of the preceding paragraph shall be set forth in a written instrument executed by any Vice President of the Company and by the Secretary or an Assistant Secretary of the Company.

Upon termination the Administrator in his or her sole discretion may pay out account balances to participants. No amendment, modification or termination shall, without the consent of a Participant, adversely affect such Participant's accruals in his/her Accounts.

(As amended through 10/9/00)

XEROX CORPORATION
DEFERRED COMPENSATION PLAN FOR EXECUTIVES
(Formerly 1989 Deferred Compensation Plan For Executives)

1997 AMENDMENT AND RESTATEMENT

Preamble. This Deferred Compensation Plan For Executives, 1997 Amendment and Restatement (the "Plan") is a private unfunded nonqualified deferred compensation arrangement for executives and all rights shall be governed by and construed in accordance with the laws of New York, except where preempted by federal law. It is intended to provide a vehicle for setting aside funds for retirement.

Section 1. Effective Date. The original effective date of the Plan is January 1, 1989. The effective date of this amendment and restatement is October 13, 1997.

Section 2. Eligibility. Any employee of Xerox Corporation (the "Company"), and any employee of a wholly owned subsidiary of the Company which has adopted this Plan with the approval of the Company's Board of Directors or the Committee (as hereinafter defined) ("Participating Subsidiary"), who is in Corporate B and A (or its equivalent) or above, and such additional group or groups of employees of the Company or of a Participating Subsidiary as designated from time to time by the Administrator, are eligible to participate in the Plan (an individual who has so elected to participate is hereinafter referred to as a "Participant"). A Participant who terminates an election to defer receipt of compensation is not eligible to make deferrals again in the Plan until twelve months after the effective date of such termination.

Section 3. Deferred Compensation Account. There shall be established for each Participant one or more deferred compensation Accounts (as hereinafter defined).

Section 4. Amount of Deferral. A Participant may elect to defer receipt of compensation for services (up to 50% in the case of base salary and up to 100% in the case of any other long or short term compensation that is eligible for deferral) as an employee of the Company or a Participating Subsidiary

otherwise payable to the Participant in the form of cash. Any amount deferred is credited to the Participant's Accounts on the date such amount is otherwise payable.

To adjust for the reduced contribution otherwise payable in cash, if applicable, to a Participant's account under the Xerox Corporation Profit Sharing and Savings Plan (the 'Profit Sharing Plan') because of the deferral of compensation under the Plan at the time of each annual employer contribution to the Participant's account under the Profit Sharing Plan, the deferred compensation account of each active Participant shall be credited with an additional hypothetical amount equal to the product of (a) the amount of deferred compensation under the Plan which would have been included in the calculation of such profit sharing contribution if such compensation had not been deferred (b) by the contribution percentage payable in cash under the Profit Sharing Plan for the relevant calendar year.

Section 5. Time of Election of Deferral. An election to defer compensation must be made by a Participant prior to the year in which the Participant would otherwise have an unrestricted right to such compensation. When an employee first becomes eligible to participate in the Plan, he or she may elect to defer any compensation to which he or she has yet to have an unrestricted right to

payment. An election to totally terminate future deferrals may be made at any time prior to the relevant payment date.

Section 6. Hypothetical Investment. Deferred compensation is assumed to be invested, without charge, in (a) the Balanced Fund, Income Fund, U. S. Stock Fund, International Stock Fund, Small Company Stock Fund or Xerox Stock Fund (or the successors thereto) established from time to time under the Profit Sharing Plan, (b) a fund with a variable fixed rate of return based upon the prime or base rate charged by one or more banks ("Prime Rate Investment") and (c) such other fixed income return investments ("Fixed Return Investment"), all as shall be made available from time by the Administrator in his or her administrative discretion ("Investments"), as elected by the Participant.

It is anticipated that the Administrator will substitute the Prime Rate Investment for the Income Fund effective January 1, 1998. Amounts deferred prior to January 1, 1998 shall have a rate of return at the Income Fund or the Prime Rate Investment as elected by Participants on forms provided by the Administrator in connection with the implementation of the Prime Investment Rate.

Elections to make hypothetical investments in any one or more of the Investments shall be subject to administrative rules adopted by the Administrator from time to time.

No shares of Xerox stock will ever actually be issued to a Participant under the Plan.

Section 7. Value of Deferred Compensation Accounts and Installment Payments. The value of each Participant's Accounts shall reflect all amounts deferred, gains, losses and rates of return from the Investments, and shall be determined at the close of business on each day on which securities are traded on the New York Stock Exchange. Hypothetical investments in the Profit Sharing Plan shall be valued on each business day based upon the value of such hypothetical investment as determined under such Plan on the valuation date under such Plan coincident with or last preceding such business day. The

value of Investments not made under the Profit Sharing Plan shall be determined from such available source or sources as the Administrator in his or her sole discretion shall from time to time determine. The date as of which investments are valued pursuant to the foregoing sentences are referred to herein as a Valuation Date.

Section 8. Manner of Electing Deferral. A Participant may elect to defer compensation by giving written notice to the Administrator on a form provided by the Company, which notice shall include (1) the percentage to be deferred; (2) if more than one is offered under the Plan, the Investment applicable to the amount deferred; and (3) the payment method that will apply to the deferred compensation. A Participant may elect up to a maximum of four separate payment methods during his or her participation in the Plan ("Accounts"). Such payment methods once made may never be changed. Each election to defer compensation under the Plan shall specify an Account from which payment will be made. The Accounts available under the Plan shall be:

Account 1 which shall be payable beginning the July 15 of a calendar year that follows the calendar year of retirement by the number of years elected by the Participant (0, 1, 2, 3, 4, or 5 years). The last payment shall be on the July 15 of the year in which the Participant attains a certain age elected by the Participant.

Account 2 which shall be payable beginning the July 15 of a calendar year that follows the calendar year of retirement by the number of years elected by the Participant (0, 1, 2, 3, 4, or 5 years) and is payable on each subsequent July 15 until the number of payments elected by the Participant have been made.

Account 3 which shall be payable on the July 15 of a calendar year that follows the calendar year of retirement by the number of years elected by the

Participant (0, 1, 2, 3, 4, or 5 years) and is payable as a single sum.

Account 4 shall be available with respect to amounts deferred during 1998 and later years. This account is payable beginning on the July 15 of a specified year whether before or after retirement. In addition to this payment date, the Participant must elect the number of payments that are to commence on this date. The payment(s) from this account can be as a single sum or payable in up to four annual installments. Once Account 4 is established (an election is made to defer and the payment date is defined), deferrals to Account 4 shall cease for any calendar year in which a payment is scheduled to be made from this Account. The full account balance shall be distributed by the end of the installment period. Once the final payment is made from this Account, the Participant may elect to create a new Account 4. The initial election or any subsequent election to use this Account must be made by December 31 of the year preceding the calendar year in which deferrals will be allocated to this Account. The first payment date that can be elected is the July 15 of the calendar year that follows the calendar year of election (calendar year containing the December 31 due date for election) by three years.

Not later than December 31, 1997, participants who are currently employed by the Company may change their payment elections previously made under the Plan which specified payment dates relating to termination, retirement, death, or disability, by selecting payments pursuant to the methods described in Accounts 1 through 3 above. Such change shall be effected by the Participant filing with the Administrator a change of election on a form or forms

established by the Administrator for such purpose. Such change shall be effective only with respect to payments in 1999 or later for participants who are employed by Xerox as of December 31, 1998.

The Administrator may adopt rules of general applicability for administration of payments under the Plan which may be elected by participants, including without limitation, fixing the maximum age selected for payments to terminate and the maximum number of payments.

Section 9. Payment of Deferred Compensation.

(a) No withdrawal may be made from the Participant's Account, except as provided under this Section and Sections 10 and 11.

(b) Payments from a Participant's Account are made in cash in accordance with the elections made under Section 8 of the Plan based on the value of the Participant's deferred compensation Accounts as of the Valuation Date immediately preceding the date of payment.

(c) Unless otherwise elected by a Participant with the written approval of the Administrator, payments of deferred compensation shall be made pursuant to the following formula: the amount of the first payment shall be a fraction of the value of the Participant's deferred compensation account on the preceding Valuation Date, the numerator of which is one and the denominator of which is the total number of installments elected, and the amount of each subsequent payment shall be a fraction of the value on the Valuation Date preceding each subsequent payment date, the numerator of which is one and the denominator of which is the total number of installments elected minus the number of installments previously paid. Any other payment method selected with the written approval of the Administrator must in all events provide for payments in substantially equal installments.

(d) Upon termination of employment, including termination resulting from death, prior to retirement, the total value of the participants Accounts under the Plan shall be paid to the Participant, or his or her estate, as the case may be, as soon as administratively possible after his or her date of termination.

(e) Upon the death of a Participant following retirement the total value of the Participant's Accounts under the Plan shall be paid in accordance with a one-time, irrevocable election made by such Participant as follows:

1. The total value shall be paid to the Participant's estate as soon as administratively possible after the death of a Participant, or

2. Payments shall continue under the election made by the Participant to the Participant's surviving spouse until the surviving spouse's death. Any remaining payments shall be paid as a single sum to the surviving spouse's estate.

(f) If a Participant dies after retirement without having made such irrevocable election, the total value of his or her Accounts under the Plan shall be paid in a single payment to the participant's estate as soon as administratively possible after notice of his or her date of death has been received by the Administrator.

Section 10. Acceleration of Payment.

(a) For Hardship. Upon written approval from the Company's Chief Executive Officer (the Company's Board of Directors, in the case of a request from the Chief Executive Officer), a Participant may be permitted to receive all or part of his accumulated benefits if, in the discretion of the Chief Executive Officer (or the Board, if applicable), it is determined that an emergency event beyond the Participant's control exists and which would cause such Participant severe financial hardship if the payment of his benefits were not approved. Any such distribution for hardship shall be limited to the amount needed to meet such emergency. A Participant who makes a hardship withdrawal cannot reenter the Plan for twelve months after the date of withdrawal.

(b) Upon a Change in Control. Within 5 days following the occurrence of a change in control of the Company (as hereinafter defined), each Participant shall receive a lump sum payment equal to the value of his Account.

For purposes hereof, a "change in control of the Company" shall be deemed to have occurred if (A) any "person" (as such term is used in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended (the "Exchange 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 Exchange 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% or more of the combined voting power of the Company's then outstanding 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% of 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.

Section 11. Other Penalized Withdrawals. Notwithstanding the provisions of Sections 9 and 10, a Participant may be permitted to receive all or part of his accumulated benefits at any time provided that (A) the Administrator approves such distribution in his or her sole discretion, and (B) the Participant forfeits a portion of his account balance equal to a percentage of the amount distributed. The percentage reduction shall be the greater of (A) six percent, or (B) a percentage equal to one-half of the prime interest rate, as determined by the Administrator.

Section 12. Time Of Investment. Amounts deferred under the Plan shall begin to be credited with gains, losses and rates of return from Investments commencing on the date credited to the Participant's Accounts.

Section 13. Participant's Rights Unsecured. The benefits payable under this Plan shall be unfunded. Consequently, no assets shall be segregated for purposes of this Plan and placed beyond the reach of the Company's general creditors. The right of any Participant to receive future installments under the provisions of the Plan shall be an unsecured claim against the general assets of the Company.

Section 14. Statement of Account. Statements will be sent to each Participant by February and August and more frequently if the Administrator so determines as to the value of their deferred compensation accounts as of the end of December and June, respectively.

Section 15. Assignability. No right to receive payments hereunder shall be transferable or assignable by a Participant, except by will or by the laws of descent and distribution or except as provided under Section 9.

Section 16. Business Days. In the event any date specified herein falls on a Saturday, Sunday or legal holiday, such date shall be deemed to refer to the next business day thereafter.

Section 17. Administration. The Plan shall be administered by the Vice President of the Company having responsibility for human resources (the "Administrator"). The Administrator shall have the authority to adopt rules and regulations for carrying out the plan, and interpret, construe and implement the provisions of the Plan.

Section 18. Amendment. The Company expressly reserves the right to amend the Plan at any time and in any particular manner. Such amendments, other than amendments relating to termination of the Plan or relating to Investments under Section 6 of the Plan, may be effected by (i) the Board of Directors, (ii) a duly constituted committee of the Board of Directors ("Committee"), or (iii) the Vice President of the Company responsible for human resources or a representative thereof. In the event such office is vacant at the time the amendment is to be made, the Chief Executive Officer of the Company shall approve such amendment or appoint a representative. Amendments relating to termination of the Plan or relating to Investments under Section 6 of the Plan shall be effected pursuant to a resolution duly adopted by the Board of Directors of the Company, or a duly constituted committee of the Board of Directors of the Company, in accordance with the

Any amendment, alteration, modification or suspension under subsection (iii) of the preceding paragraph shall be set forth in a written instrument executed by any Vice President of the Company and by the Secretary or an Assistant Secretary of the Company.

Upon termination the Administrator in his or her sole discretion may pay out account balances to participants. No amendment, modification or termination shall, without the consent of a Participant, adversely affect such Participant's accruals in his/her Accounts.

As Amended By B/D 10/9/00

XEROX CORPORATION

1998 EMPLOYEE STOCK OPTION PLAN

ARTICLE I--Purpose of the Plan

The purpose of the Xerox Corporation 1998 Employee Stock Option Plan ("Plan") is to increase the ownership interest in the Company of eligible employees of the Company so as to align such interests with those of the shareholders of the Company and to provide a further incentive to serve as an employee of the Company through the issuance of stock options.

ARTICLE II--Definitions

Unless the context clearly indicates otherwise, the following terms shall have the following meanings:

2.1 "Administrator" means the individual and/or Committee or subcommittee referred to in Paragraph 3.1 as the case may be.

2.2 "Award Summary" means the award summary or the agreement delivered by or on behalf of the Administrator to each Optionee upon grant of an Option under the Plan which shall set forth details of each Option, including, without limitation, number of shares, option exercise price, Exercise Period, Waiting Period and exercise dates.

2.3 "Board" means the Board of Directors of the Company.

2.4 "Change in Control" shall be deemed to have occurred if (A) any "person" (as such term is used in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended (the "Exchange 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 Exchange 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% or more of the combined voting power of the Company's then outstanding 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% of 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.

2.5 "CIC Price" means the higher of (a) the highest price paid for a Share 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 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.

2.6 "Company" means Xerox Corporation.

2.7 "Employee" means each employee of the Company or of any entity that is directly or indirectly controlled by the Company all of whom are eligible for grants under the Plan.

2.8 "Exercise Period" means the date which is eight years after the Option Grant Date of such Option.

2.9 "Fair Market Value" means, with respect to any date, the average between the highest and lowest sale prices per Share in the New York Stock Exchange Composite Transactions on such date as reported in the Wall Street Journal, provided that if there should be no sale of Shares reported on such date, the Fair Market Value of a Share on such date shall be deemed equal to the average between the highest and lowest sale prices per Share in such Composite Transactions for the last preceding date on which sales of Shares were reported.

2.10 "Option" means an option to purchase Shares awarded under the Plan which does not meet the requirements of Section 422 of the Internal Revenue Code of 1986, as amended, or any successor law.

2.11 "Option Grant Date" means the effective date of an option grant under the terms of the Plan.

2.12 "Option Surrender Right" has the meaning specified in Paragraph 6.4.

2.13 "Optionee" means each person to whom an Option has been granted.

2.14 "Plan" means the Xerox Corporation 1998 Employee Stock Option Plan, as amended and restated from time to time.

2.15 "Shares" means shares of the Common Stock, par value \$1.00 per share, of the Company.

ARTICLE III--Administration of the Plan

3.1 Administrator of Plan. The Plan shall be administered by the individual who is the Vice President of the Company then having responsibility for Human Resources other than in respect of matters relating to officers of the Company who are subject to Section 16 under the Securities Exchange Act of 1934, as amended ("Section 16 Officers"). The Plan shall be administered in respect of Section 16 Officers by the Executive Compensation and Benefits Committee of the Board of Directors of the Company or the successor to such Committee or by a subcommittee of such Committee.

3.2 Authority of the Administrator. Except as otherwise provided herein, the Administrator shall have full power and authority to (i) designate the Employees to whom Options are to be granted, (ii) determine the number of Shares to be covered by each Option, (iii) determine the terms and conditions of Options granted under Plan, (iv) interpret and construe the Plan, (v) adopt

such rules and regulations as the Administrator shall deem necessary and advisable to implement and administer the Plan and (vi) designate persons to carry out the Administrator's responsibilities, subject to such limitations, restrictions and conditions as the Administrator may prescribe, such determinations to be made in accordance with the Administrator's best business judgment as to the best interests of the Company and its shareholders and in accordance with the purposes of the Plan. Options granted and the number of shares covered by Options shall be based upon one or more measures of Company performance selected by the Administrator.

ARTICLE IV--Shares Subject to the Plan

The total number of Shares which may be issued upon exercise of Options under the Plan shall be 25,000,000 subject to adjustment as provided in Article IX. Any Shares issued under the Plan may consist of authorized and unissued Shares or of treasury Shares.

ARTICLE V--Non-Transferability of Options

All Options under the Plan will be nontransferable and shall not be assignable, alienable, salable or otherwise transferable by the Optionee 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 Administrator. During the life of the Optionee, Options under the Plan shall be exercisable only by him or her.

If so permitted by the Administrator, an Optionee may designate a beneficiary or beneficiaries to exercise the rights of the Optionee under this Plan upon the death of the Optionee.

ARTICLE VI--Options

Each Option shall be subject to the following terms and conditions:

6.1 Purchase Price. The purchase price per Share under each Option granted pursuant to this Article shall be 100% of the Fair Market Value per Share on the Option Grant Date. Any Option granted to replace an earlier unexercised Option Grant shall have a price per share not less than the price per share of the option being replaced.

6.2 Option Waiting Period and Exercise Dates. The Shares subject to an Option may be purchased commencing on the January 1 next following the Option Grant Date (the "Waiting Period") as follows:

33-1/3% of such Shares commencing at the end of the Waiting Period;

33-1/3% of such Shares commencing on the first day of the second year following the Waiting Period; and

33-1/3% of such Shares commencing on the first day of the third year following the Waiting Period.

Subject to Article VII, an Option may be exercised until the end of the Exercise Period. An Option, or portion thereof, may be exercised in whole or in part only with respect to whole Shares.

To the extent that an Option is not exercised when it becomes initially

exercisable, it shall not expire but shall be carried forward and shall be exercisable until the expiration of the Exercise Period. Partial exercise will be permitted from time to time within the percentage limitation described above provided that no partial exercise may be for less than the lesser of twenty Shares or the total number of Shares remaining unexercised under the Option.

6.3 Method of Exercising Option. The Options may be exercised from time to time by written notice to the Company, which shall state the election to exercise the Options and the number of shares with respect to which the Options are being exercised, and shall be signed by the person exercising the Options. Such notice must be accompanied by a check payable to the Company in payment of the full purchase price. After receipt of such notice, the Company will advise the person exercising the option of the amount of withholding tax which must be paid under U.S. Federal, and where applicable, state and local law resulting from such exercise. Upon receipt of payment of the purchase price and the withholding tax the Company shall, without transfer or issue tax to the person exercising the Options, issue a certificate or certificates for the number of shares covered by such notice of exercise. In the event that the Options are being exercised through the Company's cashless exercise program, there shall be no requirement for the Employee to deliver a check in payment of the purchase price or for the withholding tax, all of which shall be effectuated between the Company and its then acting agent appointed to administer the cashless exercise program.

6.4 Option Surrender Rights. All Options granted hereunder shall be accompanied by option surrender rights ("OSRs") covering an equal number of shares as are covered under the related Option. 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 Options, shall be paid in cash as soon as may be practicable. Upon such payment, such rights and any related Option shall be canceled. The amount of cash payable in respect of an OSR shall be determined by multiplying the number of unexercised shares under the Option to which the right relates by the difference between the option price of such shares and the CIC Price.

6.5 Award Summary. Each Option granted under the Plan shall be evidenced by an Award Summary.

6.6 Reload Options. Options shall not be granted which by the terms of the grant provide for automatic award of additional Options upon exercise thereof.

ARTICLE VII--Termination of Service

Unless otherwise determined by the Administrator, termination of service, disability, retirement or death of an Optionee shall have the following effects on Options:

7.1 Termination of Service. If an Optionee ceases to be an employee of the Company or any of its subsidiaries other than by reason of disability, retirement or death, each Option held by such Optionee may thereafter be exercised by such Optionee (or such Optionee's executor, administrator, guardian, legal representative, beneficiary or similar person) solely to the extent that they were exercisable on the date of such termination and shall expire on the earlier of: (i) three months from the date of such termination or (ii) expiration of the Exercise Period. Options which are not exercisable on the date the Optionee ceases to be such an employee shall terminate.

7.2 Disability, Retirement or Death. If an Optionee ceases to be an employee of the Company or any of its subsidiaries by reason of disability or retirement, each Option held by such Optionee may thereafter be exercised by such Optionee in accordance with the provisions of Article VI. If the Optionee dies following termination of service by reason of retirement or disability, outstanding Options shall be exercisable to the extent that they were exercisable on the date of death by such Optionee's executor, administrator, guardian, legal representative, beneficiary or similar person and shall expire on the earlier of: one year following the date of death or expiration of the Exercise Period.

If the Optionee ceases to be such an employee as a result of death after the expiration of the Waiting Period for an Option award, such Option shall be immediately vested and exercisable by the Optionee's legal representative at any time within one year of the Optionee's death but in no event after the expiration of the Exercise Period. Options which are not exercisable on the date the Optionee ceases to be such an employee in accordance with the foregoing shall terminate.

ARTICLE VIII--Amendment and Termination

The Board may amend the Plan from time to time or terminate the Plan at any time except to the extent otherwise required by the Business Corporation Law of the State of New York; provided, however, that no action authorized by this Article shall adversely change the terms and conditions of an outstanding Option without the Optionee's consent.

ARTICLE IX--Adjustment Provisions

9.1 If the Company shall at any time change the number of issued Shares without new consideration to the Company (such as by stock dividend, stock split, recapitalization, reorganization, exchange of shares, liquidation, combination or other change in corporate structure affecting the Shares) or make a distribution of cash or property which has a substantial impact on the value of issued Shares, the number of Shares covered by each outstanding Option and the purchase price per Share under each outstanding Option shall be adjusted so that the aggregate consideration payable to the Company and the value of each such Option shall not be changed.

9.2 Notwithstanding any other provision of the Plan, and without affecting the number of Shares reserved or available hereunder, the Administrator shall authorize the issuance, continuation or assumption of outstanding Options or provide for other equitable adjustments after changes in the Shares resulting from any merger, consolidation, sale of assets, acquisition of property or stock, recapitalization, reorganization or similar occurrence in which the Company is the continuing or surviving corporation, upon such terms and conditions as it may deem necessary to preserve Optionees' rights under the Plan.

9.3 In the case of any sale of assets, merger, consolidation or combination of the Company with or into another corporation other than a transaction in which the Company is the continuing or surviving corporation and which does not result in the outstanding Shares being converted into or exchanged for different securities, cash or other property, or any combination thereof (an "Acquisition"), any Optionee who holds an outstanding Option shall have the right (subject to the provisions of the Plan and any limitation applicable to the Option) thereafter and during the term of the Option, to receive upon exercise thereof the Acquisition Consideration (as defined below) receivable

upon the Acquisition by a holder of the number of Shares which would have been obtained upon exercise of the Option or portion thereof, as the case may be, immediately prior to the Acquisition. The term "Acquisition Consideration" shall mean the kind and amount of shares of the surviving or new corporation, cash, securities, evidence of indebtedness, other property or any combination thereof receivable in respect of one Share of the Company upon consummation of an Acquisition.

9.4 Notwithstanding anything to the contrary in this Article IX, if any of the events or transactions described herein constitute a Change in Control, to the extent that the CIC Price exceeds the exercise price of the related Options, then in lieu of the adjustments provided for in this Article IX, the provisions of Paragraph 6.4 shall apply and outstanding Options shall be cashed out as provided for therein.

ARTICLE X--Effective Date

The Plan shall be submitted to the shareholders of the Company for adoption in

accordance with the provisions of Section 505 of the Business Corporation Law of the State of New York and, if adopted by a majority of the votes cast at the 1998 annual meeting of shareholders, shall become effective as of the date of adoption by shareholders.

ARTICLE XI--Miscellaneous Provisions

11.1 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.

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

11.3 General Restriction. Each Option shall be subject to the requirement that, if at any time the Administrator shall determine, in its sole discretion, that the listing, registration or qualification of any Option 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 Options or the grant or settlement thereof, such Option may not be 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 Administrator.

11.4 Future Rights. No Employee shall have any rights by reason of the grant of any Options under the Plan to continue as an employee of the Company or any subsidiary of the Company for any period of time, or at any particular rate of compensation.

11.5 Rights as a Shareholder. An Optionee shall have no rights as a shareholder with respect to shares covered by Options granted hereunder until the date of issuance of a stock certificate therefor, and no adjustment will be made for dividends or other rights for which the record date is prior to the date such certificate is issued.

11.6 Fractions of Shares. The Company shall not be required to issue fractions of shares. Whenever under the terms of the Plan a fractional share would be required to be issued the Optionee shall be paid in cash for such fractional share based upon Fair Market Value at the time of exercise of the Option.

11.7 Term of the Plan. No Option shall be granted under the Plan after May 21, 2003. However, any Option theretofore granted may extend beyond such date and continue to be exercisable pursuant to its terms for its remaining Exercise Period.

CEO Challenge Bonus

A CEO Challenge Bonus program was established for the calendar years 2000 and 2001. The goals of the CEO Challenge Bonus program are to support the Company's need to retain key executives and provide additional incentives to improve the financial performance of the Company. Executive officers are eligible to participate in the CEO Challenge Bonus. The CEO Challenge bonus provides an annual opportunity equal to one-half of each executive's annual bonus target amount payable over a period of four quarters if performance targets are met. For 2000, the CEO Challenge Bonus was based on quarterly EPS targets. The EPS target for the first quarter was achieved and bonus amounts were paid accordingly. For the remaining quarters of 2000, EPS targets were not achieved and bonus opportunities were forfeited. For 2001, the CEO Challenge bonus will also be based on quarterly EPS targets.

THE DOCUMENT COMPANY
XEROX

CONFIDENTIAL

Xerox Corporation
800 Long Ridge Road
Stamford, CT 06904

Paul A. Allaire
Chairman of the Board

December 4, 2000

Mr. William F. Buehler
535 Smith Ridge Road
New Canaan, CT 06840

Dear Bill:

The purpose of this letter is to summarize the arrangements for your retirement from Xerox Corporation (the Company) as follows:

Last day of active employment:	January 15, 2001
Salary Continuance:	12 months
	January 16, 2001 to January 15, 2002
Salary Continuance Amount:	\$56,250 per month
Retirement Date:	January 16, 2002

If you obtain employment as an employee of, or consultant to, another firm or corporation (other than the Company or an affiliate) that is a direct competitor of the Company in any business presently engaged in by the Company or in which the Company as of the date hereof 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"), the salary continuance described above will terminate upon the commencement of such employment. However, if the Company advises you in writing that in its reasonable judgment such other firm or corporation is not a Competitor, the remaining salary continuance will continue to be paid. We will provide notice to you upon your request as to the competitive nature of a prospective employer.

The Company may also terminate the salary continuance in the event you disclose confidential business information or if you publicly make any

derogatory or disparaging statements about the Company, its management or its business.

If your salary continuance ends pursuant to the preceding paragraphs, your employment with the Company will terminate on the same date that salary continuance terminates and any benefits described below or otherwise that are dependent upon continued employment, including without limitation, continued vesting of benefits and determination of years of service for retirement, will also terminate. In addition, stock options both vested and unexercised and non-vested will be cancelled immediately. As referred to in this letter, your retirement date means January 16, 2002 or the earlier termination of your salary continuance pursuant to this paragraph.

BONUS

Your 2000 bonus will be paid in February 2001 based on achievement against metrics. No bonus will be paid during the time you receive salary continuance.

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.

LONG-TERM INCENTIVE AWARDS

Grant Date	Grant Price	Amount Remaining	Vesting Date	Payment Date
N/Q Stock Options:				
12/31/97 (LEEP)	\$36.7032	109,634	53,997 (Now) 55,637 on 1/1/2001	Options continue to be available as if an active employee.
10/12/98 (LEEP)	\$46.8750	70,128	46,752 (Now) 23,376 on 1/1/2001	Options continue to be available as if an active employee.
12/7/98 (LEEP)	\$54.8594	104,440	52,220 (Now) 52,220 on 1/1/2001	Options continue to be available as if an active employee.
1/1/99 (Profit Sharing)	\$59.4375	2,154	718 (Now) 718 on 1/1/2001 718 on 1/1/2002	All vested options remain exercisable for 12 months following retirement date.
11/9/99 (SO Bonus)	\$25.8125	21,563	21,563 on 3/1/2003	Options will vest as indicated for retirees and the exercise period will be until 12/31/09.
2/7/2000 (CEO Challenge)	\$21.7812	50,000	50,000 on 1/1/2005	Options not vested at time of retirement are cancelled.
5/18/00 (Non-trad NQ)	\$27.0000	100,000	50,000 on 1/1/2001 50,000 on 1/1/2002	Options continue to be available as if an active employee.
Total		457,919		
Incentive Stock Rights				
10/13/97		20,000	20,000 on 10/13/2001	
12/31/97 (LEEP)		15,896	15,896 on 3/1/2001	ISRs vest if EPS targets are met.
12/7/98 (LEEP)		10,444	10,444 on 3/1/2001	ISRs vest if EPS targets are met.
5/18/00 (Special ISR)		30,000	15,000 on 1/1/2001 15,000 on 1/1/2002	
Total		76,340		

PROFIT SHARING AND SAVINGS ACCOUNTS

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 determination of your account balances will be done at retirement.

EMPLOYEE STOCK OWNERSHIP PLAN (ESOP)

Upon retirement, 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 done at retirement.

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, you will 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 age and will be offset by your RIGP benefits. 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.

In addition to RIGP and SERP benefits you will receive a retirement supplement approved by the ECBC and communicated to you last November. It will provide the equivalent of \$75K per year and will be paid in 3 equal installments of \$280,746 beginning 1/1/02. You can elect a single lump sum payment (\$842,238) of this part of your retirement benefits if you make that election prior to December 31, 2001.

MEDICAL BENEFITS

As a retiree, you are eligible to receive medical coverage under Xerox Retiree Flex. 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 United HealthCare.

LIFE INSURANCE

Your Contributory Life Insurance coverage of \$1,500,000 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. Additional information will be sent to you from LongMiller, our consultants for this program.

DEFERRED COMPENSATION PLAN

Your deferred compensation accounts will be paid out according to the terms of your prior elections following retirement.

OTHER ARRANGEMENTS

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

Your company financial counseling program will be continued through the end of 2002.

Tax preparation will be extended through 2002 for the 2001 tax year.

When salary continuance begins, you will not be entitled to any future Executive Expense Allowance payments.

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, 2) Section 2 of Article VIII of the by-laws of the Company as in effect on the date hereof 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 Company, Ltd., or any successor insurance company.

RELEASE

This agreement shall not become effective until you execute and delivery to the Company the release in the form attached.

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 for consultation with the Company's counsel in any such litigation and to testify in such litigation at the Company's expense for travel and lodging, if required.

Margie Filter will contact you regarding your resignation as a Corporate Officer and Vice Chairman of the Board of Directors.

Bill, if you have any questions on the above, please call me or Pat Nazemetz at (203) 968-3158. Otherwise, please sign this letter and return it to me.

Sincerely,

/s/ Paul A. Allaire

Paul A. Allaire
PAA/bjf

Attachment

Copies:

HJMotroni
PMNazemetz
RLStrahota

AGREED AND ACCEPTED

/s/ W. F. Buehler
William F. Buehler

Date: 12/8/00

THE DOCUMENT COMPANY
XEROX

CONFIDENTIAL

Xerox Corporation
800 Long Ridge Road
Stamford, CT 06904

Anne M. Mulcahy
President and Chief Operating Officer

April 2, 2001

Mr. Carlos Pascual
7 Ridge Road
Weston, CT 06883

Dear Carlos:

This letter will summarize our understanding and agreement regarding your employment status. I appreciate your agreement to remain employed at Xerox Corporation ("Xerox" or the "Company") until the end of 2002. I am counting on your support to help us during this turnaround period.

I know your pension and other aspects of your pay have been of concern to you. I have received Executive Compensation and Benefits Committee approval for the following actions, assuming you remain employed through 12/31/2002:

At the earliest possible date, Xerox will direct Xerox Spain to move to "externalize" your Spanish pension in a manner consistent with proposed Spanish law requirements. For purposes of this agreement, "externalization" of the Spanish pension plans refers to actions taken by Xerox in Spain under Spanish legislation which results, inter alia, in the complete segregation of pension assets for the benefit of plan beneficiaries and the denial of any creditor access to such plan assets unless and until all plan liabilities are settled. You will sign documents as may be necessary to enable vesting at age 60 and benefits payments beginning at age 60. Your benefits will be based on your Notional Salary in Spanish Pasetas at the time of "externalization" updated by the Company's actuary with the general rules applied to the participants of the Xerox Spain Pension Fund.

To the extent "externalization" results in an imposition of U.S. Tax to you, Xerox will indemnify you for the actual amount of such tax arising from the "externalization" of your Spanish pension for the period ending 12/31/2006. For purposes of this Agreement, "Tax" shall be: (i) the incremental amount of U.S. and state individual income taxes (including any penalties or interest) net of any foreign tax credit you actually receive in Spain or any other foreign jurisdiction for such Tax (ii) plus a gross-up amount in an amount that makes you economically whole on an after-tax basis. For the sake of clarity it is understood between the parties hereto that the Tax shall be calculated by comparing the Tax you would owe with the inclusion of your Spanish pension versus the Tax you would owe without inclusion of your Spanish pension. The calculation of Tax shall be made by tax advisors

acceptable to the Company. You agree that you will cooperate with the Company and its advisors in order to determine the proper amount of Tax. Such cooperation shall include but not be limited to; providing Xerox with copies of all your relevant tax returns plus any relevant correspondence from the appropriate taxing jurisdictions and; instructing your advisors to cooperate

with Xerox including sharing copies of all their relevant tax workpapers. You will be responsible for payment of taxes in Spain, or other jurisdictions. You will be responsible for any U.S. tax payments after 12/31/2006. Xerox shall have the right to contest any imposition with the Internal Revenue Service and/or the appropriate state taxing jurisdiction ("Contest"). Xerox shall control such Contest. No payment of Tax will be due until the conclusion of the Contest. You will, and you will instruct your tax advisors, to cooperate with Xerox in a Contest.

Following the completion of your active employment on 12/31/2002, the Company will provide relocation assistance per the terms of the Transferred Relocation policy, at a cost not to exceed \$100,000, and you will remain as an employee of Xerox Espana, S.A. on salary continuance for the three-year period ending 12/31/2005. Your retirement will be effective 1/1/2006. Your rate of salary paid during salary continuance will be Pesetas 4,389,600 per month for 36 months, less applicable taxes. You agree to waive any other severance benefits that you otherwise may be eligible to receive. If you cannot waive rights to any additional severance benefit, the amount of salary continuance shall be reduced by an amount equal to the other amounts payable. Required withholding taxes will be taken out of all such payments and reported on the appropriate Form W-2 or Form 1099.

During salary continuation, you will remain as Chairman of Xerox Espana, S.A. at the discretion of the CEO of Xerox Corporation.

Salary continuance will be conditioned upon your signing a General Release acceptable to the Company prior to the commencement of salary continuance.

You agree that your awards under the New LEEP program granted effective on 1/1/2001 and to be granted effective on 1/1/2002 will vest 100% on 1/1/2007 notwithstanding any other terms or provisions of the award. You agree that these awards will be forfeited in their entirety if the Company is required to make tax reimbursement and related payments in excess of the Value of the New LEEP awards as a result of U.S. taxation of your Spanish pension. If the tax reimbursement and related payments made by the Company are less than the Value of your New LEEP awards, you will continue to vest, per the terms of the awards, in that portion of the New LEEP awards that the Value exceeds the amount of tax reimbursement and related payments made by the Company. For purposes of this paragraph, Value means an amount equal to the sum of the following:

- Number of shares of restricted stock granted to you under the New LEEP program times the Fair Market Value of each share on 1/1/2007, or any earlier vesting date; and

- An amount equal to the total spread (the Fair Market Value of Xerox stock as of 1/1/2007, or any earlier vesting date, less the option Purchase Price) on the stock options awarded to you under the New LEEP program.

. You will not be eligible for a New LEEP award in 2003.

Should you leave the Company's employment for any reason other than death or under circumstances which would give you the right to receive severance payments under the Severance Agreement between you and the Company dated as of October 15, 2000 prior to 12/31/2002:

- Unless the CEO authorizes (subject to ECBC approval) continuation of vesting in some or all LEEP awards granted 1/1/2001 and 1/1/2002 they will immediately cancel;

- You will not be eligible for any salary continuance or other termination benefits whatsoever;

- The Company's promise to reimburse you for any U.S. tax on your Spanish pension will immediately expire; and

- You will immediately reimburse the Company for any tax related payments made

to you with respect to your Spanish pension.

This letter agreement supersedes and replaces the letter agreement dated December 21, 2000.

Sincerely,

/s/ ANNE M. MULCAHY

Anne M. Mulcahy

AMM/pba

AGREED AND ACCEPTED

/s/ Carlos Pascual

Carlos Pascual

Date:

Copies:

HJMotroni
PMNazemetz
RLStrahota

Computation
of Net Income Per Common Share

(Dollars in millions, except per-share data; shares in thousands)

I. Basic Net Income (Loss) Per Common Share

Income from continuing operations
Accrued dividends on ESOP preferred stock, net
Accrued dividends on redeemable preferred stock
Adjusted income from continuing operations
Discontinued operations
Adjusted net income (loss)

Average common shares outstanding during the period
Common shares issuable with respect to
exchangeable shares
Adjusted average shares outstanding for the period

Basic earnings (loss) per share:
Continuing operations
Discontinued operations
Basic earnings (loss) per share

II. Diluted Net Income (Loss) Per Common Share

Income from continuing operations
Accrued dividends on ESOP preferred stock, net
Accrued dividends on redeemable preferred stock
ESOP expense adjustment, net of tax
Interest on convertible debt, net of tax
Adjusted income from continuing operations
Discontinued operations
Adjusted net income (loss)

Average common shares outstanding during the period
Common shares issuable with respect to:
Stock options, incentive and exchangeable shares
Convertible debt
ESOP preferred stock
Adjusted average shares outstanding for the period

Diluted earnings (loss) per share:
Continuing operations
Discontinued operations
Diluted earnings (loss) per share

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	2000	1999	1998	1997	1996
\$	(257)	\$ 1,339	\$ 463	\$ 1,452	\$ 1,206
	(35)	(38)	(46)	(44)	(43)
	-	-	-	-	(1)
	(292)	1,301	417	1,408	1,162
	-	-	(190)	-	-
\$	(292)	\$ 1,301	\$ 227	\$ 1,408	\$ 1,162

666,663	661,917	655,676	649,608	648,924
918	1,576	3,280	3,763	5,464

667,581	663,493	658,956	653,371	654,388
=====				

\$ (.44)	\$ 1.96	\$.63	\$ 2.16	\$ 1.78
-	-	(.29)	-	-

\$ (.44)	\$ 1.96	\$.34	\$ 2.16	\$ 1.78
=====				

\$ (257)	\$ 1,339	\$ 463	\$ 1,452	\$ 1,206
(35)	-	(46)	-	-
-	-	-	-	(1)
-	5	-	-	(3)
-	17	3	3	3

(292)	1,361	420	1,455	1,205
-	-	(190)	-	-

\$ (292)	\$ 1,361	\$ 230	\$ 1,455	\$ 1,205
=====				

666,663	661,917	655,676	649,608	648,924
918	10,303	13,091	11,691	16,106
-	13,191	5,287	5,287	5,288
-	51,989	-	54,687	55,962

667,581	737,400	674,054	721,273	726,280
=====				

\$ (.44)	\$ 1.85	\$.62	\$ 2.02	\$ 1.66
-	-	(.28)	-	-

\$ (.44)	\$ 1.85	\$.34	\$ 2.02	\$ 1.66
=====				

Computation of Ratio of Earnings to Fixed Charges

Year ended December 31 (in millions)	2000	1999	1998	1997	1996
Fixed Charges:					
Interest expense	\$1,031	\$ 803	\$ 749	\$ 617	\$ 592
Rental expense	115	132	145	140	140

Total fixed charges before capitalized interest and preferred stock dividend of subsidiary	1,146	935	894	757	732
Capitalized interest	3	8	-	-	-
Preferred stock dividend of subsidiary	55	55	55	50	-

Total fixed charges	\$1,204	\$ 998	\$ 949	\$ 807	\$ 732
=====					
Earnings available for fixed charges:					
Earnings**	\$ (323)	\$1,976	\$ 653	\$2,132	\$2,045
Less undistributed income in minority owned companies	(20)	(68)	(27)	(84)	(84)
Add fixed charges before capitalized interest and preferred stock dividend of subsidiary	1,146	935	894	757	732

Total earnings available for fixed charges	\$ 803	\$2,843	\$1,520	\$2,805	\$2,693
=====					
Ratio of earnings to fixed charges (1) (2)	*	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, by total fixed charges. Fixed charges consist of interest, including capitalized interest and preferred stock dividend requirements 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.

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

** Sum of "Income before Income Taxes, Equity Income and Minorities' Interests" and "Equity in Net Income of Unconsolidated Affiliates."

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

Summary of
Total Company Results

As more fully discussed below and in Note 2 to the Consolidated Financial Statements, the Company has restated its 1999 and 1998 financial statements. All dollar and per share amounts and financial ratios have been revised, as appropriate, for the effects of the restatements.

We were advised in June, 2000 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. The SEC is continuing its investigation into Mexican accounting issues and other accounting matters which include consideration of the attached Consolidated Financial Statements including all the items affected by the restatements. We continue to fully cooperate with the investigation. The Company cannot predict when the SEC will conclude its investigation or its outcome.

Management intends to restate, as appropriate, the Company's quarterly financial information, and to refile any restated quarterly financial information with the SEC. At such time, the Company's Annual Report on Form 10-K will be re-filed, as amended, for any restatement of quarterly information. Our independent auditors' opinion on the Consolidated Financial Statements for each of the years in the three year period ended December 31, 2000, presently contains an explanatory paragraph referring to our supplementary quarterly financial information and to the fact that the independent auditors were unable to complete their reviews of such quarterly information due to matters related to the restatement issues as described in Note 2 to the Consolidated Financial Statements. After we have completed our restatement of such quarterly information, the Company believes that our independent auditors will be able to complete their reviews and modify their Report of Independent Auditors accordingly.

The business challenges that began to impact our performance in the second half of 1999 continued to adversely affect our financial performance in 2000. We reported a net loss of \$257 million or 44 cents per share in 2000 compared with a profit of \$1,339 million or \$1.85 per share in 1999. These business challenges included company specific issues such as the realignment of our sales force from a geographic to an industry structure resulting in higher sales force turnover, open sales territories and lower sales productivity; the disruption and incremental costs associated with consolidation of our U.S. customer administration centers and changes in our European infrastructure; competitive and industry changes; and adverse economic conditions in our Latin American affiliates and in the U.S. toward the latter part of the year. These operational challenges, exacerbated by significant technology and acquisition investments, have resulted in credit rating downgrades, limited access to capital markets and marketplace concerns regarding our liquidity.

To counter these challenges, in October of 2000 we announced a turnaround program including anticipated asset sales totaling \$2 - \$4 billion, accelerated cost reductions and plans to transition the equipment financing business to third party vendors. At this time we believe our plan is on track as our prime objective of cash generation is being realized. We strengthened our cash position in the fourth quarter and ended the year with more than \$1.7 billion in cash and equivalents, with approximately \$400 million positive cash flow from operations in the fourth quarter. We concluded 2000 by selling our China operations to Fuji Xerox for \$550 million. In January 2001, we obtained \$435 million in financing from an affiliate of General Electric Capital Corporation (GE Capital) and announced that we were also discussing possible plans for GE Capital to provide ongoing equipment financing for Xerox customers in several European countries. In March 2001, we sold half of our ownership interest in Fuji Xerox to Fuji Photo Film Co., Ltd. (Fujifilm) for \$1,283 million in cash. In April 2001, we entered an agreement to sell our leasing businesses in four European countries to Resonia Leasing AB for approximately \$370 million in cash at approximately book value. In addition to our asset disposition

initiatives, we are aggressively finalizing and implementing cost-reduction plans, which we anticipate will yield at least \$1 billion in annualized savings by the end of 2001. Since the third quarter of 2000, we have taken actions that account for more than one-half of this target, including the reduction of approximately 2,000 and 4,300 jobs in the fourth quarter of 2000 and the first quarter of 2001, respectively.

1

We have restated our Consolidated Financial Statements for the fiscal years ended December 31, 1999 and 1998 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 application thereof. As a result of these investigations, it was determined that certain accounting practices and the application thereof misapplied generally accepted accounting principles (GAAP) and certain accounting errors and irregularities were identified. The Company has corrected the accounting errors and irregularities in its Consolidated Financial Statements. The Consolidated Financial Statements have been adjusted as follows:

In fiscal 2000 the Company had recorded charges totaling \$170 million (\$120 million after taxes) which arose from imprudent and improper business practices in Mexico that resulted in certain accounting errors and irregularities. Over a period of years, several senior managers in Mexico had collaborated to circumvent certain Xerox accounting policies and administrative procedures. The charges related to provisions for uncollectible long-term receivables, the recording of liabilities for amounts due to concessionaires and, to a lesser extent, for contracts that did not fully meet the requirements to be recorded as sales-type leases. The investigation of the accounting issues discovered in Mexico has been completed. The Company has restated its prior years' Consolidated Financial Statements to reflect reductions to pre-tax income (loss) of \$53 million and \$13 million in 1999 and 1998, respectively. The vast majority of the approximate remaining \$101 million of the fiscal 2000 Mexican charge relates to bad debt provisions.

In connection with our acquisition of the remaining 20 percent of Xerox Limited from Rank Group, Plc in 1997, we recorded a liability of \$100 million for contingencies identified at the date of acquisition. One of the investigations conducted by the Audit Committee of the Board of Directors expressed a judgment that this liability should not have been recorded. However, management believes that the liability and corresponding goodwill asset were established appropriately in 1997; such asset and liability were only 0.4 percent and 0.5 percent, respectively of total assets and total liabilities. During 1998, we determined that the liability was no longer required. During 1998 and 1999, we charged to the liability certain expenses incurred as part of the consolidation of our European back-office operations. This reversal should have been recorded as a reduction of Goodwill and Deferred tax assets. Therefore, we have restated our previously reported Consolidated Financial Statements to reflect decreases of \$67 million to Goodwill and \$33 million to Deferred tax assets and increases in Selling, administrative and general expenses of \$76 million in 1999 and \$24 million in 1998.

In addition to the above items, we have made adjustments in connection with certain misapplications of GAAP under Statement of Financial Accounting Standards No. 13, "Accounting for Leases" (SFAS No. 13). These adjustments primarily relate to the accounting for lease modifications and residual values as well as certain other items. The following table presents the effects of all the aforementioned items on our pre-tax income (loss).*

(in millions)	Year ended December 31,		
	2000	1999	1998

 Increase (decrease) to
 pre-tax income (loss)*

Mexico	\$ 69	\$ (53)	\$ (13)
Rank Group Acquisition	6	(76)	(24)
Lease issues, net	87	83	(165)
Other, net	10	(82)	18

Total	\$172	\$(128)	\$(184)

* Pre-tax income (loss) refers to income (loss) from Continuing Operations before income taxes (benefits), Equity Income and Minorities Interests. For convenience, that financial statement caption is hereafter referred to as pre-tax income (loss).

These adjustments resulted in the cumulative net reduction of Common shareholders' equity and Consolidated Tangible Net Worth (as defined in our \$7 Billion Revolving Credit Agreement) of \$137 million and \$76 million, respectively, as of December 31, 2000. Retained earnings at December 31, 1997 were restated from \$3,960 million to \$3,852 million as a result of the effect of these aforementioned adjustments on years prior to 1998.

Throughout the following Management's Discussion and Analysis of Results of Operation and Financial Condition all referenced amounts reflect the above described restatement adjustments.

Revenues of \$18.7 billion in 2000 declined 4 percent (1 percent pre-currency) from 1999. Excluding the beneficial impact of the January 1, 2000 acquisition of the Tektronix, Inc. Color Printing and Imaging Division (CPID), 2000 revenues declined 8 percent (5 percent pre-currency.) Revenues were impacted by a combination of company specific issues, an increased competitive environment and some weaker economies toward the latter part of the year. Revenues of \$19.6 billion in 1999 were flat (and increased 1 percent pre-currency) from 1998, including a very substantial revenue decline in Brazil due to the currency devaluation and subsequent economic weakness.

In reviewing our performance, we discuss our results of operations, as reported in our consolidated financial statements and also as adjusted for the effects of certain

2

special items. This means that we analyze our results both before and after the effects of these special items. We believe that this will assist readers in better understanding the trend in our results. A discussion of these special items, including a table which illustrates their effects on our Consolidated Statement of Operations, appears below.

(In millions, except per-share data)	2000	1999	1998

Memo:			
Pre-tax income (loss)	\$ (384)	\$1,908	\$ 579
Pre-tax income before restructuring and special items	62	1,908	2,223

Income (loss) from			
Continuing operations	\$ (257)	\$1,339	\$ 463
Loss from Discontinued operations	-	-	(190)

Net income (loss)	(257)	1,339	273

Restructuring and other special items	(353)	-	(1,107)
Income before special items	\$ 96	\$1,339	\$ 1,380

Earnings (loss) per share			
Income (loss) from			

Continuing operations	\$ (0.44)	\$ 1.85	\$ 0.62
Loss from Discontinued operations	-	-	(0.28)

Diluted earnings (loss) per share	(0.44)	1.85	0.34

Restructuring and special items	(0.53)	-	(1.64)
Income from Continuing operations before special items	\$ 0.09	\$ 1.85	\$ 2.26

Net loss in 2000 includes a \$200 million pre-tax gain (\$119 million after taxes) related to the Company's December 2000 sale of its China operations to Fuji Xerox, \$619 million of restructuring, inventory and asset impairment charges (\$456 million after taxes and including our \$37 million share of a Fuji Xerox restructuring charge), and a \$27 million (\$16 million after taxes) in-process research and development charge from the CPID acquisition. The net loss in 2000 was \$257 million including these items or income of \$96 million excluding these special items. Excluding the 1998 restructuring charge, income from continuing operations decreased 3 percent in 1999.

Including these special items, our diluted loss per share was \$0.44 in 2000. Excluding these special items, diluted earnings per share declined 95 percent in 2000 and decreased 18 percent in 1999.

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 changes therein, and their impacts on pre-tax income (loss):

Increase (decrease) in Pre-tax income (in millions)	2000	1999	1998

Provisions for doubtful accounts	\$ (647)	\$ (406)	\$ (303)
Provisions for obsolete and excess inventory	(146)	(158)	(85)
Revenue allocations	44	102	101
Finance discount rates	24	101	128
Indirect taxes	17	35	21
Sales and consumption taxes	11	--	51

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, and our operations in these countries have historically implemented pricing actions to recover the impact of inflation and devaluation.

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 10 percent stronger in 2000 and 4 percent stronger in 1999. As a result, foreign currency translation unfavorably impacted revenue growth by approximately 3 percentage points in 2000 and 1 percentage point in 1999.

In the early part of 1999, the Brazilian real was devalued substantially

against the U.S. dollar. For the full year, the average real exchange rate declined 36 percent to 1.80 in 1999 from 1.16 in 1998. The unfavorable impact of our Brazilian operation on our total revenue growth was approximately 4 percentage points in 1999. This included the impact of the currency devaluation and the subsequent weak economic environment.

We do not hedge the translation effect of revenues denominated in currencies where the local currency is the functional currency.

Revenue by Segment

At the beginning of 2000, we realigned our organization according to the segments identified below. It was impracticable for us to reclassify our 1998 results to conform to these segments. Accordingly no discussion of the changes in revenues for 1999 as compared to

3

1998 is presented here. Revenues and year-over-year revenue growth rates by segment are as follows:

	Revenues/1/		Growth	
	(in billions)		Post Currency	Pre- Currency
	2000	1999		
Total Revenues	\$18.7	\$19.6	(4)%	(1)%
Industry Solutions	9.2	10.1	(10)	(6)
General Markets	5.3	4.9	8	12
Developing Markets	2.7	2.8	(2)	(1)
Other Businesses	1.5	1.8	(14)	(10)
Memo: Fuji Xerox/2/	8.4	7.8	8	4

/1/ Revenues have been restated as required by FASB EITF 2000-10 for all periods presented to include shipping and handling charges billed to customers. These amounts were historically reported as a reduction of cost of goods sold.

/2/ Represents total revenue of Fuji Xerox, of which approximately 10% represents sales to the Company.

Industry Solutions Operations (ISO) covers the direct sales and service organization in North America and Europe. 2000 revenues declined 10 percent (6 percent pre-currency) as the impact of the January 2000 final phase of the realignment of the sales force from a geographic to an industry approach first necessitated establishment of many new customer relationships and subsequently resulted in increased sales turnover, open sales territories and less experienced sales personnel. This was compounded by a strengthening of our competitor's product capabilities, an increase in distributed printing which has adversely impacted new equipment sales and recurring revenues on our equipment population and, toward the latter part of the year, a weakening U.S. economic environment. U.S. revenues were further adversely impacted by customer administration issues. Revenues declined in the U.S., France and Germany, reflected good growth in the U.K. and grew modestly in Canada.

General Markets Operations (GMO) includes sales agents in North America, concessionaires in Europe and our Channels Group, which includes retailers and resellers. Including the CPID acquisition, GMO 2000 revenue grew 8 percent (12 percent pre-currency). Excluding CPID, GMO revenue declined 5 percent (1 percent pre-currency). Strong European concessionaire growth was offset by weak North American sales agent revenues and the adverse impact of declining office monochrome laser printer unit sales, which was consistent with the trend throughout the industry. As a result of the January 2000 CPID acquisition, equipment sales and supplies revenues from office color network printers were strong reflecting the introduction of new CPID color laser and solid ink

products throughout the year. Excellent growth in inkjet equipment placements, including the new DocuPrint M series resulting from our alliance with Sharp Corporation and Fuji Xerox Co., Ltd. (Fuji Xerox), was mitigated by significant inkjet equipment pricing pressures. Developing Market Operations (DMO) includes operations in Latin America, China (sold in December 2000), Russia, India, the Middle East and Africa. The 2 percent decline in DMO revenues reflected flat revenues in Brazil, a significant decline in Mexico associated with the dislocation in that operation, declines throughout the rest of Latin America and excellent growth in China, India and the Middle East. Revenues in Brazil reflected an improved economic environment but this improvement was offset by increased competitive activity and lower prices during the latter part of the year as the Company focused on reducing inventory.

The Company's Latin America operations can be subject to volatile economies and currency fluctuations. While our Brazilian operations currently represent less than 5 percent of total revenue they continue to have an adverse impact on the Company's results of operations. Historically, the Brazilian operations have managed to offset the economic impact of devaluation through pricing changes, customer upgrades and reductions in its cost base and accordingly have successfully managed their operations so as to moderate the effects of these economic events. The Brazilian economy remains unsettled, and as a result the recovery in our Brazil operation has not returned to pre-1999 levels, nor is recovery expected in 2001.

The Company sells most of its products and services under bundled arrangements which contain multiple deliverable elements, or alternatively sells its equipment and services on a stand-alone basis. In 2000, bundled transactions represented approximately 64 percent, 65 percent, and 57 percent of the total value of transactions in the U.S., Europe (excluding indirect sales channels) and DMO (primarily Brazil), respectively. Multiple element arrangements typically include equipment, services, supplies and financing components for which the customer pays a single defined price. These arrangements typically also include a variable service component for copy volumes in excess of stated minimums. Prices listed in these multiple element arrangements with our customers may not be representative of the fair value of those elements because the prices of the different components of the arrangement may be altered in customer negotiations, although the aggregate consideration may remain the same. Management's objective is to ensure that revenues under these arrangements are allocated based upon estimated fair values of the elements in accordance with GAAP. The fair value of each element is estimated based on a review of a number of factors including average selling prices for the elements when they are sold on a stand-alone basis. The average selling prices are

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based on management's best estimates of market conditions and competitive pricing considerations.

The principal change in estimate relating to such revenue allocations among multiple elements is made with respect to the estimated fair value of those elements and their related margins. This is a significant factor considered in our revenue allocation process along with other factors, such as pricing changes and customer discounts, also affect the overall allocation process. The effect of such changes in estimates of fair values and related margins in the years 2000, 1999 and 1998 was \$193 million, \$202 million, and \$141 million, respectively, which management understood to result, generally, in increases of sales revenues and decreases to deferred elements of those arrangements. The net effects of such allocations when offset by corresponding decreases in deferred revenues was to increase pre-tax income in 2000, 1999 and 1998 by \$44 million, \$102 million, and \$101 million, respectively.

As we transition to third-party vendor financing, the proportion of our sales to customers through bundled arrangements containing the same multiple deliverable elements will decrease, as third parties will finance stand-alone equipment sales.

Our primary arrangements with customers conform with SFAS No. 13 as sales-type leases allowing the recording of equipment sale revenue. Certain customer arrangements which did not meet the sales-type lease criteria for revenue recognition were recorded as operating leases.

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. The following shows the effects of such sales of equipment under operating leases, offset by the associated reductions of operating lease revenues from current and prior years transactions:

(in millions)	2000	1999	1998
Sales of equipment	\$ 22	\$ 120	\$ 74
Reduced Operating Lease Revenue	(106)	(104)	(123)
	\$ (84)	\$ 16	\$ (49)

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:

(in millions)	2000	1999	1998
Sales of equipment	\$ 126	\$280	\$--
Reduced Operating Lease Revenue	(132)	(17)	--
	\$ (6)	\$263	\$--

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. For example, the decline in 2000 from 1999 was driven by the lower volume of sales in 2000, reduced equipment on operating lease available for sale and the absence of rental revenue from sales of operating leases in prior years. The increase in 1999 resulted from a marketing strategy in Brazil following the maxi-devaluation of that country's currency in the first quarter of 1999. The strategy emphasized offering operating leases to our customers and subsequently selling the equipment under these leases to third party financial institutions to mitigate the credit risk of the portfolio. By the end of 1999 operating lease contracts increased to approximately 11 percent of total activity versus historical levels of approximately 6 percent.

As more fully discussed in the accompanying Capital Resources and Liquidity, the Company presently has limited access to the capital markets. This situation also impacts our current ability to enter into transactions for the sales of equipment subject to operating leases.

Gross Margin, Cost and Expenses

The trend in gross margin was as follows:

	2000	1999	1998
Total Gross Margin*	37.4%	43.3%	44.4%
Gross margin by revenue stream:			
Sales***	37.5	43.1	43.8
Service and rental	44.1	47.4	47.6
Document outsourcing**	24.0	29.6	32.9
Finance Income	34.5	49.4	50.1

- * Includes inventory charges associated with the 2000 and 1998 restructurings. If excluded, the gross margins would have been 37.9% and 45.0%, respectively.
- ** Equipment sales included in Document outsourcing arrangements are included in the Sales Margin.
- *** Includes inventory charges associated with the 2000 and 1998 restructuring. If excluded, sales gross margins would have been 38.4 percent and 44.9 percent in 2000 and 1998, respectively.

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Gross margin of 37.4 percent in 2000 was 5.9 percentage points below 1999 or 5.4 percentage points lower excluding the 2000 restructuring inventory charge. Approximately half of the 5.4 percentage point 2000 gross margin decline was the result of the ISO segment's weak DocuTech and production printing equipment sales. Higher growth in the lower-margin document outsourcing business of the ISO segment, and in the small office/home office business of the GMO segment, reduced the gross margin by approximately 1.5 percentage points. Our inkjet strategy for the small office/home office is to build an equipment population that will generate profitable supplies revenue over time. Significant competitive equipment pricing pressures have strained profits and liquidity as we build the inkjet equipment population. Finally, gross margin was adversely impacted by competitive price pressure, unfavorable transaction currency and temporary pricing actions to reduce inventory on certain products in the latter part of the year. Manufacturing and other productivity improvements only partially offset the above items.

The 1999 gross margin of 43.3 percent was 1.1 percentage points below 1998. Excluding the 1998 inventory restructuring charge, the 1.7 percentage point 1999 gross margin decline was due primarily to higher revenue growth in the lower-margin document outsourcing and channels businesses and the significant revenue decline in the higher-margin Brazilian operation, together with a lower gross margin in Brazil compared with the prior year. In addition, the gross margin was adversely impacted by unfavorable product mix, unfavorable currency and a decline in service gross margins as service revenue declines had not been accompanied by corresponding cost reductions. Substantial competitive price pressures were partially offset by some manufacturing and other productivity improvements.

We expect that the total gross margin will stabilize in 2001 at the fourth quarter 2000 level of 33.7 percent which was significantly lower than the full year gross margin. We expect equipment sales margins will continue to be under pressure as our business mix continues to shift to lower equipment margin products and due to competitive pricing pressures. We expect equipment margin declines will be offset by improving service margins in 2001 as productivity savings are expected to be achieved.

Financing income is determined by the discount applied to minimum contract payments, excluding service and supplies, used in the estimation of the fair value of the equipment. Finance interest rates include the aforementioned discount rates in customer arrangements as well as related sources of income. Over the years the Company's finance interest rates have changed as a result of a number of factors including money market conditions; the economic environment; debt coverage; return on equity; debt to equity ratios and other external factors which are particularly relevant to our financing business. During the period from 1998 to 2000 such finance interest rates and the Company's average cost of funds used in our customer financing activities were:

	2000	1999	1998
Average Finance Interest Rates	8.3%	9.2%	9.3%
Average Cost of Funds	5.4%	4.7%	5.1%

In line with market comparables, the Company's financing operations are targeted to achieve a 15 percent return on equity. The Company periodically reviews, and may change, the discount rates in order to be consistent with this objective and to reflect the estimated fair value of the financing component in its lease arrangements. Changes in the rate applied to a bundled arrangement may affect one or more elements of the arrangement. In general, the following changes in discount rates are reflected as reciprocal changes in equipment revenues, partially offset by the resulting change in customer finance income.

Such changes in accounting estimate had the following approximate effects on pre-tax income (loss):

Increase/(Decrease)	2000	1999	1998
Effect of changes in discount Interest rates/1/	\$24	\$101	\$128

/1/ Represents the impact of changes in discount rates net of amortization of the related cumulative unearned income effects.

Gross residual values on our finance receivables declined in 2000 by \$16 million and increased in 1999 by \$80 million from 1998. Unguaranteed residual values are assigned primarily to our high volume copying, printing and production publishing products. Residual values are reviewed on a quarterly basis as to their ultimate realization using both internal and external data. Impairments, if any, are recorded as necessary as a result of these reviews. The assigned values are generally established in order to result in a normal profit margin on the subsequent transaction.

The trend in Selling, administrative and general expenses as a percent of revenue is as follows:

	2000	1999	1998
SAG % Revenue	30.2%	27.0%	27.3%

Selling, administrative and general expenses (SAG) grew 7 percent in 2000 (3 percent excluding CPID). Excluding the favorable effect of currency, SAG grew 10 percent, or 7 percent excluding CPID. SAG includes bad debt provisions of \$647 million in 2000 which is \$241 million higher than 1999. The increase reflects higher worldwide provisions of approximately \$50

the U.S., an increase of over \$100 million in Mexico, and unsettled business and economic conditions in many Latin American countries. A review of our worldwide internal controls to determine that the issues identified in Mexico were not present elsewhere has been completed. The issues identified in Mexico were not found to be in evidence in any other major unit in which we operate however several small Developing Markets Operations affiliates were found to have used imprudent business practices resulting in certain adjustments and contributing to the impact of the restatement.

SAG growth in 2000 also includes increased salesforce payscale and incentive compensation, significant transition costs associated with implementation of the European shared services organization, continued impacts of the U.S. customer administration issues and significant marketing, advertising and promotional investments for our major inkjet printer initiative. When combined with the lower revenues, SAG as a percent of revenue deteriorated to 30.2 percent in 2000.

SAG declined 1 percent in 1999 (and was flat pre-currency). The improved ratio of SAG to revenue in 1999 reflected significant declines in general and administrative expenses due to restructuring, expense controls, substantially lower management and employee bonuses and profit sharing and the beneficial currency translation impact, including the devaluation of the Brazilian currency, partially offset by the unfavorable impact of U.S. customer administration issues. Provisions for uncollectible accounts and receivables issues were \$647 million in 2000, \$406 million in 1999 and \$303 million in 1998.

Research and development (R&D) expense grew 5 percent in 2000 including CPID and declined 4 percent in 1999. Increased spending in 2000 reflected increased program spending primarily for solid ink, solutions and FutureColor, an advanced next-generation digital printing press technology which we expect will begin early customer engagement later this year. The 1999 reduction is largely due to substantially lower management and employee bonuses and profit sharing and lower overhead. We continue to invest in technological development to maintain our position in the rapidly changing document processing market with an added focus on increasing the effectiveness and value of our R&D investment. Xerox R&D is strategically coordinated with Fuji Xerox, which invested \$615 million in R&D in 2000 for a combined total of \$1.7 billion. We expect R&D spending in 2001 will be essentially unchanged from 2000 and believe this level is adequate to remain technologically competitive.

Restructuring Charges

On March 31, 2000, we announced details of a worldwide restructuring program. In connection with this program we recorded a pre-tax provision of \$596 million (\$423 million after taxes, including our \$18 million share of a restructuring charge recorded by Fuji Xerox). The \$596 million 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 affect 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.

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, \$71 million, primarily related to severance costs for 1,000 positions, of the original \$596 million provision, was reversed. 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.

Also during the fourth quarter of 2000, we announced a turnaround program, which includes a wide-ranging plan to sell assets, cut costs and strengthen core operations. Additionally, we have initiated discussions with third parties to provide financing for customers in a manner that does not involve the Xerox balance sheet. As part of this initiative we announced the sale of certain European financing businesses, in April 2001, to Resonia Leasing AB. As more fully discussed below, in December 2000 we sold to Fuji Xerox our operations in China and Hong Kong for \$550 million, and in March 2001, we sold half of our 50

percent ownership interest in Fuji Xerox to Fujifilm for \$1,283 million, in cash. We are in discussions to form a strategic alliance for our European paper business. We are actively engaged in discussions to sell certain other assets, including: Xerox Engineering Systems and our interests in spin-off companies such as ContentGuard and Inxight. We are seeking equity investors for our inkjet business and we are exploring a joint venture with non-competitive partners for certain of our research centers including the Palo Alto Research

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Center. Lastly, we are pursuing outsourcing or selling certain manufacturing operations. It is expected that in most cases asset sales will result in a gain.

Regarding the cost reductions, we are finalizing and aggressively implementing plans designed to reduce costs by at least \$1.0 billion annually. During the fourth quarter of 2000, we recorded an additional pre-tax restructuring provision totaling \$105 million (\$87 million after taxes, including our \$19 million share of an additional restructuring charge recorded by Fuji Xerox) in connection with finalized initiatives under the turnaround program. This charge included estimated costs of \$71 million for severance costs associated with work force reductions related to the elimination of 2,300 positions worldwide and \$34 million associated with the disposition of a noncore business. The severance costs relate to further streamlining of existing work processes, elimination of redundant resources and the consolidation of existing activities into other existing operations.

At December 31, 2000, the ending liability balance is \$209 million for the March 2000 restructuring program and \$71 million for the turnaround program resulting in a total liability balance of \$280 million as of December 31, 2000. For the 1998 restructuring, the liability balance as of December 31, 2000 is \$107 million, the majority of which will be utilized throughout 2001 as all initiatives have been substantially completed.

Worldwide employment decreased by 2,100 in 2000 to 92,500, including 4,600 employees leaving the Company under the restructuring programs and a reduction of 1,300 associated with the sale of our China operations to Fuji Xerox. These reductions were partially offset by the acquisition of CPID with 2,200 employees and the net hiring of 1,600 people in the early part of the year, primarily for the Company's fast-growing document outsourcing business.

Gain on Affiliate's Sale of Stock

Gain on affiliate's sale of stock of \$21 million reflects 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 is 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. Scansoft, an equity affiliate, is a developer of digital imaging software that enables users to leverage the power of their scanners, digital cameras, and other electronic devices.

Sale of China Operations

In December 2000, we completed the sale of our China operations to Fuji Xerox for a purchase price of \$550 million and assumption of \$118 million of debt. The pre-tax gain recorded in the fourth quarter of 2000 was \$200 million.

Other, net

Other expenses, net, were \$341 million in 2000, \$285 million in 1999 and \$219 million in 1998. The \$56 million increase in Other, net in 2000 reflects increased non-financing interest expense and goodwill and intangible asset amortization offset by gains on sales of businesses, as described below, and aggregate foreign currency exchange gains. Non-financing interest expense was \$426 million in 2000, \$256 million in 1999 and \$179 million in 1998. The significant increase in 2000 is the result of the CPID acquisition, generally higher debt levels and increased interest rates. Goodwill and intangible asset amortization was \$87 million in 2000, \$53 million in 1999 and \$38 million in 1998. 2000 expenses were offset by \$99 million of mark-to-market gains resulting from unhedged foreign currency-denominated assets and liabilities.

This includes \$69 million which arose as a direct result of a December 1, 2000 rating agency downgrade of our debt, resulting in liquidation of certain derivative contracts in place to hedge our exposure to currency fluctuations. The gains represent the change in the value of the underlying assets and liabilities from the date the related derivatives were terminated. Due to the inherent volatility in the foreign currency markets, we are unable to predict the amount of any such mark-to-market gains or losses in future periods.

In April 2000, we sold a 25 percent ownership interest in our wholly-owned subsidiary, ContentGuard, to Microsoft, Inc. for \$50 million and recognized a pre-tax gain of \$23 million, which is included in Other, net. An additional pre-tax gain of \$27 million was deferred pending the achievement of certain performance criteria. In connection with the sale, ContentGuard also received \$40 million from Microsoft for a non-exclusive license of its patents and other intellectual property and a \$25 million advance against future royalty income from Microsoft on sales of products incorporating ContentGuard's technology. The license payment is being amortized over the life of the license agreement of 10 years and the royalty advance will be recognized in income as earned.

In June 2000, we sold the U.S. and Canadian commodity paper business, including an exclusive license for the Xerox brand, to Georgia Pacific and recorded a

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pre-tax gain of approximately \$40 million which is included in Other, net. In addition to the proceeds from the sale of the business, the Company will receive royalty payments on future sales of Xerox branded commodity paper by Georgia Pacific and will earn commissions on Xerox originated sales of commodity paper as an agent for Georgia Pacific.

The increase of \$66 million in Other, net for 1999 primarily reflected increased non-financing interest expense and goodwill amortization associated with our \$45 million 1999 acquisition of Omnifax, our \$62 million 1999 acquisition of majority ownership in India and our \$413 million May 1998 acquisition of XLConnect Solutions; higher non-financing interest expense related to an increase in working capital; and increased environmental expense provisions following an updated review of our environmental liabilities. These increases were partially offset by lower Year 2000 (Y2K) remediation spending and net gains from several small asset sales including the sale of our European headquarters in 1998 for a pre-tax gain of \$36 million.

Income Taxes and Equity in Net Income of Unconsolidated Affiliates

Pre-tax income/(loss) was a loss of \$384 million in 2000 including the gain from the China sale, restructuring and asset impairments and CPID in-process R&D write-off. Excluding these items, the income before income taxes was \$62 million. Pre-tax income was \$1,908 million in 1999 and \$579 million in 1998. Excluding the 1998 restructuring and inventory charges, 1998 income was \$2,223 million.

The effective tax rates, were 28.4 percent in 2000, 30.8 percent in 1999 and 25.0 percent in 1998. Excluding the aforementioned items, the effective tax rate was 32.1 percent in 2000, 30.8 percent in 1999 and 31.5 percent in 1998. The increase in the effective tax rate before special items in 2000 compared with 1999 is due primarily to losses in a low tax rate jurisdiction, offset in part by a benefit of approximately \$125 million related to favorable resolution of tax audits. The 1999 and 1998 rates benefited from increases in foreign tax credits and refunds of foreign taxes, as well as shifts in the mix of our worldwide profits.

Equity in Net Income of Unconsolidated Affiliates is principally Xerox Limited's share of Fuji Xerox income. Total equity in net income declined to \$61 million in 2000 from \$68 million in 1999 and \$74 million in 1998. The 2000 decline reflected our \$37 million share of Fuji Xerox restructuring charges and reductions in income from several smaller investments which offset improved Fuji Xerox underlying results. The decline in 1999 reflected difficult economic conditions in Japan and other Asia Pacific countries, and reductions in income from several smaller investments partially offset by favorable currency translation due to the strengthening of the yen compared with the U.S. dollar.

Fuji Xerox, an unconsolidated entity jointly owned by Xerox Limited and Fuji Photo Film Co., Ltd., develops, manufactures and distributes document

processing products in Japan and the Pacific Rim. Approximately 80 percent of Fuji Xerox revenues are generated in Japan, with Australia, New Zealand, Singapore, Malaysia, Korea, Thailand and the Philippines representing another 10 percent. Fuji Xerox conducts business in other Pacific Rim countries through joint ventures and distributors. Xerox's exposure to economic turmoil in Asia is mitigated by our joint ownership of Fuji Xerox. The remaining 10 percent of Fuji Xerox revenues are sales to Xerox.

In March 2001, we sold half of our ownership interest in Fuji Xerox to Fujifilm for \$1,283 million, in cash. The sale resulted in a pre-tax gain of \$769 million (\$300 million after taxes). Under the agreement, Fujifilm's ownership interest in Fuji Xerox is increased from 50 percent to 75 percent. While Xerox's ownership interest is decreased to 25 percent, we retain rights as a minority shareholder. All product and technology agreements between us and Fuji Xerox continue, ensuring that the two companies generally retain uninterrupted access to each other's portfolio of patents, technology and products. With its business scope focused on document processing, Fuji Xerox will continue to provide color office product technology to us and collaborate with us on research and development. We maintain our agreement with Fuji Xerox to provide them high-end production publishing and solid ink products.

Fuji Xerox 2000 revenues of \$8.4 billion grew 8 percent (4 percent pre-currency) reflecting modest revenue growth in Japan and strong revenue growth in Fuji Xerox's other Asia Pacific territories. Excluding Fuji Xerox sales to Xerox Corporation and subsidiaries, Fuji Xerox 2000 revenues grew 8 percent to \$7.6 billion. Total Fuji Xerox net income was \$214 million before after-tax restructuring expenses of \$74 million, increasing 94 percent from 1999 reflecting gross margin improvements, operating expense controls, gains on sales of assets and a lower tax rate in Japan.

Fuji Xerox revenues increased 14 percent (declined 1 percent pre-currency) to \$7.8 billion in 1999. Revenue growth benefited from favorable currency translation and reflected flat revenues in Japan and in Fuji Xerox's other Asia Pacific territories.

Total Fuji Xerox net income, before restructuring expenses, was \$110 million in 1999 and \$144 million in 1998. Fuji Xerox had after-tax restructuring expenses of \$36 million in 1998. The Xerox Limited

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share of these restructuring expenses was \$18 million. Xerox Limited's 50 percent share of Fuji Xerox income before restructuring expenses was \$107 million in 2000, \$55 million in 1999 and \$72 million in 1998.

Acquisition of the Color Printing and Imaging Division of Tektronix

In January 2000, we acquired the Color Printing and Imaging Division of Tektronix (CPID) for \$925 million in cash including \$73 million paid by Fuji Xerox for the Asia/Pacific operations of CPID. CPID manufactures and sells color printers, ink and related products and supplies. The acquisition accelerated Xerox to the number 2 market position in office color printing, doubled our reseller and dealer distribution network and provided us with scalable solid ink technology. The acquisition also enabled significant product development and SAG synergies with our monochrome printer organization.

The acquisition is subject to certain post-closing adjustments which may potentially reduce the purchase price paid. The excess of cash paid over the fair value of net assets acquired has been allocated to identifiable intangible assets and goodwill using a discounted cash flow approach by an independent appraiser. The value of the identifiable intangible assets includes \$27 million for purchased in-process research and development which was written off in 2000. Other identifiable intangible assets and goodwill are being amortized on a straight-line basis over their estimated useful lives which range from 7 to 25 years.

Share Repurchase

In April 1998, we announced that we were reactivating our \$1 billion stock repurchase program, which was suspended in April 1997 when we acquired the remaining financial interest in Xerox Limited. Although we did not repurchase any shares during 1999 or 2000, since inception of the program we have repurchased 20.6 million shares for \$594 million. We have no plans to

repurchase stock in 2001.

Delay in Filing our Consolidated Financial Statements

The investigation of the Company's accounting policies and procedures, conducted by our Audit Committee in cooperation with our independent auditors, has delayed the filing of our annual report on Form 10-K with the U.S. Securities and Exchange Commission (SEC). Until we are in compliance with the SEC's annual filing requirements the Company is unable to raise capital through registered securities offerings.

New Accounting Standards

In 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities." 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. SFAS No. 133, as amended, is effective for the Company as of January 1, 2001.

With the adoption of SFAS No. 133, we will record a net cumulative after-tax charge of \$2 million in our Consolidated Statements of Operations and a net cumulative after-tax loss of \$19 million 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 will recognize a \$403 million increase in Total Assets and a \$424 million increase in Total Liabilities.

The Company expects that the adoption of SFAS 133 will increase the future volatility of reported earnings and other comprehensive income. In general, the amount of volatility will vary with the level of derivative activities during any period.

Capital Resources and Liquidity

The availability of worldwide cash, cash equivalents and liquidity resources for Xerox and its material subsidiaries and affiliates is managed by the companies through cash management systems and internal policies and procedures. The management of such worldwide cash, cash equivalents and liquidity resources is also subject to statutes, regulations and practices of local jurisdictions in which the companies operate, the legal agreements to which the companies are parties and the continuing cooperation and policies of financial institutions utilized by the companies to maintain the cash management systems.

At December 31, 2000, 1999 and 1998, cash and equivalents on hand was \$1,741 million, \$126 million and \$79 million, respectively, and total debt, including ESOP debt, was \$18,097 million, \$15,001 million and \$15,107 million, respectively. Total debt, net of cash on hand, increased by \$1,481 million in 2000, decreased by \$153 million in 1999, and increased by \$2,200 million in 1998.

The consolidated ratio of total debt to common and preferred equity was 4.4:1, 2.8:1 and 2.8:1 as of December 31, 2000, 1999 and 1998, respectively. The increase in this ratio is attributable to the 2000 operating loss and the impact of currency devaluation on the net equity of our foreign operations. This ratio also reflects the full draw-down on our \$7.0 billion Revolving

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Credit Agreement (the "Revolver") during 2000 to maintain financial flexibility, as discussed below, which resulted in cash and equivalents on hand of \$1.7 billion at December 31, 2000. Had the Company's cash balance at December 31, 2000 been consistent with historical levels, the debt to equity ratio would have been approximately 4.0:1.

We have announced our intent to exit customer equipment financing as part of our global Turnaround Program. This, together with the fact that for much of 2000 and subsequently we have managed liquidity on a total company basis without reference to non-financing and financing capital structures, means that

it is appropriate to review the total Company's cash flows on this basis. Accordingly, we believe that a review of operating cash flow, and earnings before interest, income taxes, depreciation and amortization (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 each of the three years in the period ended December 31, 2000:

	2000	1999	1998
Income (Loss) from			
Continuing operations	\$ (257)	\$1,339	\$ 463
Income tax provision (benefit)	(109)	588	145
Depreciation and amortization	948	779	727
Restructuring charges	619	-	1,644
Interest expense (income), net	107	(278)	(394)
Gains on sales of businesses	(263)	(97)	-
Other Items	18	114	33
EBITDA	1,063	2,445	2,618
Working capital and other changes	403	(316)	(1,183)
On-Lease inventory spending	(519)	(238)	(387)
Capital spending	(452)	(594)	(566)
Restructuring payments	(372)	(437)	(332)
Financing cash flow, net of interest	(1,165)	(80)	(1,581)
Operating Cash (Usage)/ Generation*	(1,042)	780	(1,431)
Dividends	(587)	(586)	(531)
Asset sale proceeds	640	65	-
Acquisitions	(856)	(107)	(380)
Other non-operating items	(113)	78	(91)
Debt borrowings (repayments), net	3,573	(183)	2,437
Net Change in Cash	\$ 1,615	\$ 47	\$ 4

* 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 (usage)/generation was \$(1,042) million in 2000 versus \$780 million in 1999. Lower EBITDA reflected our poor 2000 operating results. Significant improvements in working capital and capital spending were more than offset by higher investments in on-lease equipment, and a significant reduction in financing cash flow. The working capital improvements stem largely from a reduction in inventories, offset partially by a net increase in accounts receivable and tax payments. The inventory reduction reflects management actions to improve inventory turns, including price reductions on slower-moving products in the latter part of 2000 and changes in the supply/demand and logistics processes. We expect to reduce inventory levels further in 2001. The accounts receivable increase largely reflects the impact of unwinding 1999 securitization transactions which did not recur in 2000. In 2000, we began to make progress reducing our receivables balances, which has been hampered by the persisting effects of changes we made in 1998 to the U.S. customer administration centers. The capital spending includes production tooling and our investments in Ireland, where we are consolidating European customer support centers and investing in inkjet supplies manufacturing. The significant decline in 2000 spending versus 1999 is due primarily to substantial completion of the Ireland projects as well as significant spending constraints. We expect 2001 spending to be approximately 25 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 significant decrease in financing cash flow in 2000 largely reflects the increase in interest costs during 2000 plus higher finance receivables in 2000 resulting from the occurrence in 1999 of several securitization transactions which did not recur in 2000 due to the downgrades of our debt explained below. Certain lease originations in 1999 were securitized in transactions treated as asset sales, thereby generating cash and removing the related financing assets from our balance sheet, while lease originations in 2000 were not securitized and therefore remained on our balance sheet at December 31, 2000.

Operating cash generation was \$780 million in 1999 versus cash usage of \$(1,431) million in 1998 reflecting significant improvements in working capital performance and financing cash flow. The working capital improvements resulted largely from a modest reduction in inventories versus growth of over \$500 million in 1998 and improvement in accounts receivable.

The accounts receivable decrease and the significant improvement in financing cash flow compared to 1998 are the result of several 1999 securitization transactions, discussed below, which generated cash in 1999 and were treated as asset sales, thereby removing the assets from our balance sheet at December 31, 1999.

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Cash restructuring payments were \$372 million, \$437 million and \$332 million in 2000, 1999 and 1998, respectively. The 2000 spending includes \$217 million related to the 1998 program, reflecting the overall wind-down of the 1998 program. The remaining \$155 million reflects new 2000 initiatives. The status of the restructuring reserves is included in Note 3 of the "Notes to Consolidated Financial Statements" of this Annual Report.

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 Xerox equipment, to fund working capital requirements and to finance acquisitions.

During 2000, the agencies that assign ratings to our debt downgraded the Company's senior debt and short-term debt several times. As of May 29, 2001, debt ratings by Moody's are Bal 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, the capital markets and uncommitted bank lines of credit have been, and are expected to continue to be, largely unavailable to us. We expect this to result in higher borrowing costs going forward.

Consequently, in the fourth quarter 2000, we drew down the entire \$7.0 billion available to us under the revolver, primarily to maintain financial flexibility and pay down debt obligations as they came due. At December 31, 2000, \$5.6 billion of the proceeds under the Revolver was used, with the balance of \$1.4 billion invested in short-term securities and included in Cash and cash equivalents in our Consolidated Balance Sheets. 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 we maintain a minimum of \$3.2 billion of Consolidated Tangible Net Worth, as defined (CTNW). At December 31, 2000, our CTNW was \$600 million in excess of the minimum requirement. Further operating losses, restructuring costs and adverse currency translation adjustments would erode this excess, while gains on asset sales, operating profits and favorable currency translation would improve the excess.

The above referenced downgrades and the resulting withdrawal by certain banks of uncommitted lines of credit eliminated a primary source of liquidity for many of our Latin American affiliates. As a result, the Company has increased its level of intercompany lending to those affiliates to replace the withdrawn credit facilities.

As of December 31, 2000, we had approximately \$2.7 billion and \$9.0 billion of commercial paper, medium term notes and bank obligations maturing in 2001

and 2002, respectively, as summarized below:

(in billions)	2001	2002
First Quarter	\$0.6	\$0.3
Second Quarter	0.9	0.9
Third Quarter	0.2	-
Fourth Quarter	1.0	7.8*
Full Year	\$2.7	\$9.0

* Includes \$7.0 billion maturity under the Revolver.

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 approximately \$255 million in cash. Except as discussed above, the Company does not have any other material obligations scheduled to mature in 2001.

We are implementing a global turnaround program which includes initiatives to reduce costs, improve operations, and sell certain assets that we believe 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 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 Fujifilm 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 receivable 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. In April 2001, we announced the sales of our leasing businesses in four European countries to Resonia Leasing AB for approx-

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imately \$370 million. These sales are part of an agreement under which Resonia will provide on-going, exclusive equipment financing to our customers in those countries.

We have also initiated a worldwide cost reduction program which is expected to result in annualized expense savings of at least \$1 billion by the end of 2001.

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 the Company not be able 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 below investment grade, effectively eliminating our ability to enter into new foreign-currency and interest rate derivative agreements and requiring us to immediately repurchase certain of its then-outstanding derivative agreements in the aggregate amount of \$108 million, including \$16 million of accrued interest. In addition, we negotiated with certain counterparties to maintain certain other

outstanding derivative agreements, for which we posted collateral totaling approximately \$5 million. To minimize the resulting exposures, we also voluntarily terminated other derivative agreements, which required gross payments to counterparties of \$42 million and resulted in gross receipts from counterparties of \$50 million. At December 31, 2000, the remaining derivative portfolio has a current net positive value to the Company of \$70 million. Should our debt ratings be downgraded by Standard and Poors to below investment grade, the Company may be required to repurchase certain of the out-of-the-money derivative agreements currently in place, in the approximate aggregate amount as of December 31, 2000 of \$100 million, including accrued interest of \$5 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 the fourth quarter 2000, we recorded mark-to-market gains of \$69 million on foreign currency-denominated assets and liabilities which were not hedged following the repurchase of the derivative contracts described above. Due to the inherent volatility in the foreign currency and interest rate markets, we are unable to predict the amount of any such mark-to-market gains or losses in future periods.

In the third quarter 2000, Xerox Credit Corporation (XCC) securitized certain finance receivables in the United States, generating gross proceeds of \$411 million. This facility was accounted for as a secured borrowing. In connection with the December 2000 credit rating downgrade, the Company renegotiated the securitization transaction, resulting in a one-time payment of approximately \$40 million, and bringing the outstanding balance on the facility to \$325 million at December 31, 2000.

In the third quarter 2000, Xerox Corporation securitized certain accounts receivable in the United States, generating gross proceeds of \$315 million. This revolving facility was accounted for as a sale of receivables, and the related amounts were removed from our balance sheet. As a result of the debt downgrade in December 2000, Xerox Corporation renegotiated the facility, which might otherwise have been required to be runoff, reducing the facility size by \$25 million to \$290 million. In the absence of any event of default, the facility size will remain at \$290 million, unless and until our debt is downgraded to or below BB by Standard and Poors and Ba2 by Moody's. In this event, the facility could go into wind-down mode and cease to be a source of liquidity, as new receivables would not be purchased under the facility unless the Company were to successfully renegotiate its terms. Given the nature of the facility, no repayment obligations would be imposed on the Company.

In the fourth quarter 2000, Xerox Canada Limited securitized certain accounts receivable in Canada, generating gross proceeds of \$38 million. This revolving facility was accounted for as a sale of receivables and the related amounts were removed from our balance sheet. The debt downgrade in December 2000 could also have required the runoff of this facility, however, this requirement was waived by the counterparty until and unless the counterparty delivers further notice. The timing of delivery of such further notice, if any, remains entirely at the option of the counterparty. As long as this downgrade condition continues to exist, such notice, if given, could cause the facility to go into wind-down mode, with consequences similar to the Xerox Corporation facility described above.

In 1999, XCC and Xerox Canada Limited securitized certain finance receivables in the United States and

Canada, generating gross proceeds of \$1,150 million and \$345 million, respectively. These amortizing facilities were accounted for as sales of receivables, and the related amounts were removed from the respective balance sheets.

In December 1999, primarily to provide additional liquidity in advance of Y2K, Xerox Corporation and certain of its subsidiaries factored accounts

receivable, generating aggregate gross proceeds of \$288 million. These short-term transactions were accounted for as sales of receivables, and the related amounts were removed from the respective balance sheets.

In 1998, Xerox Canada Limited and Xerox France securitized accounts receivable, generating aggregate gross proceeds of \$20 million and \$36 million, respectively. These short-term transactions were accounted for as sales of receivables, and the related amounts were removed from the respective balance sheets.

During 2000, 1999, and 1998, we sold 7.5 million, 0.8 million and 1.0 million equity put options, respectively, for proceeds of \$24 million, \$0.4 million, and \$5.8 million, respectively. Equity put options give the counterparty the right to sell our common shares back to us at a specified strike price. In the fourth quarter 2000, we were required to pay \$92 million to settle the put options that we issued in 2000. In 1999, we paid \$5 million to settle the put options that we issued in 1998. As of December 31, 2000, the put options we issued in 1999 remained 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.

During the first five months of 2001, we retired \$128 million of long-term debt through the exchange of 16 million shares of common stock of the Company, which increased CTNW by approximately \$117 million.

On May 10, 2001, a European affiliate of Xerox Corporation convened a meeting of holders of its (Pounds)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 and are scheduled to mature in 2003. Relating to these bonds, we are maintaining a cash position of \$194 million in a trust account representing the par value and one year's interest on these bonds. This cash is withdrawable upon 21 days written notice to the Trustee.

Risk Management

Xerox is typical of multinational corporations because it is 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 to manage interest rate and foreign currency exposures. These instruments are held solely for hedging purposes. 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. The derivative instruments we utilize include interest rate swap agreements, forward exchange contracts and foreign currency swap agreements. 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.

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 hedge 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 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.

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Assuming a 10 percent appreciation or depreciation in foreign currency exchange rates from the quoted foreign currency exchange rates at December 31, 2000, the potential change in the fair value of foreign currency-denominated assets and liabilities in each entity would aggregate approximately \$43 million, and a 10 percent appreciation or depreciation of the U.S. dollar against all currencies from the quoted foreign currency exchange rates at December 31, 2000, would have a \$664 million impact on our Cumulative Translation Adjustment portion of equity. The amount permanently invested in foreign subsidiaries and affiliates - primarily Xerox Limited, Fuji Xerox and Xerox do Brasil - and translated into dollars using the year-end exchange rate, was \$6.6 billion at December 31, 2000, net of foreign currency-denominated liabilities designated as a hedge of our net investment.

Virtually all customer-financing assets earn fixed rates of interest. Therefore, within industrialized economies, we have historically "locked 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 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 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 risks 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.

On a consolidated basis, including the impact of our hedging activities, weighted-average interest rates for 2000, 1999 and 1998 approximated 6.2 percent, 5.6 percent and 6.1 percent, respectively.

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. Applying an assumed 10 percent reduction or increase in the yield curves at December 31, 2000, the fair value of our interest rate swaps would increase or decrease by approximately \$16 million. Because the fair value of our debt instruments has been severely constrained by our current debt ratings, normal changes in interest rates will not materially affect the fair value of our debt instruments.

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 the Company to repurchase additional outstanding contracts. Therefore, the Company's 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.

Forward-Looking Cautionary Statements

This Annual Report contains forward-looking statements and information relating to Xerox that are based on our beliefs, as well as assumptions made by and

information currently available to us. The words "anticipate," "believe," "estimate," "expect," "intend," "will" and similar expressions, as they relate to us, are intended to identify forward-looking statements. Actual results could differ materially from those projected in such forward-looking statements. Information concerning certain factors that could cause actual results to differ materially is included in the Company's 2000 10-K filed with the SEC on June 7, 2001. We do not intend to update these forward-looking statements.

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Consolidated Statements of Operations

Year ended December 31 (in millions, except per-share data)	2000	1999*	1998*

Revenues			
Sales	\$10,059	\$10,441	\$10,668
Service, outsourcing, and rentals	7,718	8,045	7,783
Finance income	924	1,081	1,142

Total Revenues	18,701	19,567	19,593

Costs and Expenses			
Cost of sales	6,197	5,944	5,880
Inventory charges	90	-	113
Cost of service, outsourcing, and rentals	4,813	4,599	4,323
Equipment financing interest	605	547	570
Research and development expenses	1,044	992	1,035
Selling, administrative and general expenses	5,649	5,292	5,343
Restructuring charge and asset impairments	540	-	1,531
Gain on affiliate's sale of stock	(21)	-	-
Purchased in-process research and development	27	-	-
Gain on sale of China operations	(200)	-	-
Other, net	341	285	219

Total Costs and Expenses	19,085	17,659	19,014

Income (Loss) from Continuing Operations before Income Taxes (Benefits)			
Equity Income and Minorities' Interests	(384)	1,908	579
Income taxes (benefits)	(109)	588	145

Income (loss) from Continuing Operations after Income Taxes (Benefits)			
before Equity Income and Minorities' Interests	(275)	1,320	434
Equity in net income of unconsolidated affiliates	61	68	74
Minorities' interests in earnings of subsidiaries	43	49	45

Income (Loss) from Continuing Operations	(257)	1,339	463
Discontinued operations	-	-	(190)

Net Income (Loss)	\$ (257)	\$ 1,339	\$ 273

Basic Earnings (Loss) per Share			
Continuing operations	\$ (0.44)	\$ 1.96	\$ 0.63
Discontinued operations	-	-	(0.29)

Basic Earnings (Loss) per Share	\$ (0.44)	\$ 1.96	\$ 0.34

Diluted Earnings (Loss) per Share			
Continuing operations	\$ (0.44)	\$ 1.85	\$ 0.62
Discontinued operations	-	-	(0.28)

Diluted Earnings (Loss) per Share	\$ (0.44)	\$ 1.85	\$ 0.34

The accompanying notes on pages 20 to 47 are an integral part of the consolidated financial statements.

* As restated, see Note 2.

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Consolidated Balance Sheets

December 31 (in millions)	2000	1999*
Assets		
Cash and cash equivalents	\$ 1,741	\$ 126
Accounts receivable, net	2,281	2,633
Finance receivables, net	5,097	4,961
Inventories, net	1,932	2,290
Equipment on operating leases, net	724	695
Deferred taxes and other current assets	1,247	1,230
Total Current Assets	13,022	11,935
Finance receivables due after one year, net	7,957	8,058
Land, buildings and equipment, net	2,495	2,456
Investments in affiliates, at equity	1,362	1,615
Intangible and other assets, net	3,061	2,810
Goodwill, net	1,578	1,657
Total Assets	\$29,475	\$28,531
Liabilities and Equity		
Short-term debt and current portion of long-term debt	\$ 2,693	\$ 3,957
Accounts payable	1,033	1,016
Accrued compensation and benefits costs	662	715
Unearned income	250	186
Other current liabilities	1,630	2,176
Total Current Liabilities	6,268	8,050
Long-term debt	15,404	11,044
Postretirement medical benefits	1,197	1,133
Deferred taxes and other liabilities	1,876	2,521
Deferred ESOP benefits	(221)	(299)
Minorities' interests in equity of subsidiaries	141	127
Obligation for equity put options	32	-
Company-obligated, mandatorily redeemable preferred securities of subsidiary trust holding solely subordinated debentures of the Company	638	638
Preferred stock	647	669
Common shareholders' equity	3,493	4,648
Total Liabilities and Equity	\$29,475	\$28,531

Shares of common stock issued and outstanding at December 31, 2000 were (in thousands) 668,576. Shares of common stock issued and outstanding at December 31, 1999 were (in thousands) 665,156.

The accompanying notes on pages 20 to 47 are an integral part of the consolidated financial statements.

* As restated, see Note 2.

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Consolidated Statements of Cash Flows

Year ended December 31 (in millions)	2000	1999*	1998*
Cash Flows from Operating Activities			
Income (loss) from continuing operations	\$ (257)	\$ 1,339	\$ 463
Adjustments required to reconcile income (loss) from continuing operations to cash flows from operating activities, net of effects of acquisitions:			
Depreciation and amortization	948	779	727
Provision for doubtful accounts	647	406	303
Restructuring and other charges	646	-	1,644
Gains on sales of businesses and assets	(295)	(97)	(36)
Cash payments for restructurings	(372)	(437)	(332)
Minorities' interests in earnings of subsidiaries	43	49	45
Undistributed equity in income of affiliated companies	(20)	(68)	(27)
Decrease (increase) in inventories	279	67	(558)
Increase in on-lease equipment	(519)	(238)	(387)
Increase in finance receivables	(1,058)	(1,854)	(1,975)
Proceeds from securitization of finance receivables	-	1,495	-
Increase in accounts receivable	(270)	(400)	(596)

Proceeds from securitization of accounts receivable	328	288	56
(Decrease) increase in accounts payable and accrued compensation and benefit costs	(3)	(94)	127
Net change in current and deferred income taxes	(534)	234	(254)
Change in other current and non-current liabilities	22	126	100
Other, net	(248)	(301)	(256)
Net cash (used in) provided by operating activities	(663)	1,294	(956)
Cash Flows from Investing Activities			
Cost of additions to land, buildings and equipment	(452)	(594)	(566)
Proceeds from sales of land, buildings and equipment	44	99	74
Proceeds from sale of China operations	550	-	-
Proceeds from sales of other businesses	90	65	-
Acquisitions, net of cash acquired	(856)	(107)	(380)
Other, net	(20)	(25)	5
Net cash used in investing activities	(644)	(562)	(867)
Cash Flows from Financing Activities			
Net change in debt	3,573	(183)	2,437
Dividends on common and preferred stock	(587)	(586)	(531)
Proceeds from sales of common stock	-	128	126
Settlements of equity put options, net	(68)	(5)	-
Repurchase of preferred and common stock	-	-	(172)
Dividends to minority shareholders	(7)	(30)	(4)
Net cash provided by (used in) financing activities	2,911	(676)	1,856
Effect of exchange rate changes on cash and cash equivalents	11	(9)	(29)
Increase in cash and cash equivalents	1,615	47	4
Cash and cash equivalents at beginning of year	126	79	75
Cash and cash equivalents at end of year	\$ 1,741	\$ 126	\$ 79

The accompanying notes on pages 20 to 47 are an integral part of the consolidated financial statements.

* As restated, see Note 2.

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Consolidated Statements of Shareholders' Equity

(In millions, except share data)	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income/1/	Treasury Stock Shares	Treasury Stock Amount	Total
Balance at December 31, 1997*	652,482	\$655	\$1,075	\$3,852	\$ (705)	-	\$ -	\$4,877
Net income				273				273
Net loss during stub period				(6)				(6)
Translation adjustments								(50)
Comprehensive income					(50)			217
Purchase of treasury stock						(3,683)	(172)	(172)
Stock option and incentive plans	3,899	4	69	(65)		2,364	111	119
Xerox Canada exchangeable stock	350					12		
Convertible securities	465	1	28	(51)		898	42	20
Cash dividends declared								
Common stock (\$0.72 per share)				(475)				(475)
Preferred stock (\$6.25 per share)				(56)				(56)
Premiums from sale of put options			5					5
Tax benefits on benefit plans			88	10				98
Balance at December 31, 1998*	657,196	\$660	\$1,265	\$3,482	\$ (755)	(409)	\$ (19)	\$4,633
Net income				1,339				1,339
Translation adjustments					(957)			(957)
Minimum pension liability								(32)
Comprehensive income					(32)			350
Stock option and incentive plans	5,331	6	136	(5)		270	12	149

Xerox Canada exchangeable stock	1,362								
Convertible securities	1,267	1	63	(52)		139	7	19	
Cash dividends declared									
Common stock (\$0.80 per share)				(532)				(532)	
Preferred stock (\$6.25 per share)				(54)				(54)	
Settlement of put options			(5)					(5)	
Tax benefits on benefit plans			80	8				88	
Balance at December 31, 1999*	665,156	\$667	\$1,539	\$4,186	\$(1,744)	-	\$-	\$4,648	
Net loss				(257)				(257)	
Translation adjustments					(430)			(430)	
Minimum pension liability					5			5	
Unrealized loss on securities					(5)			(5)	
Comprehensive loss								(687)	
Stock option and incentive plans	940	1	93					94	
Xerox Canada exchangeable stock	29								
Convertible securities	2,451	2	23	(8)				17	
Cash dividends declared									
Common stock (\$0.65 per share)				(434)				(434)	
Preferred stock (\$6.25 per share)				(53)				(53)	
Put options, net			(100)					(100)	
Tax benefits on benefit plans			1	7				8	
Balance at December 31, 2000	668,576	\$670	\$1,556	\$3,441	\$(2,174)	-	\$-	\$3,493	

/1/ At December 31, 2000 Accumulated Other Comprehensive Income is composed of cumulative translation of \$(2,142), minimum pension liability of \$(27) and unrealized loss on securities of \$(5).

The accompanying notes on pages 20 to 47 are an integral part of the consolidated financial statements.

* As restated, see Note 2.

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Notes to Consolidated Financial Statements

(Dollars in millions, except per-share data and unless otherwise indicated)

1. Summary of Significant Accounting Policies

Description of Business. Xerox Corporation is The Document Company and a leader in the global document market, selling equipment and providing document solutions including hardware, services and software that enhance productivity and knowledge sharing. Our activities encompass developing, manufacturing, marketing, servicing, and financing a complete range of document processing products and solutions.

Basis of Consolidation. The consolidated financial statements include the accounts of Xerox Corporation and all majority owned subsidiaries (the Company). All significant intercompany accounts and transactions have been eliminated. References herein to "we" or "our" refer to Xerox and consolidated subsidiaries unless the context specifically requires otherwise.

Xerox Limited, Xerox Holding (Nederland) BV, Xerox Investments (Bermuda) Limited, Xerox Holdings (Bermuda) Limited and their respective subsidiaries are referred to as Xerox Limited.

Investments in which we have a 20 to 50 percent ownership interest are generally accounted for on the equity method.

Upon the sale of stock by a subsidiary, we recognize a gain or loss in our consolidated statement of operations equal to our proportionate share of the increase or decrease in the subsidiary's equity.

For acquisitions accounted for by the purchase method, operating results are included in the consolidated statements of operations from the date of acquisition. See Note 4 on page 25.

Earnings per Share. Basic earnings per share are based on net income less preferred stock dividend requirements divided by the average common shares

outstanding during the period. Diluted earnings per share assume exercise of in-the-money stock options outstanding and full conversion of convertible debt and convertible preferred stock into common stock at the later of the beginning of the year or date of issuance, unless they are antidilutive.

Income (loss) from Continuing Operations before Income Taxes (Benefits), Equity Income and Minorities' Interests. Throughout these notes to consolidated financial statements, we refer to the effects of certain changes in estimates and other adjustments on Income (loss) from Continuing Operations before Income Taxes (Benefits), Equity Income and Minorities' Interests. For convenience and ease of reference, that financial statement caption is hereafter referred to as "pre-tax income (loss)."

Use of Estimates. The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Estimates are used for, but not limited to: accounting for residual values; allocation of revenues and fair values in multiple element arrangements; allowance for doubtful accounts; inventory valuation; merger, restructuring and other related charges; asset impairments; depreciable lives of assets; useful lives of intangible assets and goodwill; pension assumptions; and tax valuation allowances. Future events and their effects can not be perceived with certainty. Accordingly our accounting estimates require the exercise of judgment. The accounting estimates used in the preparation of our Consolidated Financial Statements will change as new events occur, as more experience is acquired, as additional information is obtained and as the Company's operating environment changes. Actual results could differ from those estimates.

Changes in Estimates. In the ordinary course of accounting for items such as revenue allocations and related estimated fair values in multiple element arrangements, allowances for doubtful accounts, inventory valuation, and residual values, among others, we make changes in estimates as appropriate in the circumstances. Such changes and refinements in estimation methodologies are reflected in reported results of operations and, if material, the approximate effects of changes in estimates are disclosed in the Notes to our Consolidated Financial Statements.

Accounting Changes-Accounting for Derivative Instruments. In 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting

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for Derivative Instruments and Hedging Activities." 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. SFAS No. 133, as amended, is effective for the Company as of January 1, 2001.

With the adoption of SFAS No. 133, we will record a net cumulative after-tax charge of \$2 in our statements 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 will recognize a \$403 increase in Total Assets and a \$424 increase in Total Liabilities.

We expect that the adoption of SFAS 133 will 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.

Reclassifications. The FASB Emerging Issues Task Force (EITF) issued a pronouncement that requires a change in the way we classify shipping and handling costs billed to customers. Commencing in the fourth quarter of 2000, the EITF required that all amounts billed to a third party customer related to product shipping and handling must be classified as revenue, and costs incurred must be classified as an expense. Shipping and handling amounts billed to customers have historically been recorded as a reduction of cost of goods sold.

Prior period financial statements have been reclassified to conform with the 2000 presentation.

Revenue Recognition. In the normal course of business the Company generates revenue through the sale of equipment, services, and supplies and income associated with the financing of its equipment sales. Revenue is recognized when earned. More specifically revenue related to the Company's sales of its products and services are as follows:

Equipment:

Revenues from the sale of equipment under installment arrangements, from sales-type leases or on credit are recognized at the time of sale or at the inception of the lease, respectively. For equipment sales which require the Company to install the product at the customer location, revenue is recognized when the equipment has been delivered to and installed at the customer location. Sales of customer installable and retail channels type products are recognized upon shipment. Revenues from equipment under other leases and similar arrangements are accounted for by the operating lease method and are recognized over the lease term.

Sales of equipment subject to the Company's operating leases to third party finance companies (the counter-party) or through structured financings with third parties are recorded as sales at the time the equipment is accepted by the counter-party. 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 for a fee on a non-discriminatory basis. In North America these transactions are structured to provide cash proceeds up front from the counter-party versus collection over time. In Latin America the counter-party pays the Company a fixed amount each month, mitigating risk and variability from the cash flow stream.

Services:

Service revenues are derived primarily from maintenance contracts on our equipment sold to custom-ers and are recognized over the term of the contracts.

Supplies:

Supplies revenue generally is recognized upon shipment.

Financing:

Finance income is earned on an accrual basis under an effective annual yield method.

The Company sells its equipment and services on a stand-alone basis and also enters into bundled arrangements which contain multiple deliverable elements. These multiple element arrangements typically include equipment, services, supplies and financing components for which the customer pays a single defined price for all elements. These arrangements typically also include a variable service component for copy volumes in excess of stated minimums. When separate prices are listed in these multiple element arrangements with our customers they may not be representative of the fair values of those elements because the prices of the different components of the arrangement may be altered in customer negotiations,

although the aggregate consideration may remain the same. Therefore, revenues under these arrangements are allocated based upon estimated fair values of each element, in accordance with Generally Accepted Accounting Principles (GAAP). The fair value of each element is estimated based on a review of a number of factors including average selling prices for the elements when they are sold on

a stand-alone basis. The average selling prices are based on management's best estimates of market conditions and competitive pricing considerations.

The principal change in estimate relating to such revenue allocations among multiple elements is made with respect to the estimated fair value of those elements and their related margins. This is a significant factor considered in our revenue allocation process along with other factors, such as pricing changes and customer discounts, which also affect the overall allocation process. The effect of such changes in estimates of fair values and related margins in the years 2000, 1999 and 1998 was \$193, \$202, and \$141, respectively, which generally resulted in increases of sales revenues and decreases to deferred elements of those arrangements. The net effects of such allocations when offset by corresponding decreases in the amortization of deferred revenues was to increase pre-tax income in 2000, 1999 and 1998 by \$44, \$102, and \$101, respectively.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101 "Revenue Recognition in Financial Statements" (SAB 101). SAB 101 summarizes certain of the staff's views in applying generally accepted accounting principles to revenue recognition in financial statements. We conducted a review of our revenue recognition policies during the fourth quarter of our fiscal year ended December 31, 2000. We have determined that our policies are in conformance with SAB 101 in all material respects.

Cash and Cash Equivalents. Cash and cash equivalents consist of cash on hand and investments with original maturities of three months or less.

Provisions for Losses on Uncollectible Receivables. The provisions for losses on uncollectible trade and finance receivables are determined principally on the basis of past collection experience.

Inventories. Inventories are carried at the lower of average cost or realizable values.

Buildings and Equipment and Equipment on Operating Leases. Our fixed assets are depreciated over their estimated useful lives. Equipment on operating leases is depreciated to its estimated residual value. Depreciation is computed using principally the straight-line method. Significant improvements are capitalized; maintenance and repairs are expensed. See Notes 7 and 8 on page 28.

Goodwill. Goodwill represents the cost of acquired businesses in excess of the fair value of identifiable net assets purchased, and is amortized on a straight-line basis over periods ranging from 15 to 40 years. Goodwill is reported net of accumulated amortization, and the recoverability of the carrying value is evaluated on a periodic basis by assessing current and future levels of income and cash flows as well as other factors. Accumulated amortization at December 31, 2000 and 1999 was \$220 and \$176, respectively.

Classification of Commercial Paper and Bank Notes Payable. As of December 31, 2000, all indebtedness is classified as a short-term or long-term liability based upon its contractual maturity date. In prior years, it was our policy to classify as long-term debt that portion of commercial paper and notes payable that was intended to match fund finance receivables due after one year to the extent that we had the ability under our revolving credit agreement to refinance such commercial paper and notes payable on a long-term basis. See Note 12 on page 32.

Foreign Currency Translation. The functional currency for most foreign operations is the local currency. Net assets are translated at current rates of exchange, and income and expense items are translated at the average exchange rate for the year. The resulting translation adjustments are recorded in Accumulated Other Comprehensive Income. The U.S. dollar is used as the functional currency for certain subsidiaries that conduct their business in U.S. dollars or operate in hyperinflationary economies. A combination of current and historical exchange rates is used in remeasuring the local currency transactions of these subsidiaries, and the resulting exchange adjustments are included in income. Aggregate foreign currency gains/(losses) were \$99, \$(1) and \$(29) in 2000, 1999 and 1998, respectively, and are included in Other, net in the consolidated statements of operations.

Stock-Based Compensation. The Company follows the intrinsic value-based method of accounting for its stock-based compensation.

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2. Restatement

We have restated our Consolidated Financial Statements for the fiscal years ended December 31, 1999 and 1998 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 application thereof. As a result of these investigations, it was determined that certain accounting practices and the application thereof misapplied GAAP and certain accounting errors and irregularities were identified. The Company has corrected the accounting errors and irregularities in its Consolidated Financial Statements. The Consolidated Financial Statements have been adjusted as follows:

In fiscal 2000 the Company had initially recorded charges totaling \$170 (\$120 after taxes) which arose from imprudent and improper business practices in Mexico that resulted in certain accounting errors and irregularities. Over a period of years, several senior managers in Mexico had collaborated to circumvent certain of Xerox's accounting policies and administrative procedures. The charges related to provisions for uncollectible long-term receivables, the recording of liabilities for amounts due to concessionaires and, to a lesser extent, for contracts that did not fully meet the requirements to be recorded as sales-type leases. The investigation of the accounting issues discovered in Mexico has been completed. The Company has restated its prior year Consolidated Financial Statements to reflect reductions to pre-tax income of \$53 and \$13 in 1999 and 1998, respectively. It is not practical to determine what portion, if any, of the approximate remaining \$101 of the Mexican charge reflected in adjusted 2000 results of operations relates to prior years.

In connection with our acquisition of the remaining 20 percent of Xerox Limited from Rank Group, Plc in 1997, we recorded a liability of \$100 for contingencies identified at the date of acquisition. During 1998, we determined that the liability was no longer required. During 1998 and 1999, we charged to the liability certain expenses incurred as part of the consolidation of our European back-office operations. This reversal should have been recorded as a reduction of Goodwill and Deferred tax assets. Therefore, we have restated our previously reported Consolidated Financial Statements to reflect decreases of \$67 to Goodwill and \$33 of Deferred tax assets and increases in Selling, administrative and general expenses of \$76 in 1999 and \$24 in 1998.

In addition to the above items, we have made adjustments in connection with certain misapplications of GAAP under SFAS No. 13, "Accounting for Leases." These adjustments primarily relate to the accounting for lease modifications and residual values as well as certain other items.

The following table presents the effects of all of the aforementioned adjustments on pre-tax income (loss).

	Year Ended December 31,		
	2000	1999	1998

Increase (decrease) to pre-tax income (loss):			
Mexico	\$ 69	\$ (53)	\$ (13)
Rank Group acquisition	6	(76)	(24)
Lease issues, net	87	83	(165)
Other, net	10	(82)	18

Total	\$172	\$ (128)	\$ (184)

These adjustments resulted in the cumulative net reduction of Common shareholders' equity and Consolidated Tangible Net Worth (as defined in our \$7 Billion Revolving Credit Agreement) of \$137 and \$76, respectively, as of December 31, 2000.

Retained earnings at December 31, 1997 was restated from \$3,960 to \$3,852 as a result of the effect of these aforementioned adjustments on years prior to 1998.

The following tables present the impact of the adjustments and restatements on a condensed basis.

	Amount Previously Reported	As Adjusted
	-----	-----
(in millions, except per share amounts)		
Year ended December 31, 2000:*		
Statement of operations:		
Revenues	\$18,632	\$18,701
Costs and expenses	19,188	19,085
Income (loss) from continuing operations	(384)	(257)
Basic loss per share	\$ (0.63)	\$ (0.44)
Diluted loss per share	\$ (0.63)	\$ (0.44)
Balance Sheet:		
Current finance receivables, net	\$ 5,141	\$ 5,097
Inventories, net	1,930	1,932
Equipment and operating leases, net	717	724
Deferred taxes and other current assets	1,284	1,247
Finance receivables due after one year, net	8,035	7,957
Intangible and other assets, net	3,062	3,061
Goodwill, net	1,639	1,578
Other current liabilities	1,648	1,630
Deferred taxes and other liabilities	1,933	1,876
Common shareholders' equity	3,630	3,493

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	Amount Previously Reported	As Restated
	-----	-----
(in millions, except per share amounts)		
Year ended December 31, 1999:**		
Statement of operations:		
Revenues	\$19,548	\$19,567
Costs and expenses	17,512	17,659
Income (loss) from continuing operations	1,424	1,339
Basic earnings per share	\$ 2.09	\$ 1.96
Diluted earnings per share	\$ 1.96	\$ 1.85
Balance Sheet:		
Accounts receivable, net	\$ 2,622	\$ 2,633
Current finance receivables, net	5,115	4,961
Inventories, net	2,285	2,290
Equipment and operating leases, net	676	695
Finance receivables due after one year, net	8,203	8,058
Intangible and other assets, net	2,831	2,810
Goodwill, net	1,724	1,657
Other current liabilities	2,163	2,176

Deferred taxes and other liabilities	2,623	2,521
Common shareholders' equity	4,911	4,648
Year ended December 31, 1998:**		
Statement of operations:		
Revenues	\$19,747	\$19,593
Costs and expenses	18,984	19,014
Income (loss) from continuing operations	585	463
Basic earnings per share	\$ 0.82	\$ 0.63
Diluted earnings per share	\$ 0.80	\$ 0.62

* As reported in the Company's unaudited financial statements included in its report on Form 8-K dated April 19, 2001.

** Revenues and costs and expenses have been reclassified to reflect the Change in classification of shipping and handling costs as discussed in Note 1.

3. Restructuring

March 2000 Restructuring. In March 2000, we announced details of a worldwide restructuring program. In connection with this program, we initially 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 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 the incurrence of 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. As a result, we were unable to, and do not expect to, complete certain actions originally contemplated at the time that the March 2000 restructuring provision was recorded. Accordingly, during the fourth quarter of 2000, and in connection with the turnaround program discussed below, \$71 (\$47 after taxes), \$59 related to severance costs for 1,000 positions and \$12 related to lease cancellation and other costs, of the original \$596 provision, was reversed. 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.

As of December 31, 2000, approximately 2,400 employees have left the Company under the March 2000 restructuring program.

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, have led to a net loss in 2000, credit rating agency downgrades, limited access to capital markets and market-place concerns regarding our liquidity. In response to these challenges, in October 2000, we announced a

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turnaround program which includes a wide-ranging plan to sell assets, cut costs and strengthen core operations. Additionally, we are exploring alternatives 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. As more fully discussed in Note 5 on page 26, in December 2000, we sold our operations in China to Fuji Xerox for \$550. We are engaged in other activities which will enhance our liquidity. These activities include asset sales, strategic alliances, and the sale or outsourcing of certain manufacturing operations. It is expected that in most cases asset sales will result in a gain.

Regarding the cost reductions, we are in the process of finalizing plans designed to reduce costs by at least \$1.0 billion annually. In connection therewith, during the fourth quarter of 2000, we recorded an additional pre-tax restructuring provision totaling \$105 (\$87 after taxes, including our \$19 share of an additional provision recorded by Fuji Xerox) in connection with finalized initiatives under the turnaround program. This charge included estimated costs of \$71 for severance costs associated with work force reductions related to the elimination of 2,300 positions worldwide and \$34 of asset impairments associated with the disposition of a non-core business. The severance costs relate to further 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:

	Original		Charges	
	Reserve	Reversals	Against Reserve	12/31/00 Balance

March 2000 restructuring:				
Cash charges				
Severance and related costs	\$384	\$ (59)	\$ (130)	\$195
Lease cancellation and other costs	51	(12)	(19)	20

Subtotal	435	(71)	(149)	215
Non-cash charges				
Asset impairment	71	-	(71)	-
Inventory charges	90	-	(90)	-

Subtotal	161	-	(161)	-
Currency changes	-	-	(6)	(6)

Subtotal	596	(71)	(316)	209

Turnaround Program:				
Severance and related costs				
Asset impairment	71	-	-	71
	34	-	(34)	-

Subtotal	105	-	(34)	71

Total	\$701	\$(71)	\$(350)	\$280

With respect to the March 2000 restructuring program as of March 31, 2001, the remaining liability is \$131. All remaining liabilities represent committed obligations of the Company to be paid primarily during 2001 and are included in the caption Other current liabilities in the consolidated balance sheet.

1998 Restructuring. In 1998, we announced a worldwide restructuring program. In connection with this program, we recorded a pre-tax provision of \$1,644.

As of December 31, 2000, this program has been substantially completed and the remaining liability balance is \$107 after fourth quarter reversals of \$11. The remaining liability is for salary continuance payments and the runoff of lease cancellation payments. There were no material changes to the program since its announcement in April 1998. The remaining liability is fully committed and the majority will be utilized throughout 2001.

4. Acquisitions

In January 2000, we and Fuji Xerox completed the acquisition of the Color Printing and Imaging Division of Tektronix, Inc. (CPID). The aggregate consideration paid of \$925 in cash, which includes \$73 paid directly by Fuji Xerox, is subject to certain post-closing adjustments. CPID manufactures and sells color printers, ink and related products, and supplies. The acquisition was accounted for in accordance with the purchase method of accounting.

The excess of cash paid over the fair value of net assets acquired has been allocated to identifiable intangible assets and goodwill using a discounted cash flow approach by an independent appraiser. The value of the identifiable intangible assets includes \$27 for purchased in-process research and development which was written off in 2000. This charge represents the fair value of certain acquired research and development projects that were determined not to have reached technological feasibility as of the date of the acquisition and was determined based on a methodology that focused on the after-tax cash flows of the in-process products and the stage of completion of the individual research and development projects. Other identifiable intangible assets are exclusive of intangible assets acquired by Fuji Xerox, and include the installed customer base (\$209), the distribution network (\$123), the existing technology (\$103), the workforce (\$71), and trademarks (\$23). These identifiable assets are included in Intangibles and other assets in the Consolidated Balance Sheets.

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The remaining excess has been assigned to Goodwill, however such amount may be affected by any post-closing adjustments which could potentially reduce the purchase price.

Other identifiable intangible assets and Goodwill are being amortized on a straight-line basis over their estimated useful lives which range from 7 to 25 years.

In connection with the CPID acquisition we recorded approximately \$45 for anticipated costs associated with exiting certain activities of the acquired operations. These activities include: the consolidation of duplicate distribution facilities; the rationalization of the service organization; and the exiting of certain lines of the CPID business. The costs associated with these activities include inventory write-offs, severance charges, contract cancellation costs and fixed asset impairment charges. We expect these actions to be completed in 2001.

In August 1999, we purchased the OmniFax division from Danka Business Systems for \$45 in cash. OmniFax is a supplier of business laser multifunction fax systems. The acquisition resulted in goodwill of approximately \$22 (including transaction costs), which is being amortized over 15 years.

Also during 1999, we paid \$62 to increase our ownership in our India operations from approximately 40 percent to 68 percent. This transaction resulted in additional goodwill of \$48, which is being amortized over 40 years.

In May 1998, we acquired XLConnect Solutions, Inc., an information technology

services company, and its parent company, Intelligent Electronics, Inc., for \$413 in cash. The transaction resulted in goodwill of \$395, which is being amortized over 25 years. The Company is continuing to integrate XLConnect Solutions Inc. with its Industry Solutions business segment. This integration is designed to increase the revenue of our industry solutions operations, and to achieve cost savings and synergies. While this integration is taking longer than originally anticipated, the Company believes that events and changes in circumstances since the acquisition do not presently indicate an impairment of goodwill. However, the Company intends to continue the integration efforts and will perform an assessment of the recoverability of goodwill should circumstances change.

5. Divestitures

In December 2000 we sold our China operations to Fuji Xerox for \$550. In connection with the sale, Fuji Xerox assumed \$118 of indebtedness. The pre-tax gain recorded in the fourth quarter of 2000, was \$200.

In June 2000, we sold the U.S. and Canadian commodity paper business, including an exclusive license for the Xerox brand, to Georgia Pacific and recorded a pre-tax gain of approximately \$40 which is included in Other, net. In addition to the proceeds from the sale of the business, the Company will receive royalty payments on future sales of Xerox branded commodity paper by Georgia Pacific and will earn commissions on Xerox originated sales of commodity paper as an agent for Georgia Pacific.

In April 2000, we sold a 25 percent ownership interest in our wholly owned subsidiary, ContentGuard, to Microsoft, Inc. for \$50 and recognized a pre-tax gain of \$23, which is included in Other, net. An additional pre-tax gain of \$27 was deferred, pending the resolution of certain performance criteria, and is included in Unearned income in the Consolidated Balance Sheets. In connection with the sale, ContentGuard also received \$40 from Microsoft for a non-exclusive license of its patents and other intellectual property and a \$25 advance against future royalty income from Microsoft on sales of products incorporating ContentGuard's technology. The license payment is being amortized over the life of the license agreement of 10 years and the royalty advance will be recognized in income as earned.

6. Receivables, Net

Finance Receivables. Finance receivables result from installment arrangements and sales-type leases arising from the marketing of our business equipment products. These receivables generally mature over two to five years and are typically collateralized by a security interest in the underlying assets. The components of Finance receivables, net at December 31, 2000, 1999 and 1998 follow:

	2000	1999	1998

Gross receivables	\$14,556	\$14,478	\$15,957
Unearned income	(1,733)	(1,733)	(2,185)
Unguaranteed residual values	681	697	617
Allowance for doubtful accounts	(450)	(423)	(441)

Finance receivables, net	13,054	13,019	13,948
Less current portion	5,097	4,961	5,055

Amounts due after one year, net	\$ 7,957	\$ 8,058	\$ 8,893

Contractual maturities of our gross finance receivables subsequent to December 31, 2000 follow:

2001	2002	2003	2004	2005	Thereafter
\$5,654	\$3,980	\$2,706	\$1,580	\$540	\$96

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Experience has shown that a portion of these finance receivables will be prepaid prior to maturity. Accordingly, the preceding schedule of contractual maturities should not be considered a forecast of future cash collections.

Unguaranteed residual values are assigned primarily to our high volume copying, printing and production publishing products. The assigned values are generally established in order to result in a normal profit margin in the subsequent transaction.

In September 2000, we transferred \$457 of finance receivables to a special purpose entity for cash proceeds of \$411 and a retained interest of \$46. The transfer agreement includes a repurchase option; accordingly the proceeds were accounted for as a secured borrowing. At December 31, 2000 the balance of receivables transferred was \$411 and is included in Finance receivables, net in the Consolidated Balance Sheets. The remaining secured borrowing balance of \$325 is included in Debt.

In 1999, we sold \$1,495 of finance receivables and recorded a net increase in finance income of approximately \$17 which includes the unfavorable flow-through impacts. The retained interests remaining from these sales were not material at December 31, 2000.

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 finance 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. These transactions resulted in sales of \$126 and \$280 in 2000 and 1999, respectively. The contribution to Pre-tax income resulting from these transactions was \$92 and \$155 in 2000 and 1999, respectively.

Finance Interest Rates

Financing income is determined by the discount rate applied to minimum contract payments, excluding service and supplies, used in the estimation of the fair value of the equipment. Finance interest rates include the aforementioned discount rates in customer arrangements, as well as related sources of income. Over the years, the Company's finance interest rates have changed as a result of a number of factors including money market conditions; the economic environment; debt coverage; return on equity; debt to equity ratios and other external factors which are particularly relevant to our financing business. During the period of 1998 to 2000 such finance interest rates as a percentage of the average finance receivables portfolio and the Company's average cost of funds used in our customer financing activities were:

	2000	1999	1998
Average Finance Interest Rates	8.3%	9.2%	9.3%
Average Cost of Funds	5.4%	4.7%	5.1%

In line with market comparables, the Company's financing operations are targeted to achieve a 15 percent return on equity. The Company periodically

reviews, and may change, the discount rates in order to be consistent with this objective and to reflect the estimated fair value of the financing component in its lease arrangements. Changes in the rate applied to a bundled arrangement may affect one or more elements of the arrangement. In general, the following changes in discount rates are reflected as reciprocal changes in equipment revenues, partially offset by the resulting change in customer finance income.

Such changes in accounting estimate had the following approximate effects on pre-tax income (loss):

Increase/(Decrease)	2000	1999	1998

Effect of changes in discount rates/1/	\$24	\$101	\$128

1 Represents the impact of changes in customer finance rate estimates net of amortization of the related cumulative unearned income effects.

Accounts Receivable. In 2000, we entered into agreements to sell, on an ongoing basis, a defined pool of accounts receivable to special purpose entities. At December 31, 2000, the total pool of accounts receivable transferred was approximately \$900. The special purpose entities, in turn, sell participating interests in such accounts receivable to investors up to a maximum amount of \$330. Under the terms of the agreement, new receivables are added to the pool as collections reduce previously sold accounts receivable. Investors have a priority collection interest in the entire pool of receivables, and as a result, we have retained credit risk to the extent the pool exceeds the amount sold to investors. We continue to service the receivables on behalf of the special purpose entities and receive a servicing fee adequate to compensate for our responsibilities.

At December 31, 2000, \$328 in net proceeds were received from sales of participating interests to investors and were recorded as a reduction in Accounts receivable, net in the Consolidated Balance Sheets. The earnings impact related to the receivables sold under these agreements was not material.

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Our retained interests, which are included in Accounts receivable, net, are recorded at fair value using estimates of dilution based on historical experience. These estimates are adjusted regularly based on actual experience with the pool, including defaults and credit deterioration.

If historical dilution percentages were to increase one percentage point, the value of the Company's retained interest would be reduced by approximately \$9.

Allowances for doubtful accounts on our accounts receivable balances at December 31, 2000, 1999 and 1998 amounted to \$282, \$137 and \$102, respectively.

7. Inventories and Equipment on Operating Leases, Net

The components of inventories at December 31, 2000, 1999 and 1998 follow:

	2000	1999	1998

Finished goods	\$1,439	\$1,805	\$1,929
Work in process	147	122	111
Raw materials	346	363	464

Inventories	\$1,932	\$2,290	\$2,504

Equipment on operating leases and similar arrangements consists of our business equipment products that are rented to customers and are depreciated to estimated residual value. Equipment on operating leases and the related accumulated depreciation at December 31, 2000, 1999 and 1998 follow:

	2000	1999	1998
Equipment on operating leases	\$2,124	\$1,777	\$2,057
Less: Accumulated depreciation	1,400	1,082	1,260
Equipment on operating leases, net	\$ 724	\$ 695	\$ 797

We sold equipment subject to operating leases and similar arrangements to third party finance companies for cash in the amounts of \$22, \$120 and \$74 in 2000, 1999 and 1998, respectively. The contribution to Pre-tax income resulting from these transactions was \$9, \$65 and \$24 in 2000, 1999 and 1998, respectively.

Depreciable lives vary from two to four years. Our business equipment operating lease terms vary, generally from 12 to 36 months. Scheduled minimum future rental revenues on operating leases with original terms of one year or longer are:

2001	2002	2003	Thereafter
\$320	\$151	\$71	\$43

Total contingent rentals, principally usage charges in excess of minimum allowances relating to operating leases, for the years ended December 31, 2000, 1999 and 1998 amounted to \$120, \$163 and \$161, respectively.

8. Land, Buildings and Equipment, Net

The components of land, buildings and equipment, net at December 31, 2000, 1999 and 1998 follow:

	Estimated Useful Lives (Years)	2000	1999	1998
Land		\$ 70	\$ 66	\$ 80
Buildings and building equipment	25 to 50	1,064	1,087	973
Leasehold improvements	Lease term	426	434	425
Plant machinery	4 to 12	1,981	1,897	1,926
Office furniture and equipment	3 to 15	1,304	1,339	1,299
Other	3 to 20	199	235	260
Construction in				

progress	295	328	283

Subtotal	5,339	5,386	5,246

Less accumulated depreciation	2,844	2,930	2,880

Land, buildings and equipment, net	\$2,495	\$2,456	\$2,366

We lease certain land, buildings and equipment, substantially all of which are accounted for as operating leases. Total rent expense under operating leases for the years ended December 31, 2000, 1999 and 1998 amounted to \$344, \$397 and \$436, respectively. Future minimum operating lease commitments that have remaining non-cancelable lease terms in excess of one year at December 31, 2000 follow:

2001	2002	2003	2004	2005	Thereafter

\$290	\$238	\$193	\$155	\$132	\$426

In certain circumstances, we sublease space not currently required in operations. Future minimum -sub-lease income under leases with non-cancelable terms in excess of one year amounted to \$50 at December 31, 2000.

In 1994, we awarded a contract to Electronic Data Systems Corp. (EDS) to operate our worldwide data processing and telecommunications network through the year 2004. Xerox has the right to terminate this agreement with six months' notice to EDS. Minimum payments due EDS under the contract follow:

2001	2002	2003	2004

\$217	\$198	\$183	\$95

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9. Investments in Affiliates, at Equity

Investments in corporate joint ventures and other companies in which we generally have a 20 to 50 percent ownership interest at December 31, 2000, 1999 and 1998 follow:

	2000	1999	1998

Fuji Xerox	\$1,259	\$1,513	\$1,354
Other investments	103	102	102

Investments in affiliates, at equity	\$1,362	\$1,615	\$1,456

Xerox Limited owned 50 percent of the outstanding stock of Fuji Xerox, a corporate joint venture with Fuji Photo Film Co., Ltd. (Fujifilm) at December 31, 2000. See Note 20 on page 46. Fuji Xerox is headquartered in Tokyo and operates in Japan and other areas of the Pacific Rim, Australia and New Zealand. Condensed financial data of Fuji Xerox for its last three fiscal years follow:

	2000	1999	1998

Summary of Operations			
Revenues	\$8,401	\$7,751	\$6,809
Costs and expenses	8,115	7,440	6,506

Income before income taxes	286	311	303
Income taxes	146	201	195

Net income	\$ 140	\$ 110	\$ 108

Balance Sheet Data			
Assets			
Current assets	\$3,162	\$3,521	\$2,760
Non-current assets	3,851	3,521	3,519

Total assets	\$7,013	\$7,042	\$6,279

Liabilities and Shareholders'			
Equity			
Current liabilities	\$3,150	\$2,951	\$2,628
Long-term debt	445	297	234
Other non-current liabilities	852	951	895
Shareholders' equity	2,566	2,843	2,522

Total liabilities and shareholders' equity	\$7,013	\$7,042	\$6,279

10. Segment Reporting

In the first quarter of 2000, we completed the realignment of our operations to better align the Company to serve its diverse customers/distribution channels and to provide an industry-oriented focus for global document services and solutions. As a result of this realignment, our reportable segments have been revised accordingly and are as follows: Industry Solutions, General Markets, Developing Markets and Other businesses.

The Industry Solutions operating segment (ISO) covers the direct sales and service organizations in North America and Europe. It is organized around key industries and focused on providing our largest customers with document solutions consisting of hardware, software and services, including document outsourcing, systems integration and document consulting.

The General Markets operating segment (GMO) includes sales agents in North America, concessionaires in Europe and our Channels Group which includes retailers and resellers. It is responsible for increasing penetration of the general market space, including small office solutions, products for networked work group environments and personal/ home office products. In addition, it has responsibility for product development and acquisition for its markets, providing customer and channel-ready products and solutions.

The Developing Markets operating segment (DMO) includes operations in Latin America, Russia, India, the Middle East and Africa. It takes advantage of growth opportunities in emerging markets/countries around the world, building on the leadership Xerox has already established in a number of those markets.

Other businesses includes several units, none of which met the thresholds for separate segment reporting. The revenues included in this group are primarily

from Xerox Supplies Group (XSG) and Xerox Engineering Systems (XES) and corporate inter-segment eliminations.

All corporate and shared service unit expenses, including interest and depreciation, have been allocated to the operating segments.

Other businesses' total assets include XES, XSG, deferred tax assets, which have not been allocated, the investment in Fuji Xerox and the remaining investments in discontinued operations. The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies.

It is not practicable to discern the segment information for 1998 for the above segments due to internal reorganizations. Accordingly, 1998 realigned segment amounts have not been presented.

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Operating segment profit or loss information for the years ended December 31, 2000 and 1999 for our realigned segments is as follows:

	Industry Solutions	General Markets	Developing Markets	Other Businesses	Total
2000					
Information about profit or loss					
Revenues from external customers	\$ 8,619	\$4,827	\$2,533	\$1,798	\$17,777
Finance income	529	238	157	-	924
Intercompany revenues	38	215	-	(253)	-
Total segment revenues	9,186	5,280	2,690	1,545	18,701
Depreciation and amortization	584	227	132	5	948
Interest expense	584	272	165	10	1,031
Segment profit (loss)/1/	110	(126)	(116)	194	62
Earnings (loss) of non-consolidated affiliates/2/	(1)	-	-	99	98
Information about assets					
Investments in non-consolidated affiliates	16	-	7	1,339	1,362
Total assets	18,662	3,129	4,470	3,214	29,475
Capital expenditures	184	137	79	52	452
1999/3/					
Information about profit or loss					
Revenues from external customers	\$ 9,463	\$4,489	\$2,542	\$1,992	\$18,486
Finance income	622	249	210	-	1,081
Intercompany revenues	60	132	-	(192)	-
Total segment revenues	10,145	4,870	2,752	1,800	19,567
Depreciation and amortization	486	182	106	5	779
Interest expense	488	189	120	6	803
Segment profit	1,328	162	214	204	1,908
Earnings (loss) of non-consolidated affiliates	4	-	(5)	69	68
Information about assets					
Investments in non-consolidated affiliates	25	-	8	1,582	1,615
Total assets	18,487	1,703	4,636	3,705	28,531
Capital expenditures	300	153	94	47	594

/1/ Segment profit (loss) excludes the impact of the 2000 restructuring charge \$(619), the purchased in-process research and development \$(27), and the gain on sale of our China operations \$200.

/2/ Excludes our \$37 share of a restructuring charge recorded by Fuji Xerox.

/3/ 1999 amounts as restated, see Note 2.

Products and services and geographic area data follow:

	Revenues		
	2000	1999	1998
Information about products and services			
Black and white office and small office/home office (SOHO)	\$ 7,410	\$ 8,150	\$ 8,384
Black and white production	4,940	5,904	5,954

Color copying and printing	2,897	1,851	1,726
Other products and services	3,454	3,662	3,529
Total	\$18,701	\$19,567	\$19,593

	Revenues			Long-Lived Assets		
	2000	1999	1998	2000	1999	1998
Information about Geographic Areas						
United States	\$10,397	\$10,585	\$10,211	\$2,282	\$2,228	\$2,085
Europe	4,870	5,414	5,237	968	616	503
Other Areas	3,434	3,568	4,145	600	751	804
Total	\$18,701	\$19,567	\$19,593	\$3,850	\$3,595	\$3,392

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Operating segment profit or loss information, using the prior years' basis of presentation, for the years ended December 31, 2000, 1999, and 1998 is as follows:

	Core Business	Fuji Xerox	Paper and Media	Other	Total
2000					
Information about profit or loss					
Revenues from external customers	\$14,493	-	\$1,156	\$2,128	\$17,777
Finance income	918	-	-	6	924
Intercompany revenues	(294)	-	-	294	-
Total segment revenues	15,117	-	1,156	2,428	18,701
Depreciation and amortization	943	-	-	5	948
Interest expense	1,031	-	-	-	1,031
Segment profit (loss)/1/	352	-	85	(375)	62
Earnings (loss) of non-consolidated affiliates/2/	4	\$ 107	-	(13)	98
Information about assets					
Investments in non-consolidated affiliates	71	1,259	-	32	1,362
Total assets	26,224	1,259	69	1,923	29,475
Capital expenditures	430	-	-	22	452
1999/4/					
Information about profit or loss					
Revenues from external customers	\$15,501	-	\$1,148	\$1,837	\$18,486
Finance income	1,071	-	-	10	1,081
Intercompany revenues	(206)	-	-	206	-
Total segment revenues	16,366	-	1,148	2,053	19,567
Depreciation and amortization	774	-	-	5	779
Interest expense	803	-	-	-	803
Segment profit (loss)	1,886	-	62	(40)	1,908
Earnings of non-consolidated affiliates	13	\$ 55	-	-	68
Information about assets					
Investments in non-consolidated affiliates	102	1,513	-	-	1,615
Total assets	25,036	1,513	86	1,896	28,531
Capital expenditures	580	-	-	14	594
1998/4/					
Information about profit or loss					
Revenues from external customers	\$15,623	-	\$1,162	\$1,666	\$18,451

Finance income	1,133	-	-	9	1,142
Intercompany revenues	(326)	-	-	326	-

Total segment revenues	16,430	-	1,162	2,001	19,593
Depreciation and amortization	709	-	-	18	727
Interest expense	749	-	-	-	749
Segment profit (loss)/3/	2,240	-	58	(75)	2,223
Earnings of non-consolidated affiliates/2/	19	\$ 72	-	1	92
Information about assets					
Investments in non-consolidated affiliates	81	1,354	-	21	1,456
Total assets	25,842	1,354	84	2,348	29,628
Capital expenditures	539	-	-	27	566

- /1/ Segment profit (loss) excludes the impact of the 2000 restructuring charge \$(619), the purchased in-process research and development \$(27), and the gain on sale of our China operations \$200.
- /2/ Excludes our \$37 and \$18 share of a restructuring charge recorded by Fuji Xerox in 2000 and 1998, respectively.
- /3/ Segment profit (loss) excludes the impact of the 1998 restructuring charge of \$1,644.
- /4/ 1999 and 1998 amounts as restated, see Note 2.

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11. Discontinued Operations

Our remaining investment in our Insurance and Other Financial Services (IOFS) and Third-Party Financing and Real Estate discontinued businesses is included in the Consolidated Balance Sheets at December 31, 2000 and 1999 as follows:

Balance Sheet Caption	2000	1999

Intangible and other assets	\$534	\$1,130
Long-term debt	-	50
Deferred taxes and other liabilities	-	378

Net investment	\$534	\$ 702

The majority of the remaining investment relates to a \$462 performance-based instrument received from the sale of one of the Talegen Holdings, Inc. (Talegen) insurance companies, The Resolution Group, Inc. (TRG). The instrument is Class 2 preferred stock of TRG. TRG has two classes of stock outstanding. The Class 1 shares are 100 percent owned by Fairfax Financial Holdings Limited, one of the largest insurers in North America. We own substantially all of the Class 2 shares. The terms of the performance criteria relate to TRG's available cash flow as defined. Commencing in January 2001, the Class 2 shareholders are entitled to receive 72.5 percent of the available cash and the Class 1 holder receives the remaining 27.5 percent. An initial distribution of \$4 was received by us in January 2001. Current projections indicate that we expect to fully recover the remaining \$458 by 2018.

Xerox Financial Services, Inc. (XFSI), a wholly owned subsidiary, continues to provide aggregate excess of loss reinsurance coverage (the Reinsurance Agreements) to one of the former Talegen units and TRG through Ridge Reinsurance Limited (Ridge Re), a wholly owned subsidiary of XFSI. The coverage limits for these two remaining Reinsurance Agreements total \$578.

Both the Company and XFSI have guaranteed that Ridge Re will meet all of its financial obligations under the two remaining Reinsurance Agreements. In April 2001 we replaced \$660 of letters of credit, which supported Ridge Re ceded reinsurance obligations, with trusts which include the Ridge Re investment portfolio of \$405 plus approximately \$255 in cash. These trusts are required to

provide security with respect to aggregate excess of loss reinsurance obligations under the two remaining Reinsurance Agreements.

12. Debt

Short-Term Debt. Short-term borrowings data at December 31, 2000 and 1999 follow:

	Weighted Average Interest Rates at		
	12/31/00	2000	1999
Notes payable	10.20%	\$ 169	\$ -
Commercial paper	7.01	141	-
Total short-term debt		310	-
Current maturities of long-term debt		2,383	3,957
Total		\$2,693	\$3,957

Debt classification. Prior to the year 2000 we had employed a match funding policy for customer financing assets and related liabilities. Under this policy, the interest and currency characteristics of the indebtedness were, in most cases, matched to the interest and currency characteristics of the finance receivables. At December 31, 1999, our debt was classified based on the expected date of repayment of such indebtedness in accordance with our match funding policy. Further, at December 31, 1999, certain other short-term obligations were classified as long-term based on management's intent to refinance certain of these obligations on a long term basis and the ability to do so with credit available under the Revolving Credit Agreement (Revolver).

The full utilization of our Revolver and our recent credit downgrades significantly changed the nature of our indebtedness and impacted our ability to continue with our historical match funding policy. We no longer match fund our indebtedness with cash collections expected to be generated from finance receivables. We expect to pay down our outstanding obligations as they mature. Accordingly, at December 31, 2000, our debt has been classified in the Consolidated Balance Sheets, based on the contractual maturity dates of the underlying debt instruments. Prior years' balances have not been reclassified.

The Company believes its liquidity is presently sufficient to meet current and anticipated needs going forward, subject to the timely implementation and execution of various business initiatives as discussed in Note 3 on Page 24.

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Long-Term Debt. A summary of long-term debt by final maturity date at December 31, 2000 and 1999 follows:

	Weighted Average Interest Rates at		
	12/31/00	2000	1999
U.S. Operations			
Xerox Corporation			
(parent company)			

Guaranteed ESOP				
notes due 2000-2003	7.53%	\$	221	\$ 299
Notes due 2000	-	-	-	2,041
Notes due 2001	6.50		737	721
Notes due 2002	7.59		330	230
Notes due 2003	5.61		1,313	1,398
Notes due 2004	5.01		483	502
Notes due 2006	7.25		25	-
Notes due 2007	7.38		25	-
Notes due 2011	7.01		50	-
Notes due 2016	7.20		250	250
Convertible notes due 2018	3.63		617	601
Notes due 2038	5.96		25	25
Revolving credit agreement, maturing in 2002	6.93		4,400	-
Capital leases and other debt due 2000-2018	8.17		91	120

Subtotal			8,567	6,187

Xerox Credit Corporation				
Notes due 2000	-	-	-	2,026
Notes due 2001	6.66		326	401
Notes due 2002	2.80/1/		666	668
Notes due 2003	6.61		460	200
Notes due 2005	1.50/1/		904	-
Notes due 2007	2.00/1/		270	-
Notes due 2008	6.30		25	-
Notes due 2012	7.09		125	-
Notes due 2013	6.50		60	-
Notes due 2014	6.06		50	-
Notes due 2018	7.00		25	-
Secured borrowings/2/ due 2001-2003	6.70		325	-
Revolving credit agreement, maturing in 2002	6.94		1,020	-
Floating rate notes due 2048	6.44		60	60

Subtotal			4,316	3,355

Total U.S. operations			\$12,883	\$9,542

1 Weighted average interest rates include Japanese yen bonds of \$1,174 and \$488 issued by Xerox Credit Corporation in 2000 and 1999, respectively, with interest rates ranging from 1.50-2.00% and 0.80%, respectively.

2 Refer to Note 6 on page 26 for further discussion of secured borrowings.

	Weighted Average Interest Rates at 12/31/00	2000	1999

International Operations			
Xerox Capital (Europe) plc			
Various obligations, payable in:			
Euros			
due 2000-2008	5.50%	\$ 698	\$ 755
Japanese yen			
due 2001-2005	0.53	950	-
U.S. dollars			

due 2000-2008	6.10	1,025	1,991
Revolving credit agreement, maturing in 2002 (U.S. Dollars)	6.96	1,080	-

Subtotal		3,753	2,746

Other International Operations			
Various obligations, payable in:			
Canadian dollars			
due 2000-2007	11.74	55	88
Pounds sterling			
due 2000-2003	9.00	187	202
Italian lire			
due 2000-2001	4.72	117	133
Euros			
due 2000-2008	7.90	159	194
U.S. dollars			
due 2000-2008	7.67	128	249
Revolving credit agreement, maturing in 2002 (U.S. dollars)			
	6.83	500	-
Capital leases and other debt			
due 2000-2004	6.23	5	20

Subtotal		1,151	886

Total international operations		4,904	3,632

Other borrowings deemed long-term			
		-	1,827

Subtotal		17,787	15,001
Less current maturities		2,383	3,957

Total long-term debt		\$15,404	\$11,044

Consolidated Long-Term Debt Maturities.

Payments due on long-term debt for the next five years and thereafter follow:

2001	2002	2003	2004	2005	Thereafter
\$2,383	\$8,994	\$2,630	\$1,718	\$1,010	\$1,052

Certain of our debt agreements allow us to redeem outstanding debt prior to scheduled maturity. Outstanding debt issues with call features are classified in the preceding five-year maturity table in accordance

with management's current expectations. The actual decision as to early redemption will be made at the time the early redemption option becomes exercisable and will be based on liquidity, prevailing economic and business conditions, and the relative costs of new borrowing.

Convertible Debt. In 1998, we issued convertible subordinated debentures for net proceeds of \$575. The amount due upon maturity in April 2018 is \$1,012, resulting in an effective interest rate of 3.625 percent per annum, including

1.003 percent payable in cash semiannually beginning in October 1998. These debentures are convertible at any time at the option of the holder into 7.808 shares of our stock per \$1,000 principal amount at maturity of debentures. This debt contains a put option which requires us to purchase any debenture, at the option of the holder, on April 21, 2003, for a price of \$649 per \$1,000 principal. We may elect to settle the obligation in cash, shares of common stock, or any combination thereof.

Lines of Credit. We have a \$7 billion revolving credit agreement with a group of banks, which matures in October 2002. This revolver is also accessible by the following wholly owned subsidiaries: Xerox Credit Corporation (up to a \$7 billion limit) and Xerox Canada Capital Ltd. and Xerox Capital (Europe) plc (up to a \$4 billion limit) with our guarantee. Amounts borrowed under this facility are at rates based, at the borrower's option, on spreads above certain reference rates such as LIBOR. This agreement contains certain covenants the most restrictive of which require that we maintain a minimum level of tangible net worth and limit the amounts of outstanding secured borrowings, as defined in the agreement. We are in compliance with these covenants at December 31, 2000. The balance outstanding under this line of credit was \$7 billion at December 31, 2000. In addition, our foreign subsidiaries had unused committed long-term lines of credit used to back short-term indebtedness that aggregate \$43 in various currencies at prevailing interest rates.

Guarantees. At December 31, 2000, we have guaranteed the borrowings of our ESOP and \$4,710 of indebtedness of our foreign subsidiaries.

Interest. Interest paid by us on our short- and long-term debt, amounted to \$1,024, \$787 and \$859 for the years ended December 31, 2000, 1999 and 1998, respectively.

A summary of the cash related changes in consolidated indebtedness for the three years ended December 31, 2000 follows:

	2000	1999	1998
Cash proceeds from (payments of) short-term debt, net	\$(1,234)	\$(4,140)	\$ 553
Cash proceeds from long-term debt	10,520	5,446	3,464
Principal payments on long-term debt	(5,713)	(1,489)	(1,580)
Total net cash changes in debt	\$ 3,573/1/	\$ (183)/2/	\$ 2,437

/1/ Excludes debt of \$118, which was assumed by Fuji Xerox in connection with the divestiture of our China operations, and accretion of \$16 on convertible debt.

/2/ Excludes debt of \$51 assumed with the increased ownership in our India joint venture and accretion of \$26 on convertible debt.

13. Financial Instruments

Derivative Financial Instruments. Certain financial instruments with off-balance-sheet risk have been entered into by us to manage our interest rate and foreign currency exposures. These instruments are held solely for hedging purposes and include interest rate swap agreements, forward exchange contracts and foreign currency swap agreements. We do not enter into derivative instrument transactions for trading or other speculative purposes.

We typically enter into simple, unleveraged derivative transactions which, by their nature, have low credit and market risk. Our policies on the use of

derivative instruments prescribe an investment-grade counterparty credit floor and at least quarterly monitoring of market risk on a counterparty-by-counterparty basis. We utilize numerous counterparties to ensure that there are no significant concentrations of credit risk with any individual counterparty or groups of counterparties. Based upon our ongoing evaluation of the replacement cost of our derivative transactions and counterparty credit-worthiness, we consider the risk of credit default significantly affecting our financial position or results of operations to be remote.

We employ the use of hedges to reduce the risks that rapidly changing market conditions may have on the underlying transactions. Typically, our currency and interest rate hedging activities are not affected by changes in market conditions, as forward contracts and swaps are arranged and normally held to maturity in order to lock in currency rates and interest rate spreads related to underlying transactions.

During 2000 the agencies that assign ratings to our debt downgraded our debt. These downgrades significantly reduced our access to capital markets. Furthermore, the specific downgrade of our debt on December 1, 2000 triggered the repurchases of a number of derivative contracts, which were in place at

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that time, and further downgrades could require that we 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 employ our match funding strategy, has been severely constrained. These derivative contract repurchases resulted in un-hedged foreign currency denominated assets and liabilities. We recorded mark-to-market gains during December 2000 of \$69 as a direct result of these un-hedged exposures.

None of our hedging activities involves exchange-traded instruments.

Interest Rate Swaps. We enter into interest rate swap agreements to manage interest rate exposure, although the recent downgrades of our indebtedness have limited our ability to manage this exposure. An interest rate swap is an agreement to exchange interest rate payment streams based on a notional principal amount. We follow settlement accounting principles for interest rate swaps whereby the net interest rate differentials to be paid or received are recorded currently as adjustments to interest expense.

Virtually all customer financing assets earn fixed rates of interest. Accordingly, through the use of interest rate swaps in conjunction with the contractual maturity terms of outstanding debt, we "lock in" an interest spread by arranging fixed-rate interest obligations with maturities similar to the underlying assets. Additionally, in industrialized countries customer financing assets are funded with liabilities denominated in the same currency. We refer to the effects of these conservative practices as "match funding" our customer financing assets. This practice effectively eliminates the risk of a major decline in interest margins resulting from adverse changes in the interest rate environment. Conversely, this practice does effectively eliminate the opportunity to materially increase margins when interest rates are declining. As previously disclosed, our credit ratings have been downgraded during 2000. These downgrades have severely limited our current ability to manage our exposure to interest rate changes which has historically been managed through the practice of match funding our finance receivables.

More specifically, pay-fixed/receive-variable interest rate swaps are often used in place of more expensive fixed-rate debt for the purpose of match funding fixed-rate customer contracts.

Pay-variable/receive-variable interest rate swaps (basis swaps) are used to transform variable rate, medium-term debt into commercial paper or local currency LIBOR rate obligations. Pay-variable/receive-fixed interest rate swaps are used to transform term fixed-rate debt into variable rate obligations. The transactions performed within each of these three categories enable the cost-effective management of interest rate exposures. During 2000, the average notional amount of an interest rate swap agreement was \$25.

The total notional amounts of these transactions at December 31, 2000 and 1999, based on contract maturity, follow:

	2000	1999
Commercial paper/bank borrowings	\$ 4,538	\$ 5,352
Medium-term debt	8,666	10,493
Long-term debt	2,267	4,238
Total	\$15,471	\$20,083

The aggregate notional amounts of interest rate swaps by maturity date and type at December 31, 2000 and 1999 follow:

	2000	2001	2002- 2004	2005- 2018	Total
2000					
Pay fixed/receive variable	\$ -	\$1,321	\$ 4,490	\$1,319	\$ 7,130
Pay variable/receive variable	-	1,677	1	-	1,678
Pay variable/receive fixed	-	1,540	4,175	948	6,663
Total	\$ -	\$4,538	\$ 8,666	\$2,267	\$15,471
Memo:					
Interest rate paid	-	5.74%	5.95%	7.01%	6.04%
Interest rate received	-	5.08%	5.85%	5.36%	5.55%
1999					
Pay fixed/receive variable	\$2,699	\$2,202	\$ 6,742	\$ 340	\$11,983
Pay variable/receive variable	443	550	-	-	993
Pay variable/receive fixed	2,210	718	3,544	635	7,107
Total	\$5,352	\$3,470	\$10,286	\$ 975	\$20,083
Memo:					
Interest rate paid	5.94%	4.39%	5.41%	6.25%	5.42%
Interest rate received	5.48%	5.18%	5.38%	6.75%	5.44%

Forward Exchange Contracts. We utilize forward exchange contracts to hedge against the potentially adverse impacts of foreign currency fluctuations on foreign currency-denominated receivables and payables; firm foreign currency commitments; and investments in foreign operations. Firm foreign currency commitments generally represent committed purchase orders for foreign-sourced inventory. These contracts generally mature in six months or less. At December 31, 2000 and 1999, we had outstanding forward exchange contracts of \$1,788 and \$3,838, respectively. Of the outstanding contracts at December 31, 2000, the largest single currency represented was the Euro. Contracts denominated in Euros, Canadian dollars, U.S. dollars, Brazilian reais and Japanese yen accounted for over 90 percent of our forward exchange contracts. On contracts that hedge foreign currency-denominated receivables and payables, gains or losses are reported currently in income, and premiums or discounts are amortized to income and included in Other, net in the Consolidated Statements of Operations. Gains or losses, as well as premiums or discounts, on contracts

that hedge firm commitments are deferred and subsequently recognized as part of the underlying transaction. At December 31, 2000, we had a net deferred loss of \$8. Gains or losses on contracts that hedge an investment in a foreign operation are reported currently in the balance sheet as a component of cumulative translation adjustments. The premium or discount on contracts that hedge an investment in a foreign operation are amortized to income and included in Other, net in the Consolidated Statements of Operations. During 2000, the average notional amount of a forward exchange contract amounted to \$14.

Foreign Currency Swap Agreements. We enter into cross-currency interest rate swap agreements, whereby we issue foreign currency-denominated debt and swap the proceeds with a counterparty. In return, we receive and effectively denominate the debt in local currencies. Currency swaps are utilized as hedges of the underlying foreign currency borrowings, and exchange gains or losses are recognized currently in Other, net in the Consolidated Statements of Operations. At December 31, 2000 and 1999, we had outstanding cross-currency interest rate swap agreements with aggregate notional amounts of \$4,222 and \$3,968, respectively. Of the outstanding agreements at December 31, 2000, the largest single currency represented was the U.S. dollar. Contracts denominated in U.S. dollars, British pounds sterling, Japanese yen and French francs accounted for over 75 percent of our currency interest rate swap agreements.

Fair Value of Financial Instruments. The estimated fair values of our financial instruments at December 31, 2000 and 1999 follow:

	2000		1999	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	\$ 1,741	\$1,741	\$ 126	\$ 126
Accounts receivable, net	2,281	2,281	2,633	2,633
Short-term debt	2,693	2,356	3,957	3,957
Long-term debt	15,404	9,433	11,044	10,882
Interest rate and currency swap agreements	-	129	-	(40)
Forward exchange contracts	-	(59)	-	131

The fair value amounts for Cash and cash equivalents and Accounts receivable, net approximate carrying amounts due to the short maturities of these instruments.

The fair value of Short and Long-term debt was estimated based on quoted market prices for these or similar issues or on the current rates offered to us for debt of the same remaining maturities. The difference between the fair value and the carrying value represents the theoretical net premium or discount we would pay or receive to retire all debt at such date. We have no plans to retire significant portions of our debt prior to scheduled maturity. We are not required to determine the fair value of our finance receivables.

The fair values for interest rate and cross-currency swap agreements and forward exchange contracts were calculated by us based on market conditions at year-end and supplemented with quotes from brokers. They represent amounts we would receive (pay) to terminate/replace these contracts. We have no present plans to terminate/replace significant portions of these contracts.

14. Employee Benefit Plans

We sponsor numerous pension and other postretirement benefit plans in our U.S. and international operations.

	Pension Benefits		Other Benefits	
	2000	1999	2000	1999
Change in Benefit Obligation				
Benefit obligation, January 1	\$8,418	\$8,040	\$ 1,060	\$ 1,095
Service cost	167	191	24	27
Interest cost	453	1,009	85	77
Plan participants' contributions	19	14	-	-
Plan amendments	1	-	-	-
Actuarial (gain)/loss	48	(79)	218	(78)
Currency exchange rate changes	(197)	(139)	(2)	2
Divestitures	(15)	-	-	-
Curtailments	(10)	(3)	-	-
Settlements	-	2	-	-
Special termination benefits	34	11	4	2
Benefits paid	(663)	(628)	(75)	(65)
Benefit obligation, December 31	8,255	8,418	1,314	1,060
Change in Plan Assets				
Fair value of plan assets, January 1	8,771	7,958	-	-
Actual return on plan assets	651	1,422	-	-
Employer contribution	84	96	75	65
Plan participants' contributions	19	14	-	-
Currency exchange rate changes	(218)	(91)	-	-
Divestitures	(18)	-	-	-
Benefits paid	(663)	(628)	(75)	(65)
Fair value of plan assets, December 31	8,626	8,771	-	-
Funded status (including under-funded and non-funded plans)	371	353	(1,314)	(1,060)
Unamortized transition assets	(15)	(36)	-	-
Unrecognized prior service cost	17	21	(3)	(4)
Unrecognized net actuarial (gain) loss	(433)	(381)	120	(69)
Net amount recognized	\$ (60)	\$ (43)	\$ (1,197)	\$ (1,133)
Amounts recognized in the consolidated balance sheets consist of:				
Prepaid benefit cost	\$ 378	\$ 377	\$ -	\$ -
Accrued benefit liability	(468)	(456)	(1,197)	(1,133)
Intangible asset	3	4	-	-
Accumulated other comprehensive income	27	32	-	-
Net amount recognized	\$ (60)	\$ (43)	\$ (1,197)	\$ (1,133)
Under-funded or non-funded plans				
Aggregate benefit obligation	\$ 348	\$ 497	\$ 1,314	\$ 1,060
Aggregate fair value of plan assets	\$ 180	\$ 174	\$ -	\$ -
Weighted average assumptions as of December 31				
Discount rate	7.0%	7.4%	7.5%	8.0%
Expected return on plan assets	8.9	8.9		
Rate of compensation increase	3.8	4.2		

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	Pension Benefits			Other Benefits		
	2000	1999	1998	2000	1999	1998
Components of Net Periodic Benefit Cost						
Defined benefit plans						
Service cost	\$ 167	\$ 191	\$ 172	\$ 24	\$ 27	\$ 26

Interest cost	453	1,009	916	85	77	72
Expected return on plan assets	(522)	(1,090)	(1,010)	-	-	-
Recognized net actuarial (gain)/loss	4	11	10	-	1	-
Amortization of prior service cost	4	8	6	-	-	-
Recognized net transition asset	(16)	(18)	(19)	-	2	-
Recognized curtailment/settlement gain	(46)	(9)	(60)	-	-	-

Net periodic benefit cost	44	102	15	109	107	98
Defined contribution plans	14	28	32	-	-	-

Total	\$ 58	\$ 130	\$ 47	\$109	\$107	\$98

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. For measurement purposes, an 8.5 percent annual rate of increase in the per capita cost of covered health care benefits was assumed for 2000. The rate was assumed to decrease to 5.25 percent in 2005 and thereafter.

A one-percentage-point change in assumed health care cost trend rates would have the following effects:

	One- percentage- point increase	One- percentage- point decrease

Effect on total service and interest cost components	\$ 4	\$(3)
Effect on postretirement benefit obligation	\$75	\$(60)

Employee Stock Ownership Plan (ESOP) Benefits. In 1989, we established an ESOP and sold to it 10 million shares of Series B Convertible Preferred Stock (Convertible Preferred) of the Company for a purchase price of \$785. Each ESOP share is convertible into six common shares of the Company. The Convertible Preferred has a \$1 par value and a guaranteed minimum value of \$78.25 per share and accrues annual dividends of \$6.25 per share. The ESOP borrowed the purchase price from a group of lenders. The ESOP debt is included in our consolidated balance sheets because we guarantee the ESOP borrowings. A corresponding amount classified as Deferred ESOP benefits represents our commitment to future compensation expense related to the ESOP benefits.

The ESOP will repay its borrowings from dividends on the Convertible Preferred and from our contributions. The ESOP's debt service is structured such that our annual contributions (in excess of dividends) essentially correspond to a specified level percentage of participant compensation. As the borrowings are repaid, the Convertible Preferred is allocated to ESOP participants and Deferred ESOP benefits are reduced by principal payments on the borrowings. Most of our domestic employees are eligible to participate in the ESOP.

Information relating to the ESOP for the three years ended December 31, 2000 follows:

	2000	1999	1998

Interest on ESOP Borrowings	\$24	\$28	\$33

Dividends declared on Convertible			

Preferred Stock	\$53	\$54	\$56

Cash contribution to the ESOP	\$49	\$44	\$41

Compensation expense	\$48	\$46	\$44

We recognize ESOP costs based on the amount committed to be contributed to the ESOP plus related trustee, finance and other charges.

15. Income and Other Taxes

The parent company and its domestic subsidiaries file consolidated U.S. income tax returns. Generally, pursuant to tax allocation arrangements, domestic subsidiaries record their tax provisions and make payments to the parent company for taxes due or receive payments from the parent company for tax benefits utilized.

Income (loss) before income taxes from continuing operations for the three years ended December 31, 2000 consists of the following:

	2000	1999	1998

Domestic income	\$ 49	\$1,176	\$616
Foreign income (loss)	(433)	732	(37)

Income (loss) before income taxes	\$ (384)	\$1,908	\$579

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Provisions (benefits) for income taxes from continuing operations for the three years ended December 31, 2000 consist of the following:

	2000	1999	1998

Federal income taxes			
Current	\$ 8	\$168	\$ 265
Deferred	(131)	166	(152)
Foreign income taxes			
Current	76	124	178
Deferred	(77)	51	(201)
State income taxes			
Current	23	52	70
Deferred	(8)	27	(15)

Income taxes	\$ (109)	\$588	\$ 145

A reconciliation of the U.S. federal statutory income tax rate to the effective income tax rate for continuing operations for the three years ended December 31, 2000 follows:

	2000	1999	1998
U.S. federal statutory income tax rate	(35.0)%	35.0%	35.0%
Foreign earnings and dividends taxed at different rates	40.7	(7.0)	(9.0)
Goodwill amortization	3.0	.7	1.0
Tax-exempt income	(4.1)	(1.0)	(3.0)
State taxes	1.6	2.7	6.2
Audit resolutions	(32.6)	-	-
Other	(2.0)	.4	(5.2)
Effective income tax rate	(28.4)%	30.8%	25.0%

The 2000 effective tax rate of (28.4) percent includes a tax benefit for the 2000 restructuring, the CPID in-process research and development write-off, and the tax provision for the gain on sale of the China operations. Excluding these items, the 2000 effective tax rate is 32.1 percent which is 1.3 percentage points higher than 1999. The increase in the effective tax rate is due primarily to losses in a low-tax rate jurisdiction offset by favorable resolution of tax audits.

The 1999 effective tax rate of 30.8 percent is 0.7 percentage points lower than 1998 after excluding the 1998 worldwide restructuring program from the 1998 effective tax rate.

On a consolidated basis, we paid a total of \$354, \$238 and \$217 in income taxes to federal, foreign and state income-taxing authorities in 2000, 1999 and 1998, respectively.

Total income tax expense (benefit) for the three years ended December 31, 2000 was allocated as follows:

	2000	1999	1998
Income taxes (benefits) on income (loss) from continuing operations	\$ (109)	\$ 588	\$ 145
Tax benefit included in minorities' interests/1/	(20)	(20)	(20)
Discontinued operations	-	(26)	(54)
Goodwill	(42)	-	-
Common shareholders' equity/2/	39	(106)	(140)
Total	\$ (132)	\$ 436	\$ (69)

/1/ Benefit relates to preferred securities as more fully described in Note 17 on page 43.

/2/ For dividends paid on shares held by the ESOP, cumulative translation adjustments and tax benefit on nonqualified stock options.

Deferred income taxes have not been provided on the undistributed earnings of foreign subsidiaries and other foreign investments carried at equity. The amount of such earnings included in consolidated retained earnings at December 31, 2000 was approximately \$5.0 billion. These earnings have been substantially reinvested, and we do not plan to initiate any action that would precipitate the payment of income taxes thereon, except for any actions contemplated by the Company's turnaround program which are disclosed in Note 3 on page 24. It is not practicable to estimate the amount of additional tax that might be payable on the foreign earnings.

The tax effects of temporary differences that give rise to significant portions of the deferred taxes at December 31, 2000 and 1999 follow:

	2000	1999

Tax effect of future tax deductions		
Depreciation	\$ 386	\$ 385
Postretirement medical benefits	448	438
Restructuring reserves	143	175
Other operating reserves	162	199
Allowance for doubtful accounts	170	111
Deferred compensation	149	159
Tax credit carryforwards	159	116
Research and development	866	641
Other	270	283
	\$ 2,753	\$ 2,507

Valuation allowance	(51)	(49)
Total	\$ 2,702	\$ 2,458

Tax effect of future taxable income		
Installment sales and leases	\$ (872)	\$ (962)
Deferred income	(1,017)	(846)
Other	(298)	(348)

Total	\$(2,187)	\$(2,156)

The valuation allowance for deferred tax assets as of January 1, 1999 was \$53. The net change in the

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total valuation allowance for the years ended December 31, 2000 and 1999 was an increase of \$2 and a decrease of \$4, respectively. The valuation allowance relates to foreign credit carryforwards and foreign net operating loss carryforwards for which the Company has concluded it is more likely than not that these tax credits and net operating loss carryforwards will not be realized in the ordinary course of operations.

The above amounts are classified as current or long-term in the Consolidated Balance Sheets in accordance with the asset or liability to which they relate. Current deferred tax assets at December 31, 2000 and 1999 amounted to \$450 and \$478, respectively.

Although realization is not assured, we have concluded that it is more likely than not that the deferred tax assets for which a valuation allowance was determined to be unnecessary, will be realized in the ordinary course of operations based on scheduling of deferred tax liabilities and income from operating activities. The amount of the net deferred tax assets considered realizable, however, could be reduced in the near term if actual future income taxes are lower than estimated, or if there are differences in the timing or amount of future reversals of existing taxable temporary differences. A substantial portion of our net deferred tax assets are in jurisdictions where the net operating loss carryforward periods are either unlimited (net deferred tax asset of \$64) or 20 years (net deferred tax asset of \$1.2 billion).

At December 31, 2000, we have tax credit carryforwards for income tax purposes of \$159 available to offset future income taxes, of which \$136 is available to carryforward indefinitely. We also have net operating loss carryforwards for income tax purposes of \$157 that are available to offset future taxable income through 2007 and \$1.0 billion available to offset future taxable income indefinitely.

The Company incurs indirect taxes such as property and payroll taxes in the various countries in which it operates. Changes in estimates for these taxes

occur in the ordinary course of accounting for such items. Changes resulting from, but not limited to, refinements of tax computations, systems and other procedural changes as well as other factors amounted to an increase in pre-tax income (loss) of \$17, \$35 and \$21 in the years 2000, 1999 and 1998, respectively.

The Company is also subject to sales and consumption taxes in the various countries in which it operates. Changes in estimates for these taxes resulting from structural realignments or other factors amounted to an increase in pre-tax income (loss) of \$11 and \$51 in the years 2000 and 1998, respectively.

Xerox's Brazilian operations have received assessments for indirect taxes totaling approximately \$400 million related principally to the internal transfer of inventory. We do not agree with these assessments and intend to vigorously defend our position. We, as supported by the opinion of legal counsel, do not believe that the ultimate resolution of these assessments will materially impact the consolidated financial statements.

16. 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. Briefing at the Court of Appeals for the Federal Circuit is complete and oral argument took place on May 9, 2001.

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, and March 31, 2001 respectively, four additional complaints were filed in the same court on behalf of an additional 79, 141, 76, and 51 plaintiffs, respectively, with the same claims for damages as the June 1999 action. Three of the four additional cases have been served on the Company.

Plaintiffs in all five 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

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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 five 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.

Two putative shareholder derivative actions are pending in the Supreme Court of the State of New York, County of New York 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 inadequately 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 pending complaints 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

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motion to dismiss. On May 10, 2001 the court entered an order which, among other things, approved that agreement. The individual defendants deny the wrongdoing alleged in the complaints and intend to vigorously defend the actions.

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, at least five 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. 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 he 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. He 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 alleged in the complaint 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. The Individual Defendants deny the wrongdoing alleged in the complaint and intend to vigorously defend the action.

A class was recently certified in an action originally filed in the United States District Court for the Southern District of Illinois last August. Plaintiffs bring this action on behalf of themselves and an alleged class of over 25,000 persons who received lump sum distributions from the Company's Retirement Income Guarantee Plan after January 1, 1990. Plaintiffs assert violations of ERISA, claiming that the lump sum distributions were improperly calculated. The damages sought are not specified. The Company has asked the court to reconsider its certification of the class. The Company denies any wrongdoing and intends to vigorously defend the action.

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.

17. Preferred Securities

As of December 31, 2000, we have four series of outstanding preferred securities. In total we are authorized to issue 22 million shares of cumulative preferred stock, \$1 par value.

Convertible Preferred Stock. As more fully described in Note 14 on page 37, we sold, for \$785, 10 million shares of our Series B Convertible Preferred Stock (ESOP shares) in 1989 in connection with the establishment of our ESOP. As employees with vested ESOP shares leave the Company, these shares are redeemed by us. We have the option to settle such redemptions with either shares of common stock or cash.

Outstanding preferred stock related to our ESOP at December 31, 2000 and 1999 follows (shares in thousands):

	2000		1999	
	Shares	Amount	Shares	Amount
Convertible Preferred Stock	8,260	\$647	8,551	\$669

Preferred Stock Purchase Rights. We have a shareholder rights plan designed to deter coercive or unfair takeover tactics and to prevent a person or persons from gaining control of us without offering a fair price to all shareholders.

Under the terms of the plan, one-half of one preferred stock purchase right (Right) accompanies each share of outstanding common stock. Each full Right entitles the holder to purchase from us one three-hundredth of a new series of preferred stock at an exercise price of \$250.

Within the time limits and under the circumstances specified in the plan, the Rights entitle the holder to acquire either our common stock, the surviving company in a business combination, or the purchaser of our assets, having a value of two times the exercise price.

The Rights may be redeemed prior to becoming exercisable by action of the

Board of Directors at a redemption price of \$.01 per Right. The Rights expire in April 2007.

The Rights are non-voting and, until they become exercisable, have no dilutive effect on the earnings per share or book value per share of our common stock.

Deferred Preferred Stock. In 1996, a subsidiary of ours issued 2 million deferred preferred shares for Canadian (Cdn.) \$50 million. The U.S. dollar value was \$37 and is included in Minorities' interests in equity of subsidiaries in the Consolidated Balance Sheets. These shares are mandatorily redeemable on February 28, 2006 for Cdn. \$90 million. The difference between the redemption amount and the proceeds from the issue is being amortized, through the redemption date, to Minorities' interests in earnings of subsidiaries in the Consolidated Statements of Operations. We have guaranteed the redemption value.

Company-obligated, mandatorily redeemable preferred securities of subsidiary trust holding solely subordinated debentures of the Company. In 1997, a trust sponsored and wholly owned by the Company issued \$650 aggregate liquidation amount preferred securities (the Original Preferred Securities) to investors and 20,103 shares of common securities to

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the Company, the proceeds of which were invested by the trust in \$670 aggregate principal amount of the Company's newly issued 8 percent Junior Subordinated Debentures due 2027 (the Original Debentures). In June 1997, pursuant to a registration statement filed by the Company and the trust with the Securities and Exchange Commission, Original Preferred Securities with an aggregate liquidation preference amount of \$644 and Original Debentures with a principal amount of \$644 were exchanged for a like amount of preferred securities (together with the Original Preferred Securities, the Preferred Securities) and 8 percent Junior Subordinated Debentures due 2027 (together with the Original Debentures, the Debentures) which were registered under the Securities Act of 1933. The Debentures represent all of the assets of the trust. The proceeds from the issuance of the Original Debentures were used by the Company for general corporate purposes. The Debentures and related income statement effects are eliminated in the Company's consolidated financial statements.

The Preferred Securities accrue and pay cash distributions semiannually at a rate of 8 percent per annum of the stated liquidation amount of \$1,000 per Preferred Security. The Company has guaranteed (the Guarantee), on a subordinated basis, distributions and other payments due on the Preferred Securities. The Guarantee and the Company's obligations under the Debentures and in the indenture pursuant to which the Debentures were issued and the Company's obligations under the Amended and Restated Declaration of Trust governing the trust, taken together, provide a full and unconditional guarantee of amounts due on the Preferred Securities.

The Preferred Securities are mandatorily redeemable upon the maturity of the Debentures on February 1, 2027, or earlier to the extent of any redemption by the Company of any Debentures. The redemption price in either such case will be \$1,000 per share plus accrued and unpaid distributions to the date fixed for redemption.

18. Common Stock

We have 1.05 billion authorized shares of common stock, \$1 par value. At December 31, 2000 and 1999, 98.1 and 84.3 million shares, respectively, were reserved for issuance under our incentive compensation plans. In addition, at December 31, 2000, 13.2 million common shares were reserved for the conversion of \$670 of convertible debt, and 48.9 million common shares were reserved for conversion of ESOP-related Convertible Preferred Stock.

Treasury Stock. The Board of Directors has authorized us to repurchase up to \$1 billion of our common stock. The stock may be repurchased from time to time on the open market depending on market and other conditions. No shares were repurchased during 2000 or 1999. During 1998, we repurchased 3.7 million shares

for \$172. Since inception of the program we have repurchased 20.6 million shares for \$594. Common shares issued for stock option exercises, conversion of convertible securities and other exchanges were partially satisfied by reissuances of treasury shares.

Put Options. In connection with the share repurchase program, during 2000, 1999 and 1998, we sold 7.5 million, 0.8 million and 1.0 million put options, respectively, that entitle the holder to sell one share of our common stock to us at maturity at a specified price. These put options can be settled in cash at our option. The put options had original maturities ranging from six months to two years.

In 2000, we recorded the receipt of a premium of approximately \$24 on the sale of equity put options. This premium was recorded as an addition to Common shareholders' equity. In October 2000, the holder of these equity put options exercised their option for early termination and settlement. The cost of this settlement to the Company was approximately \$92 for 7.5 million shares with an average strike price of \$18.98 per share. This transaction was recorded as a reduction of Common shareholders' equity.

At December 31, 2000, 0.8 million put options remain outstanding with a strike price of \$40.56 per share. Under the terms of this contract we had the option of physical or net cash settlement. Accordingly, this amount is classified as temporary equity in the consolidated balance sheets at December 31, 2000. In January 2001 these put options 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.

In 1999, put options on 1.0 million shares of common stock were exercised and settled for a net cash payment of \$5.

Stock Option and Long-Term Incentive Plans. We have a long-term incentive plan whereby eligible employees may be granted nonqualified stock options and performance unit rights. Beginning in 1998 and subject to vesting and other requirements, performance unit rights are typically paid in our common stock. The value of each performance unit is based on

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the growth in earnings per share during the year in which granted. Performance units ratably vest in the three years after the year awarded.

Stock options and rights are settled with newly issued or, if available, treasury shares of our common stock. Stock options generally vest in three years and expire between eight and ten years from the date of grant. The exercise price of the options is equal to the market value of our common stock on the effective date of grant.

At December 31, 2000 and 1999, 36.0 million and 36.2 million shares, respectively, were available for grant of options or rights. The following table provides information relating to the status of, and changes in, options granted:

Employee Stock Options (Options in thousands)	2000		1999		1998	
	Average Stock Options	Average Option Price	Average Stock Options	Average Option Price	Average Stock Options	Average Option Price
Outstanding at January 1	43,388	\$42	30,344	\$33	27,134	\$26
Granted	19,338	22	19,059	51	8,980	47
Cancelled	(4,423)	38	(870)	47	(199)	37
Exercised	(70)	22	(5,145)	23	(5,571)	20
Outstanding at December 31	58,233	35	43,388	42	30,344	33
Exercisable at end of year	23,346		13,467		9,622	

Options outstanding and exercisable at December 31, 2000 are as follows:

Thousands except per-share data		Options Outstanding		Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted		Number Exercisable	Weighted Average Exercise Price
		Average Remaining Contractual Life	Weighted Average Exercise Price		
\$10.94 to \$16.38	319	8.25	\$14.59	-	\$ -
16.91 to 23.25	22,694	7.34	21.47	5,780	20.59
25.38 to 36.70	13,799	5.67	31.43	7,794	33.04
41.72 to 60.95	21,421	6.33	53.26	9,772	51.45
\$10.94 to \$60.95	58,233	6.58	\$35.48	23,346	\$37.66

We do not recognize compensation expense relating to employee stock options because the exercise price of the option equals the fair value of the stock on the effective date of grant. If we had determined the compensation based on the value as determined by the modified Black-Scholes option pricing model, the pro forma net income (loss) and earnings (loss) per share would be as follows:

	2000	1999	1998
Net income (loss) - as reported	\$ (257)	\$1,339	\$ 273
Net income (loss) - pro forma	(359)	1,238	228
Basic EPS - as reported	(0.44)	1.96	0.34
Basic EPS - pro forma	(0.59)	1.81	0.27
Diluted EPS - as reported	(0.44)	1.85	0.34
Diluted EPS - pro forma	(0.59)	1.71	0.27

These pro forma disclosures are not necessarily indicative of future amounts.

As reflected in the pro forma amounts in the previous table, the fair value of each option granted in 2000, 1999 and 1998 was \$7.50, \$15.83 and \$13.31, respectively. The fair value of each option granted was estimated on the date of grant using the following weighted average assumptions:

	2000	1999	1998
Risk-free interest	6.7%	5.1%	5.2%
Expected life in years	7.1	6.2	5.3
Expected volatility	37.0%	28.0%	24.9%
Expected dividend yield	3.7%	1.8%	1.4%

19. Earnings per Share

A reconciliation of the numerators and denominators of the basic and diluted EPS calculation follows:

(Shares in thousands)	2000			1999			1998		
	Income (Numer-ator)	Shares (Denom-inator)	Per-Share Amount	Income (Numer-ator)	Shares (Denom-inator)	Per-Share Amount	Income (Numer-ator)	Shares (Denom-inator)	Per-Share Amount
Basic EPS									
Income (loss) from continuing operations	\$ (257)			\$1,339			\$463		
Accrued dividends on preferred stock, net	(35)			(38)			(46)		
Basic EPS	\$ (292)	667,581	\$ (0.44)	\$1,301	663,493	\$1.96	\$417	658,956	\$0.63
Diluted EPS									
Stock options and other incentives					8,727			9,811	
ESOP Adjustment, net of tax				43	51,989				
Convertible debt, net of tax				17	13,191		3	5,287	
Diluted EPS	\$ (292)	667,581	\$ (0.44)	\$1,361	737,400	\$1.85	\$420	674,054	\$0.62

Note: Recalculation of per-share amounts may be off by \$0.01 in certain instances due to rounding.

20. Subsequent Events

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 \$474. The proceeds were accounted for as a secured borrowing. At March 31, 2001 the balance of receivables transferred was \$734 and is included in Finance receivables, net in the Consolidated Balance Sheets. The remaining secured borrowing balance of \$340 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.

In the first five months of 2001, we retired \$128 of long-term debt through the exchange of 16 million shares of common stock valued at \$100. The retirements resulted in a pre-tax extraordinary gain of \$28 (\$17 after taxes or \$0.02 per share) for a net equity increase of approximately \$117.

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 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 others portfolio of patents.

We maintain a cash position of approximately \$194 in a trust account representing the par value and one years interest relating to the bonds issued by our subsidiary Xerox Finance (Nederland) BV. This cash is withdrawable upon 21 days written notice to the Trustee.

During the first quarter of 2001, and in connection with the turnaround program, we recorded an additional pre-tax restructuring provision totaling \$108 (\$73 after taxes), in connection with finalized initiatives under the turnaround program. This charge includes estimated costs of \$97 for severance costs associated with work force reductions related to the elimination of 1,000 positions worldwide and \$11 of asset impairments. 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.

In April 2001, we announced the sale of our leasing businesses in four European countries to Resonia Leasing AB (Resonia) for approximately \$370 in cash. The assets were sold for approximately book value and include the leasing portfolios in the respective countries, title to the underlying equipment included

in the lease portfolios and certain employees and systems used in the operations of the businesses. Under the terms of the agreement Resonia will provide on-going exclusive equipment financing to Xerox customers in those countries.

The Company's Audit Committee, in cooperation with our independent auditors, undertook an investigation of certain of the Company's accounting policies and procedures. This investigation began in April 2001 and was substantially completed by the end of May 2001, resulting in the accounting adjustments and restatements described in Note 2.

A number of securities and other litigation is pending against the Company. See Note 16 for a description of those items including disclosure of certain related subsequent events.

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Quarterly Results of Operations
(Unaudited)

In millions, except per-share data	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Full Year

2000/2,3/					
Revenues	\$4,540	\$4,778	\$4,552	\$4,831	\$18,701
Costs and Expenses	4,884	4,531	4,706	4,964	19,085

Income (Loss) before Income Taxes (Benefits), Equity Income and Minorities' Interests	(344)	247	(154)	(133)	(384)
Income Taxes (Benefits)	(112)	73	(17)	(53)	(109)
Equity in Net Income of Unconsolidated Affiliates	4	46	10	1	61
Minorities' Interests in Earnings of Subsidiaries	11	12	10	10	43

Net Income (Loss)	\$ (239)	\$ 208	\$ (137)	\$ (89)	\$ (257)

Basic Earnings (Loss) per Share	\$ (0.38)	\$ 0.30	\$ (0.22)	\$ (0.15)	\$ (0.44)

Diluted Earnings (Loss) per Share/1/	\$ (0.38)	\$ 0.28	\$ (0.22)	\$ (0.15)	\$ (0.44)

1999/2,3/					
Revenues	\$4,327	\$4,902	\$4,733	\$5,605	\$19,567
Costs and Expenses	3,933	4,368	4,235	5,123	17,659

Income before Income Taxes, Equity Income and Minorities' Interests	394	534	498	482	1,908
Income Taxes	120	160	154	154	588
Equity in Net Income of Unconsolidated Affiliates	10	24	5	29	68
Minorities' Interests in Earnings of Subsidiaries	8	13	14	14	49

Net Income	\$ 276	\$ 385	\$ 335	\$ 343	\$ 1,339

Basic Earnings per Share	\$ 0.40	\$ 0.56	\$ 0.49	\$ 0.50	\$ 1.96

Diluted Earnings per Share/1/	\$ 0.38	\$ 0.53	\$ 0.46	\$ 0.47	\$ 1.85

/1/ The sum of quarterly diluted earnings per share differ from the full-year amounts because securities that are antidilutive in certain quarters are not antidilutive on a full-year basis.

/2/ As restated. See footnote No. 2. The above restated quarterly financial statements may be subject to additional adjustment, among quarters within years.

/3/ The above data has not been reviewed by our independent auditors in accordance with standards established by the American Institute of Certified Public Accountants.

Report of Independent Auditors

Report of Independent Auditors
To the Board of Directors and Shareholders of
Xerox Corporation:

We have audited the consolidated balance sheets of Xerox Corporation and consolidated subsidiaries as of December 31, 2000 and 1999, and the related consolidated statements of operations, cash flows, and shareholders' equity for each of the three years in the three year period ended December 31, 2000. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements appearing on pages 16 through 47 present fairly, in all material respects, the financial position of Xerox Corporation and consolidated subsidiaries as of December 31, 2000 and 1999, and the results of their operations and their cash flows for each of the three years in the three year period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the consolidated financial statements, the accompanying consolidated balance sheet as of December 31, 1999, and the related consolidated statements of operations, cash flows, and shareholders' equity for the years ended December 31, 1999 and December 31, 1998 have been restated.

The supplementary quarterly financial information on page 48 of the Company's Annual Report contains information that we did not audit, and accordingly, we do not express an opinion on that information. We did not have an adequate basis to complete reviews of the quarterly information in accordance with standards established by the American Institute of Certified Public Accountants, due to the matters related to the restatement issues as described in Note 2 to the consolidated financial statements.

/s/ KPMG LLP
KPMG LLP
Stamford, Connecticut
May 30, 2001

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Five Years in Review

(Dollars in millions, except per-share data)	2000*	1999*	1998*	1997*	1996*
Per-Share Data					
Earnings (loss) from continuing operations					
Basic	\$ (0.44)	\$ 1.96	\$ 0.63	\$ 2.01	\$ 1.75
Diluted	(0.44)	1.85	0.62	1.89	1.64
Dividends declared	0.65	0.80	0.72	0.64	0.58
Operations					

Revenues/1/	\$18,701	\$19,567	\$19,593	\$18,225	\$17,609
Research and development expenses	1,044	992	1,035	1,065	1,044
Income (loss) from continuing operations	(257)	1,339	463	1,359	1,191
Net income (loss)	(257)	1,339	273	1,359	1,191

Financial Position					
Accounts and finance receivables, net	\$15,335	\$15,652	\$16,618	\$14,323	\$13,395
Inventories, net	1,932	2,290	2,504	2,058	1,972
Equipment on operating leases, net	724	695	797	760	704
Land, buildings and equipment, net	2,495	2,456	2,366	2,377	2,256
Investment in discontinued operations	534	702	1,670	3,025	4,398
Total assets	29,475	28,531	29,628	27,582	26,819

Consolidated capitalization					
Short-term debt	2,693	3,957	4,104	3,707	3,536
Long-term debt	15,404	11,044	11,003	8,946	8,697

Total debt	18,097	15,001	15,107	12,653	12,233
Deferred ESOP benefits	(221)	(299)	(370)	(434)	(494)
Minorities' interests in equity of subsidiaries	141	127	124	127	843
Obligation for equity put options	32	-	-	-	-
Company-obligated, mandatorily redeemable preferred securities of subsidiary trust holding solely subordinated debentures of the Company	638	638	638	637	-
Preferred stock	647	669	687	705	721
Common shareholders' equity	3,493	4,648	4,633	4,877	4,352
Total capitalization/3/	22,827	20,784	20,819	18,565	17,655

Selected Data and Ratios					
Common shareholders of record at year-end	59,874	55,297	52,048	54,689	55,908
Book value per common share/2/	\$ 5.20	\$ 6.96	\$ 7.01	\$ 7.43	\$ 6.69
Year-end common stock market price	\$ 4.63	\$ 22.69	\$ 59.00	\$ 36.94	\$ 26.31
Employees at year-end	92,500	94,600	92,700	91,500	86,700
Working capital	\$ 6,754	\$ 3,885	\$ 3,932	\$ 3,026	\$ 2,925
Current ratio	2.1	1.5	1.5	1.4	1.4
Additions to land, buildings and equipment	\$ 452	\$ 594	\$ 566	\$ 520	\$ 510
Depreciation on buildings and equipment	\$ 417	\$ 416	\$ 362	\$ 400	\$ 372

- 1 Revenues for 1996 through 2000 have been restated to include shipping and handling charges billed to customers as revenues. These amounts were historically reported as a reduction of cost of goods sold.
 - 2 Book value per common share is computed by dividing common shareholders' equity by outstanding common shares plus common shares reserved for the conversion of the Xerox Canada Inc. Exchangeable Class B Stock.
 - 3 In 1997, \$100 of liabilities were recorded and which were reversed in 1998 and 1999. The effects of such reversal on pre-tax income have been restated (see Note 2 to the Consolidated Financial Statements). The \$100 represents .5 percent of both total liabilities and total capitalization.
- * Amounts as adjusted or restated.

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Officers

Paul A. Allaire
Chairman of the Board and
Chief Executive Officer
Chairman of the Executive Committee

Anne M. Mulcahy
President and
Chief Operating Officer

Barry D. Romeril
Vice Chairman and
Chief Financial Officer

Allan E. Dugan
Executive Vice President
President, Worldwide Business Services

Carlos Pascual
Executive Vice President
President, Developing Markets Operations

Ursula M. Burns
Senior Vice President
Corporate Strategic Services

Worldwide Business Services

Thomas J. Dolan
Senior Vice President
President, Global Solutions Group

James A. Firestone
Senior Vice President
Corporate Strategy and
Marketing Group

Herve J. Gallaire
Senior Vice President
Xerox Research and Technology and Chief Technical Officer

Anshoo S. Gupta
Senior Vice President
President, Production
Solutions Group
Global Solutions Group

Gilbert J. Hatch
Senior Vice President
President, Office Systems Group

Michael C. Mac Donald
Senior Vice President
President, North American Solutions Group

Hector J. Motroni
Senior Vice President and
Chief Staff Officer

Gerald K. Perkel
Senior Vice President
President, Office Printing Business

Brian E. Stern
Senior Vice President
President, Xerox Technology Enterprises

Guilherme M.N. Bettencourt
Vice President
Presidente, Xerox do Brasil, Ltda.
Developing Markets Operations

John Seely Brown
Vice President and Chief Scientist

Christina E. Clayton
Vice President and General Counsel

Patricia A. Cusick
Vice President and
Chief Information Officer
Worldwide Business Services

J. Michael Farren
Vice President
External Affairs

Anthony M. Federico
Vice President
General Manager, Production Solutions Business Team
Global Solutions Group

Eunice M. Filter
Vice President, Treasurer and Secretary

Emerson U. Fullwood
Vice President
President, Regional Operations
Developing Markets Operations

William R. Goode
Vice President
Deputy Managing Director, European Solutions Group

James H. Lesko
Vice President
President, Xerox Supplies Group
Worldwide Business Services

Rafik O. Loutfy
Vice President and Center Manager
Xerox Canada Research Centre

Jean-Noel Machon
Vice President
President, European Solutions Group

Diane E. McGarry
Vice President
Operations Support,
Office of the President and
Chief Operating Officer

James J. Miller
Vice President
General Manager, Small Office / Home Office Business Group

Patricia M. Nazemetz
Vice President
Human Resources

Russell Y. Okasako
Vice President
Taxes

Ronald E. Rider
Vice President
Digital Imaging Technology Center
Xerox Research and Technology

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Directors

Frank D. Steenburgh
Vice President
Senior Vice President/General Manager, e-Services
Global Solutions Group

Gregory B. Tayler
Vice President and Controller

Joseph M. Valenti
Vice President
Senior Vice President, North American Solutions Group Services

Armando Zagalo de Lima
Vice President
Senior Vice President and
Chief Operating Officer

European Solutions Group

Myra R. Drucker
Assistant Treasurer and
Chief Investment Officer

Gary R. Kabureck
Assistant Controller

Richard Ragazzo
Assistant Treasurer

Martin S. Wagner
Assistant Secretary
Associate General Counsel, Corporate Finance and Ventures

Paul A. Allaire /1/
Chairman of the Board and
Chief Executive Officer
Chairman of the Executive Committee
Xerox Corporation
Stamford, Connecticut

Antonia Ax:son Johnson /2, 3/
Chairman
Axel Johnson Group
Stockholm, Sweden

Vernon E. Jordan, Jr. /1, 4, 5/
Senior Managing Director
Lazard Freres & Co., LLC
New York, New York
Of Counsel
Akin, Gump, Strauss,
Hauer & Feld, LLP
Attorneys-at-Law
Washington, DC

Yotaro Kobayashi
Chairman of the Board
Fuji Xerox Co., Ltd.
Tokyo, Japan

Hilmar Kopper /2, 5/
Chairman of the Supervisory Board
Deutsche Bank AG
Frankfurt, Germany

Ralph S. Larsen /1, 3, 5/
Chairman and
Chief Executive Officer
Johnson & Johnson
New Brunswick, New Jersey

George J. Mitchell /4, 5/
Special Counsel
Verner, Liipfert, Bernhard, McPherson & Hand
Washington, DC

Anne M. Mulcahy /1/
President and
Chief Operating Officer
Xerox Corporation
Stamford, Connecticut

N. J. Nicholas, Jr. /2, 4/
Investor
New York, New York

John E. Pepper /2, 3/
Chairman of the Board and
Chairman, Executive Committee
of the Board
The Procter & Gamble Company
Cincinnati, Ohio

Barry D. Romeril
Vice Chairman and
Chief Financial Officer
Xerox Corporation
Stamford, Connecticut

Martha R. Seger /2, 4/
Principal
Martha R. Seger Financial Group, Inc.
Birmingham, Michigan

Thomas C. Theobald /2, 3/
Managing Director
William Blair Capital Partners, LLC
Chicago, Illinois

- /1/ Member of the Executive Committee
- /2/ Member of the Audit Committee
- /3/ Member of the Executive Compensation and Benefits Committee
- /4/ Member of the Finance Committee
- /5/ Member of the Nominating Committee

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How to Reach Us

Xerox Corporation	Xerox Europe	Fuji Xerox Co., Ltd.
800 Long Ridge Road	Riverview	2-17-22 Akasaka
P.O. Box 1600	Oxford Road	Minato-ku, Tokyo 107
Stamford, CT 06904	Uxbridge	Japan
203 968-3000	Middlesex	81 3 3585-3211
	United Kingdom	
	UB8 1HS	
	44 1895 251133	

Shareholder Information

For Shareholder Services, call 800-828-6396 (TDD: 800-368-0328)

For Investor Information, including comprehensive earnings releases:
www.xerox.com/investor or www.xerox.com and select "investor information".
Earnings releases also available by mail:
800-828-6396

Products and Services

www.xerox.com or by phone:

- . 800 ASK-XEROX (800 275-9376) for any product or service
- . 800 TEAM-XRX (800 832-6979) for any small office or home office product

. 877 362-6567 for networked products sold through resellers

Additional Information

The Xerox Foundation and Community
Involvement Program: 203 968-3333

Xerox diversity programs and
EEO-1 reports: 716 423-6157

Environmental, Health and
Safety Progress Report: 800 828-6571

Questions from Students and Educators:
E-mail: Nancy.Dempsey@usa.xerox.com

Dividends Paid to Shareholders

At its February 5, 2001, meeting, the Company's Board of Directors declared the regular quarterly dividend of \$.05 per share on the common stock and a quarterly dividend of \$1.5625 per share on the preferred stock. Previously, at its October meeting, the Board voted to decrease the dividend to \$.05 per share, from the \$.20 per share in prior quarters, payable January 1, 2001. The Series B Convertible Preferred stock was issued in July 1989 in connection with the formation of a Xerox Employee Stock Ownership Plan.

Xerox Common Stock Prices and Dividends

New York Stock Exchange composite prices

2000	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
High	\$29.75	\$29.31	\$20.38	\$15.31
Low	20.13	17.75	14.75	4.44
Dividends Paid	\$ 0.20	\$ 0.20	\$ 0.20	\$ 0.20

1999	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
High	\$63.00	\$63.69	\$59.75	\$42.81
Low	51.63	52.50	40.50	19.88
Dividends Paid	\$ 0.18	\$ 0.20	\$ 0.20	\$ 0.20

Stock Listed and Traded

Xerox common stock (XRX) is listed on the New York Stock Exchange and the Chicago Stock Exchange. It is also traded on the Boston, Cincinnati, Pacific Coast, Philadelphia, London and Switzerland exchanges.

Auditors
KPMG LLP
Certified Public Accountants
Stamford Square
3001 Summer Street
Stamford, CT 06905
203 356-9800

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DocuColor (R) is a trademark of Identix Inc., licensed to Xerox Corporation.

Subsidiaries of Xerox Corporation

The following companies are subsidiaries of Xerox Corporation as of May 1, 2001. The names of a number of other subsidiaries have been omitted as they would not, if considered in the aggregate as a single subsidiary, constitute a significant subsidiary:

Name of Subsidiary -----	Incorporated In -----
Intelligent Electronics, Inc.	Pennsylvania
Intellinet, Ltd.	Pennsylvania
RNTS, Inc.	Colorado
Xerox Connect, Inc.	Pennsylvania
Kapwell, Ltd	Bermuda
Proyectos Inverdoco, C.A.	Venezuela
Goodkap, Ltd.	Bermuda
Kapskew, Ltd.	Bermuda
Xerox de Venezuela, C.A.	Venezuela
Pacific Services and Development Corporation	Delaware
Inversiones San Simon, S.A.	Venezuela
Estacionamiento Bajada III, C.A.	Venezuela
Xerox Argentina, I.C.S.A.	Argentina
Xerox Canada Capital Ltd.	Ontario
Xerox Canada Inc.	Ontario
Xerox Canada Acceptance Inc.	Canada
Xerox Canada Facilities Management Ltd.	Ontario
Xerox Canada Finance Inc.	Ontario
Xerox Canada Ltd.	Canada
Xerox Canada Manufacturing & Research Inc.	Ontario
Xerox de Chile S.A.	Chile
Xerox Financial Services, Inc.	Delaware
OakRe Life Insurance Company	Missouri
Ridge Reinsurance Limited	Bermuda
Talegen Holdings, Inc.	Delaware
VRN Inc.	Delaware
Xerox Credit Corporation	Delaware
XFS Merchant Partner, Inc.	Delaware
Xerox Foreign Sales Corporation	Barbados
Xerox Investments (Europe) BV	Netherlands
Xerox Holdings (Ireland) Limited	Ireland
Xerox (Europe) Limited	Ireland
Xerox XF Holdings (Ireland) Limited	Ireland
Xerox Israel Ltd.	Israel
Xerox UK Holdings Limited	United Kingdom
Triton Business Finance Limited	United Kingdom
Xerox Engineering Systems Europe Limited	United Kingdom
Xerox Research (UK) Limited (in liquidation)	United Kingdom
Xerox Trading Enterprises Limited	United Kingdom
Xerox Overseas Holdings Limited	United Kingdom
Xerox Holding (Nederland) B.V.	Netherlands
Xerox XHB Limited	Bermuda
Xerox XIB Limited	Bermuda

Xerox Limited	United Kingdom
Fuji Xerox Co., Ltd. *	Japan
Xerox (Hong Kong) Limited	Hong Kong

NV Xerox Credit S.A.	Belgium
NV Xerox Management Services S.A.	Belgium
N.V. Xerox S.A.	Belgium
The Limited Liability Company Xerox (Ukraine) Limited	Ukraine
Xerox AB	Sweden
Xerox AG	Switzerland
Xerox A/S	Denmark
Xerox AS	Norway
Xerox Austria GmbH	Austria
Xerox Beograd d.o.o.	Yugoslavia
Xerox Bulgaria	Bulgaria
Xerox Buro Araciari Ticaret ve Servis A.S.	Turkey
Xerox (C.I.S.) LLC	Russia
Xerox Czech Republic s r.o.	Czech Republic
Xerox Direct Nord GmbH	Germany
Xerox Direct Ost GmbH	Germany
Xerox Direct Rhein-Main GmbH	Germany
Xerox Direct Sud GmbH	Germany
Xerox Direct Sud-West GmbH	Germany
Xerox Espana-The Document Company, S.A.U.	Spain
Xerox (Nigeria) Limited	Nigeria
Xerox Oy	Finland
Xerox Polska Sp.zo.o	Poland
Xerox Portugal Equipamentos de Escritorio, Limitada	Portugal
Xerox (Romania) Echipmante Si Servici S.A.	Romania
Xerox (Romania) SRL	Romania
Xerox Slovenia d.o.o.	Slovenia
Xerox South Africa (Proprietary) Limited	South Africa
Xerox S.p.A.	Italy
Xerox - THE DOCUMENT COMPANY S.A.S.	France
Xerox Hellas AEE	Greece
Xerox Hungary Trading Company Ltd.	Hungary
Xerox Kenya Limited	Kenya
Xerox Mexicana, S.A. de C.V	Mexico
Xerox Middle East Investments (Bermuda) Limited	Bermuda
Bessemer Insurance Limited	Bermuda
Investissements Xerographiques Marocains S.A.	Morocco
Reprographics Egypt Limited	Egypt
Xerox Egypt S.A.E.	Egypt
Xerox Finance Leasing S.A.E.	Egypt
Xerox Participacoes Ltda.	Brazil
Xerox do Brasil Ltda.	Brazil
Xerox Comercio e Industria Ltda	Brazil
Xerox Desenvolvimento de Sistemas e de Tecnologia Ltda	Brazil
Xerox Real Estate Services, Inc.	New York
Xerox Realty Corporation	Delaware
Xerox Servicios Tecnicos, C.A.	Venezuela
XESystems, Inc.	Delaware

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* Indicates only 50% is owned, directly or indirectly, by Xerox Corporation.

Consent of Independent Auditors

To the Board of Directors and Shareholders of Xerox Corporation:

We consent to the incorporation by reference in the Registration Statements of Xerox Corporation on Forms S-8 (Nos. 333-93269, 333-09821, 333-22059, 333-22037, 333-22313, 33-65269, 33-44314, 33-44313, 33-18126, 2-86275, 2-86274) and Forms S-3 (Nos. 33-9486, 33-32215, 333-59355 and 333-73173) of our report dated May 30, 2001 relating to the consolidated balance sheets of Xerox Corporation and subsidiaries as of December 31, 2000 and 1999, and the related consolidated statements of operations, cash flows, and shareholders' equity and related financial statement schedule for each of the years in the three-year period ended December 31, 2000, which report appears in the 2000 Annual Report on Form 10-K of Xerox Corporation.

Our report dated May 30, 2001 indicates that the Company's consolidated balance sheet as of December 31, 1999, and the related consolidated statements of operations, cash flows, and shareholder's equity for the years ended December 31, 1999 and December 1998, have been restated.

Our audit report also indicates that the supplementary quarterly financial information included in the Company's consolidated financial statements contains information that we did not audit, and accordingly, we do not express an opinion on that information. We did not have an adequate basis to complete reviews of the quarterly information in accordance with standards established by the American Institute of Certified Public Accountants due to the matters related to the restatement issues as described in Note 2 to the consolidated financial statements.

/s/ KPMG LLP

Stamford, Connecticut
June 7, 2001

DIRECTORS AND OFFICERS INFORMATION

Directors Of Xerox

Shareholders annually elect directors to serve for one year and until their successors have been elected and shall have qualified.

Summary of Director Annual Compensation

Cash..... \$40,000
 Restricted Stock \$25,000 (number of shares based upon market value at time fee is payable-quarterly)
 Options..... 5,000 shares
 Expenses..... Out-of-pocket expenses in connection with service

Eligibility: Directors who are our employees receive no compensation for service as a director. Directors who are employees of subsidiary companies are not eligible to receive stock option awards.

Options: Issued at the fair market value on date of grant (generally on the date of the annual meeting of shareholders). The options vest over a three year period. Upon the occurrence of a change in control, as defined, all outstanding options become exercisable.

Restricted Stock: The number of shares issued is based on the market value at the time the fee is payable, which is in quarterly installments. The shares held by directors under this Plan are included in the Xerox securities owned shown in the biographies of the directors. The shares may not be sold or transferred except upon death, retirement, disability, change in control or termination as a director with the consent of the majority of the Board.

Terms Used in Biographies

Certain terms used in the biographies may be unfamiliar to you, so we are defining them here.

Xerox securities owned means the Company's Common Stock, including restricted shares of Common Stock issued under the Restricted Stock Plan For Directors, and Series B Convertible Preferred Stock. Series B shares are owned through the individual's account in the Xerox Employee Stock Ownership Plan. None of the nominees owns any of the Company's other securities.

Options/Rights is the number of the Company's shares of Common Stock subject to stock options and incentive stock rights held by a nominee.

Immediate family means the spouse, the minor children and any relatives sharing the same home as the nominee.

Unless otherwise noted, all Xerox securities held are owned beneficially by the nominee. This means he or she has or shares voting power and/or investment power with respect to the securities, even though another name--that of a broker, for example--appears in the Company's records. All ownership figures are as of March 30, 2001.

Paul A. Allaire
 Age: 62 Director since: 1986

Xerox securities owned: 390,083 common shares; 381 Series B Convertible Preferred shares

Options/Rights: 3,563,144 common shares

Occupation: Chairman of the Board and Chief Executive Officer, Xerox Corporation

Other Directorships: Lucent Technologies Inc.; priceline.com, Incorporated; Sara Lee Corporation; and SmithKline Beecham plc

Other Background: Joined Xerox in 1966. Stepped down as Chief Executive Officer in April 1999 and returned to the position in May 2000.

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Antonia Ax:son Johnson

Age: 57 Director since: 1996

Xerox securities owned: 4,707 common shares and an indirect interest in approximately 8,664 common shares through the Deferred Compensation Plan

Options/Rights: 25,000 common shares

Occupation: Chairman, Axel Johnson Group

Other Directorships: Axel Johnson AB; Axel Johnson Inc.; Axel Johnson International; Ahlens AB; Axfood AB; Nordstjernan AB; NCC AB

Vernon E. Jordan, Jr.

Age: 65 Director since: 1974

Xerox securities owned: 30,745 common shares and an indirect interest in approximately 6,960 common shares through the Deferred Compensation Plan

Options/Rights: 25,000 common shares

Occupation: Senior Managing Director, Lazared Freres & Co. LLC; Of Counsel, Akin, Gump, Strauss, Hauer & Feld, LLP

Other Directorships: America Online Latin America, Inc.; American Express Company; Callaway Golf Company; Clear Channel Communications, Inc.; Dow Jones & Co., Inc.; FirstMark Communications International, LLC; J.C. Penney Company, Inc.; Revlon Group; Ryder System, Inc.; Sara Lee Corporation; Shinsei Bank, Ltd; and Union Carbide Corporation

Other Background: Joined Lazard Freres & Co. LLC in January 2000. Became a partner in the law firm of Akin, Gump, Strauss, Hauer & Feld in 1982.

Yotaro Kobayashi

Age: 67 Director since: 1987

Xerox securities owned: 30,622 common shares

Options/Rights: 16,700 common shares

Occupation: Chairman of the Board, Fuji Xerox Co., Ltd.

Other Directorships: Fuji Xerox Co., Ltd.; Callaway Golf Company; Nippon Telegraph and Telephone Corporation; and American Productivity & Quality Center.

Other Background: Joined Fuji Photo Film Co., Ltd. in 1958, was assigned to Fuji Xerox Co., Ltd. in 1963, named President and Chief Executive Officer in 1978 and Chairman and Chief Executive Officer in 1992.

Hilmar Kopper

Age: 66 Director since: 1991

Xerox securities owned: 21,328 common shares

Options/Rights: 20,050 common shares

Occupation: Chairman of the Supervisory Board, Deutsche BankAG

Other Directorships: Akzo Nobel NV; Bayer AG; DaimlerChrysler AG; Solvay SA; Unilever NV

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Ralph S. Larsen

Age: 62 Director since: 1990

Xerox securities owned: 24,490 common shares and an indirect interest in approximately 26,871 common shares through the Deferred Compensation Plan

Options/Rights: 25,000 common shares

Occupation: Chairman and Chief Executive Officer, Johnson & Johnson

Other Directorships: Johnson & Johnson; AT&T

George J. Mitchell

Age: 67 Director since: 1996

Xerox securities owned: 6,749 common shares and an indirect interest in approximately 5,286 common shares through the Deferred Compensation Plan

Options/Rights: 25,000 common shares

Occupation: Special Counsel, Verner, Liipfert, Bernhard, McPherson and Hand, Chartered

Other Directorships: Federal Express Corporation; Starwood Hotels & Resorts; UNUM Provident Corporation; The Walt Disney Company; Casella Waste Systems, Inc.; Unilever; Staples, Inc.

Anne M. Mulcahy

Age: 48 Director since: 2000

Xerox securities owned: 80,371 common shares; 569 Series B Convertible Preferred shares

Options/Rights: 1,796,848 common shares

Occupation: President and Chief Operating Officer, Xerox Corporation

Other Directorships: Target Corporation; Axel Johnson Inc.; Catalyst; Fannie Mae; Fuji Xerox Co., Ltd; Xerox (Europe) Limited

Other Background: Joined Xerox in 1976 as a sales representative and held various sales and senior management positions. Named Vice President for Human Resources in 1992; Senior Vice President in 1998; and Executive Vice President in 1999. Elected President and Chief Operating Officer in May 2000.

N. J. Nicholas, Jr.

Age: 61 Director since: 1987

Xerox securities owned: 22,703 common shares and an indirect interest in approximately 26,497 common shares through the Deferred Compensation Plan

Options/Rights: 25,000 common shares

Occupation: Investor

Other Directorships: Boston Scientific Corporation; priceline.com, Incorporated

John E. Pepper

Age: 62 Director since: 1990

Xerox securities owned: 57,001 common shares and an indirect interest in approximately 6,047 common shares through the Deferred Compensation Plan: immediate family owns 16,000 shares

Options/Rights: 25,000 common shares

Occupation: Chairman of the Board and Chairman of the Executive Committee, The Procter & Gamble Company

Other Directorships: Motorola, Inc.; The Procter & Gamble Company; Boston Scientific Corporation

Other Background: Joined Procter & Gamble in 1963. Named Executive Vice President and elected to the Board of Directors in 1984, named President in 1986, Chairman and Chief Executive in 1995, Chairman in 1999, retired as an active employee in September 1999, and re-elected Chairman of the Board in June 2000.

Barry D. Romeril

Age: 57 Director since: 1999

Xerox securities owned: 144,021 common shares; 227 Series B Convertible Preferred shares and an indirect interest in approximately 31,154 shares through the Deferred Compensation Plan

Options/Rights: 1,193,548 common shares

Occupation: Vice Chairman and Chief Financial Officer, Xerox Corporation

Other Directorships: Billiton plc; The Concours Group Inc; Booktec.com; Fuji Xerox Co., Ltd.; Xerox (Europe) Limited; Xerox Investments (Nederland) BV

Other Background: Joined Xerox in 1993 as Executive Vice President and Chief Financial Officer. Elected Vice Chairman of the Board of Directors in 1999.

Martha R. Seger

Age: 69 Director since: 1991

Xerox securities owned: 14,006 common shares and an indirect interest in approximately 10,949 common shares through the Deferred Compensation Plan

Options/Rights: 25,000 common shares

Occupation: Financial economist and Former Governor, Federal Reserve System; currently Distinguished Visiting Professor of Finance, Arizona State University

Other Directorships: Fluor Corporation; Michigan Mutual and the Amerisure Companies; The Kroger Co.; Tucson Electric Power Co. and its holding company, Unisouce Energy; Massey Energy

Thomas C. Theobald

Age: 63 Director since: 1983

Xerox securities owned: 24,115 common shares and an indirect interest in approximately 10,415 common shares through the Deferred Compensation Plan

Options/Rights: 25,000 common shares

Occupation: Managing Director, William Blair Capital Partners, LLC

Other Directorships: Anixter International; Jefferson Wells International;

Ownership of Company Securities

We do not know of any person who, or group which, owns beneficially more than 5% of any class of its equity securities as of December 31, 2000, except as set forth below/(1)/.

Title of Class	Name and Address of Beneficial Owner	Amount Beneficially Owned of Class	Percent of Class
Series B Convertible Preferred Stock/(2)/	State Street Bank and Trust Company, as Trustee, 225 Franklin Street, Boston, MA 02110/(3)/	8,256,791	100%
Common Stock	State Street Bank and Trust Company, as Trustee under other plans and accounts 225 Franklin Street, Boston, MA 02110	90,912,742/(4)/	12.7%/(5)/
Common Stock	Capital Research and Management Company 333 South Hope Street Los Angeles, CA 90071	36,095,700/(6)/	5.4%
Common Stock	Dodge & Cox One Sansome Street San Francisco, CA 94104	53,176,018/(7)/	8.0%

- (1) The words "group" and "beneficial" are as defined in regulations issued by the Securities and Exchange Commission (SEC). Beneficial ownership under such definition means possession of sole voting power, shared voting power, sole dispositive power or shared dispositive power. The information provided in this table is based solely upon the information contained in the Form 13G filed by the named entity with the SEC.
- (2) These shares have equal voting rights with the Common Stock except that each share of Preferred Stock has six votes per share.
- (3) Held as Trustee under the Xerox Employee Stock Ownership Plan. Each participant may direct the Trustee as to the manner in which shares allocated to his or her account shall be voted. The Trust Agreement provides that the Trustee shall vote any shares allocated to participants' accounts as to which it has not received voting instructions in the same proportions as shares in participants' accounts as to which voting instructions are received. Shares which have not been allocated are voted in the same proportion. The power to dispose of shares is governed by the terms of the Plan and elections made by participants.
- (4) Within this total as to certain of the shares, State Street Bank and Trust Company has sole voting power for 10,972,321 shares, shared voting power for 78,552,915 shares, sole dispositive power for 12,489,357 shares and shared dispositive power for 78,423,385 shares.
- (5) Percentage based upon assumption that all Series B Convertible Preferred Stock were converted into 49,540,746 shares of Common Stock.
- (6) Capital Research has sole dispositive power over all of the shares and no voting power.
- (7) Within this total as to certain of the shares, Dodge & Cox has sole voting power for 49,638,318 shares, shared voting power for 469,300 shares, sole dispositive power for 53,176,018 shares and no shared dispositive power for any of the shares.

Shares of Common Stock and Series B Convertible Preferred Stock (converted to Common Stock at a ratio of six to one) of the Company owned beneficially by its current (as of May 30, 2001) directors, each of the executive officers named in the Summary Compensation Table below and directors and all officers as a group, as of March 30, 2001, were as follows:

Name of Beneficial Owner	Amount Beneficially Owned	Total Stock Interest
Paul A. Allaire.....	3,031,790	3,955,514
Allan E. Dugan.....	475,111	917,998
Antonia Ax:son Johnson.....	24,706	38,371
Vernon E. Jordan, Jr.....	50,744	62,705
Yotaro Kobayashi.....	42,321	47,322
Hilmar Kopper.....	36,377	41,378
Ralph S. Larsen.....	44,489	76,361
George J. Mitchell.....	26,748	37,035
Anne M. Mulcahy.....	393,183	1,917,732
N. J. Nicholas, Jr.....	42,702	74,200
John E. Pepper.....	77,000	88,047
Barry D. Romeril.....	549,666	1,370,888
Martha R. Seger.....	34,005	49,955
Thomas C. Theobald.....	44,114	59,530
Directors and All Officers as a group	8,171,448	17,534,623

Note: B.R. Inman and Patricia F. Russo resigned as directors of the Company on May 17, 2001 and April 6, 2001, respectively, and are not included in the table above.

Percent Owned by Directors and Officers: Less than 1% of the aggregate number of shares of Common Stock and Series B Stock outstanding at March 30, 2001 is owned by each director and officer. The amount beneficially owned by all directors and officers as a group amounted to approximately 1%.

Amount Beneficially Owned: The numbers shown are the shares of Common Stock considered owned by the directors and officers in accordance with SEC rules. Shares of Common Stock which officers and directors had a right, within 60 days, to acquire upon the exercise of options or rights are included. All these are counted as outstanding for purposes of computing the percentage of Common Stock and Series B Stock outstanding and beneficially owned.

Total Stock Interest: The numbers shown include the amount shown in the Amount Beneficially Owned column plus options held by officers not exercisable within 60 days, incentive stock units and restricted shares. The numbers also include the interests of officers and directors in the Xerox Stock Fund under the Profit Sharing and Savings Plan and the Deferred Compensation Plans.

Executive Compensation

Report of the Executive Compensation and Benefits
Committee of the Board of Directors

Executive Officer Compensation

The Executive Compensation and Benefits Committee (Committee) of the Board of Directors determines the compensation paid to the Company's executive officers. The Committee's members are all independent, non-employee directors of the Company. The Committee does the following:

- . establishes the policies that govern the compensation paid to Xerox executive officers;
- . determines overall and individual compensation goals and objectives;
- . makes awards; and
- . certifies achievement of performance under the Company's various annual and long-term incentive plans and approves actual compensation payments.

Under the Committee's established policy, compensation and benefits provided executive officers are targeted at levels equal to or better than the compensation paid by a peer group of companies for equivalent skills and competencies for positions of similar responsibilities and desired levels of performance. The Company's executive compensation policies, plans and programs are designed to provide competitive levels of compensation that align pay with the Company's annual and long-term performance objectives. They also recognize corporate and individual achievement while supporting the Company objectives of attracting, motivating and retaining high-performing executives.

In determining compensation levels to meet compensation policy objectives, the Committee annually reviews, evaluates and compares Xerox executive officer compensation to relevant external competitive compensation data. During the year, the Committee reviewed the reported compensation data of firms that were part of the Business Week Computers and Peripherals Industry Group (included in the data shown on the performance graph below). The Committee also reviewed a broader group of organizations with which the Company is likely to compete for executive expertise and which are of similar size and scope. The latter group includes large capitalization, global companies in technology, office equipment and other industries.

The Committee sets base salaries taking into account the competitive data referenced above. In addition, a substantial portion, generally two-thirds or more of targeted total compensation, of each executive officer's total compensation is at risk and variable from year to year because it is linked to specific performance measures of the business.

The principal variable pay programs used in 2000 to align executive officer pay with Company and individual performance are briefly described below:

Executive Performance Incentive Plan (EPIP): Approved by shareholders at the Company's Annual Meeting on May 18, 1995, EPIP provides the Committee with an incentive vehicle to compensate eligible executives for significant contributions to the performance of the Company. By design, EPIP permits the tax deductibility of payments made under EPIP even if an executive's compensation exceeds \$1,000,000 in any year. Under federal tax law under certain circumstances such excess would not be deductible.

Under EPIP the Committee established a pool of 2% of the Company's Document Processing profit before tax (PBT) for the 2000 one-year performance period. For the three-year period commencing in 1998, a pool of 1 1/2% of cumulative PBT was established. Ten percent (10%) of the resulting PBT pool was made payable to Mr. Allaire. Five percent (5%) of the pool was made payable to each of the other participants in EPIP.

EPIP gives the Committee discretion to reduce the amount otherwise payable under an award to any participant to any amount, including zero, except in the case of a change in control as defined. The Committee cannot increase the amount determined by the above formula.

For the full year 2000, Mr. Allaire and 15 other executive officers participated in EPIP.

For 2000, the PBT pool amounted to \$3,960,000 and because of the Company's failure to meet its performance goals, the Committee exercised its discretion by reducing total amounts payable to participating executive officers from the pool from \$3,366,000 to \$595,050.

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Annual Performance Incentive Plan (APIP): Under APIP, executive officers of the Company may be entitled to receive performance-related cash payments. Payments are only made if Committee-established annual performance objectives are met.

The Committee approved an annual incentive target and maximum opportunity, expressed as a percentage of 2000 base salary, for each participating officer. At its meeting held on February 7, 2000, the Committee also established overall Document Processing threshold, target and maximum measures of performance and associated payment schedules.

The performance measures and weightings for 2000 were earnings per share (35%), revenue growth (25%), cash conversion cycle (20%), and customer satisfaction (20%). Additional goals were also established for each officer that included business unit specific and/or individual performance goals and objectives. The weights associated with each business-unit specific or individual performance goal and objective used vary and range from 20 percent to 50 percent of the total.

For 2000, the performance against established measures was a significant disappointment. EPS was below threshold levels, revenue growth was negative, and both cash conversion and customer satisfaction were below threshold levels. As a result, no officers received a payment under APIP. The named officers did not receive a merit salary increase. Certain executive officers received an adjustment to their base salary levels as a result of new responsibilities and/or to reflect competitive market levels.

Leveraged Executive Equity Plan (LEEP): Under the terms of the 1991 Long-Term Incentive Plan, the Committee implemented a three-year plan beginning in 1998 for key management executives, including most executive officers. The plan focuses on the achievement of performance objectives of the Document Processing business of the Company. When the objectives of the plan are achieved, shareholder value is enhanced and the plan provides for an opportunity to realize long-term financial rewards. The 1998-2000 performance cycle of LEEP required each executive participant to maintain, directly or indirectly, an investment in shares of common stock of the Company having a value as of December 31, 1997 of either 100%, 200%, 300% or 400% of a participant's annual base salary (investment shares).

In 1998 the Committee granted awards under LEEP to approximately 40 key executives that provided for non-qualified stock options for shares of common stock and incentive stock units. The award to each participant was based on the ratio of ten option shares and two incentive stock units for each investment share. The options became exercisable in three annual cumulative installments beginning in the year following the award. The incentive stock rights are payable in shares of common stock and vest in three annual installments beginning in the year following the award, provided specific Document Processing earnings per share (EPS) goals were achieved for each preceding year.

Thirty-three percent (33%) of the non-qualified stock options granted under the 1998 cycle became exercisable on January 1, 1999, January 1, 2000 and January 1, 2001, respectively.

For 2000, the EPS goal was not achieved and none of the incentive stock units vested.

At its meeting on December 4, 2000, the Committee approved a new three-year (2001-2003) performance cycle of LEEP (New LEEP). New LEEP is intended to

deliver highly competitive compensation opportunities linked to the successful implementation of the Company's turnaround plan and to provide significant retention incentives for participating executives.

New LEEP consists primarily of three equal annual grants of stock options and restricted stock. Award levels are determined to provide competitive long-term incentive opportunities if the business turnaround plan is successfully implemented. Stock options under New LEEP vest fully after three years and remain exercisable for ten years following their date of grant. Restricted stock awarded under New LEEP vests 100% after one year. All executive officers and select other senior executives are eligible for New LEEP. The first annual grant under New LEEP was made on January 1, 2001. There is no requirement for investment shares under New LEEP.

CEO Challenge Bonus: At its February 7, 2000 meeting, the Committee established the CEO Challenge Bonus program for the calendar years 2000 and 2001. The goals of the CEO Challenge Bonus program are to support the Company's need to retain key executives and provide additional incentives to improve the financial performance of the Company. Participants in LEEP, including the executive officers, are eligible to participate in the CEO Challenge Bonus. The CEO Challenge bonus provides an annual opportunity equal to one-half of each executive's annual bonus target amount payable over a period of four quarters if performance targets are met. For 2000, the CEO Challenge Bonus was based on quarterly EPS targets. The EPS target for the first quarter was achieved and bonus amounts were paid accordingly. For the remaining quarters of 2000, EPS targets were not achieved and bonus opportunities were forfeited. For 2001, the CEO Challenge bonus will also be based on quarterly EPS targets.

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In its effort to retain key executives and to provide incentives that focus on shareholder value, the Committee awarded retention stock options to select key executives, including the executive officers other than the Chairman and CEO. The retention stock options vest over two years if EPS targets are met; and vest 100% on December 31, 2004 if EPS targets are not met. The retention stock options provide for dividend equivalents paid in cash until the stock options vest.

Select executive officers also were awarded incentive stock rights that fully vest on January 1, 2002. Beginning with the third quarter of 2000, the incentive stock rights also provide for the payment of dividend equivalents. Incentive stock rights were awarded to a select group of officers who are critical for the Company to retain in order for the Company to implement its turnaround plan.

Chief Executive Officer Compensation

The compensation paid to G. Richard Thoman, President and Chief Executive Officer from January 1, 2000 until May 11, 2000, when he resigned, was established by the Committee at its December 6, 1999 and February 7, 2000 meetings. The Committee's actions are described below as they relate to Mr. Thoman's compensation as reported in the charts and tables that accompany this report.

Base Salary: Mr. Thoman's annualized base salary remained at \$900,000.

2000 Bonus: Mr. Thoman's annual target bonus remained at 100% and his quarterly CEO Challenge bonus target was established at 13%.

Long-Term Incentive: Mr. Thoman was granted a stock option award for 100,000 shares that was scheduled to vest over two years if EPS targets were met and vest 100% on December 31, 2004, if EPS targets were not met.

At its meeting on February 7, 2000, the Committee awarded Paul A. Allaire a stock option award for 200,000 shares that vested on January 1, 2001. The stock

option award was made to retain Mr. Allaire in his role as Chairman of the Board of the Company.

Upon the resignation of Mr. Thoman on May 11, 2000, the Board of Directors requested Mr. Allaire to assume the additional role of Chief Executive Officer of the Company. In recognition of Mr. Allaire's additional role, and after reviewing the compensation levels provided to the Chairmen and Chief Executive Officers of other companies, the Committee authorized the following compensation:

Base Salary: Mr. Allaire's base salary was increased to \$1,200,000 per year.

2000 Bonus: Mr. Allaire's annual bonus target percentage and quarterly CEO Challenge Bonus target remained at 100% and 13% respectively.

Long-Term Incentive: Mr. Allaire was granted a stock option award for 250,000 shares, one-half of which vested on January 1, 2001 with the balance vesting on January 1, 2002; and incentive stock rights for 100,000 shares, one-half of which vested on January 1, 2001, with the balance vesting on January 1, 2002. Mr. Allaire received an award under the New LEEP program as described earlier in the section summarizing Executive Officer Compensation. Under New LEEP, on January 1, 2001, Mr. Allaire received a stock option grant for 350,000 shares that will vest on January 1, 2002, and a restricted stock award of 350,000 shares that will also vest on January 1, 2002. In addition, effective January 1, 2001, Mr. Allaire was awarded participation in a cash long-term incentive program that would pay Mr. Allaire \$3,000,000 at target levels of Company performance (maximum of \$5,000,000), subject to negative discretion by the Committee, for the performance cycle ending December 31, 2001.

The Committee made these awards to provide the incentives necessary to retain and motivate Mr. Allaire to take the actions necessary to implement the turnaround plan, focus Mr. Allaire on the development of his potential successor and provide compensation competitive with the Chairmen and Chief Executive Officers of other companies.

Detailed information concerning Mr. Allaire's compensation as well as that of other highly compensated executives is displayed on the accompanying charts and tables.

Ralph S. Larsen, Chairman
B. R. Inman
Antonia Ax:son Johnson
John E. Pepper
Thomas C. Theobald

February 5, 2001

Compensation Committee Interlocks and Insider Participation

Paul A. Allaire, Chairman and Chief Executive Officer of the Company, serves on the compensation committee of Lucent Technologies, Inc. until May 18, 2000. Patricia F. Russo, a director of the Company until she resigned on April 6, 2001, served on the Executive Compensation and Benefits Committee of the Company and, at the same time, was an Executive Vice President of Lucent.

Summary Compensation Table

The Summary Compensation Table below provides certain compensation information for the Chief Executive Officer and the most highly compensated key executive officers (Named Officers) serving at the end of the fiscal year ended December 31, 2000 and for G. Richard Thoman who served as Chief Executive Officer until May 11, 2000 for services rendered in all capacities during the fiscal years ended December 31, 2000, 1999, and 1998. The table includes the dollar value of

base salary, bonus earned, option awards (shown in number of shares) and certain other compensation, whether paid or deferred.

SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Annual Compensation				Long-Term Compensation Awards			
		Salary (\$)	Annual Bonus			Restricted Stock (\$) (E)	Underlying Options/SARs (#) (F)	All Other Compensation (\$) (G)	
			Cash Bonus (\$) (A)	91 Plan (\$) (B)	Total Annual Bonus (\$) (C) (= A+B)				Other Annual Compensation (\$) (D)
Paul A. Allaire.....	2000	1,125,000	121,875	0	121,875	162,881	2,681,250	450,000	17,055
Chairman and Chief	1999	975,000	0	0	0	118,644	0	54,764	16,290
Executive Officer	1998	975,000	1,600,000	2,924,133	4,524,133	177,310	0	239,082	318,455
Anne M. Mulcahy.....	2000	721,667	45,063	0	45,063	107,659	2,681,250	310,000	34,642
Chief Operating	1999	425,000	0	0	0	88,647	0	15,328	13,578
Officer	1998	312,500	263,000	599,804	862,804	62,791	0	49,044	53,929
Barry D. Romeril.....	2000	641,667	57,500	0	57,500	114,894	804,375	150,000	27,729
Vice Chairman	1999	575,000	0	0	0	170,047	0	24,415	27,141
	1998	513,333	488,000	909,740	1,397,740	138,049	1,145,903	178,822	114,853
William F. Buehler...	2000	641,667	57,500	0	57,500	136,102	804,375	150,000	14,828
Vice Chairman	1999	575,000	0	0	0	100,575	0	23,717	14,374
	1998	464,833	450,000	857,704	1,307,704	91,953	1,145,903	174,568	98,868
Allan E. Dugan.....	2000	462,500	37,188	0	37,188	91,746	0	50,000	29,702
Executive	1999	425,000	0	0	0	109,414	0	16,066	29,085
Vice President	1998	359,000	306,000	717,719	1,023,719	81,092	0	58,686	95,955
G. Richard Thoman....	2000	326,087	487,500	0	487,500	107,971	0	100,000	3,950,000
Chief Executive	1999	900,000	0	0	0	189,642	0	293,562	3,827,580
Officer (H)	1998	700,000	930,000	2,099,341	3,029,341	374,636	1,793,683	335,128	3,960,560

(A) This column reflects annual cash bonuses earned during the years indicated under EPIP and for the year 2000, the CEO Challenge Bonus. In addition, the amount shown for G.R. Thoman for 2000 includes a prorated 2000 bonus that was agreed to be paid in 2001 under the Letter Agreement entered into with Company in May 2000 in connection with his separation.

(B) This column reflects amounts earned under the Company's 1991 Long-Term Incentive Plan (1991 Plan). Under the 1991 Plan, awards of incentive stock units were made in 1998 to each of the Named Officers which become payable as to one-third of the total if the Company's Document Processing earnings per share reach a specified level in 1998, 1999 and 2000. The 2000 level was not reached and the final one-third of the units did not vest. The value of one-third of the incentive stock units, is reported in the column above for the year 1998 in which the earnings per share objective was reached. The Company and the Executive Compensation and Benefits Committee view these amounts as long-term incentive compensation.

(C) Total Annual Bonus is the sum of the amounts under the EPIP, CEO Challenge Award and 1991 Plan.

(D) Other Annual Compensation includes executive expense allowance, dividend equivalents paid on outstanding incentive stock rights, perquisite compensation and above market interest on deferred compensation. Included in Other Annual Compensation for 2000 is \$55,275 of perquisite compensation for William F. Buehler, \$29,949 of which relates to personal use of corporate aircraft. Also included in Other Annual Compensation for 1998 is \$50,337 of perquisite compensation for G. Richard Thoman, \$34,881 of which relates to personal use of corporate aircraft.

(E) This column reflects incentive stock unit awarded under the 1991 Plan or a predecessor plan where each unit represents one share of stock to be issued upon vesting at the attainment of a specific retention period. Each unit is entitled to the payment of dividend equivalents at the same time and in the

same amount declared on one share of the Company's common stock. The number of units held by the Named Officers and their value as of December 31, 2000 (based upon the closing market price on that date of \$4.625 was as follows: P.A. Allaire -- 100,000 (\$462,500), A.M. Mulcahy -- 153,440 (\$709,660), B.D. Romeril -- 114,453 (\$529,345), W.F. Buehler -- 50,000 (\$231,250), and A.E. Dugan -- 63,456 (\$293,484) G. R. Thoman -- 80,000 (\$370,000). Excludes grants of restricted stock made on January 1, 2001 under New LEEP (as described in the Report of the Executive Compensation and Benefits Committee) as follows: P.A. Allaire -- 350,000 (\$1,662,500), A.M. Mulcahy -- 250,000 (\$1,187,500), B.D. Romeril -- 125,000 (\$593,750), A.E. Dugan -- 75,000 (\$326,250).

- (F) The Company no longer grants stock appreciation rights (SARs) in tandem with stock options. All stock options were awarded under the 1991 Plan. As discussed under the report of the Executive Compensation and Benefits Committee, stock options were awarded under a three-year performance cycle of LEEP that ended on December 31, 2000. Excludes grants of stock options made on January 1, 2001 under New LEEP (as described in the Report of the Executive Compensation and Benefits Committee as follows: P.A. Allaire -- 350,000, A.M. Mulcahy -- 934,600, B.D. Romeril -- 467,300, A.E. Dugan -- 280,400.
- (G) The total amounts shown in this column consist of the Company's profit sharing contribution, whether under the Profit Sharing and Savings Plan or its policy of paying directly to the officer the amount which cannot be made under the Plan by reason of the Employee Retirement Income Security Act of 1974, and the estimated dollar value of the benefit to the officer from the Company's portion of insurance premium payments under the Company's Contributory Life Insurance Plan on an actuarial basis. The Company will recover all of its premium payments at the end of the term of the policy, generally at age 65. For 2000 the amounts were: P.A. Allaire: \$0 profit sharing; \$17,055 life insurance; A.M. Mulcahy: \$0 profit sharing; \$34,642 life insurance; B.D. Romeril: \$0 profit sharing; \$27,729 life insurance; W.F. Buehler: \$0 profit sharing; \$14,828 life insurance; and A.E. Dugan: \$0 profit sharing; \$29,702 life insurance. In addition, the amount shown for G.R. Thoman includes a payment of \$3.75 million, which was agreed to be paid in 1998, 1999 and 2000 under the Letter Agreement entered into with Company in June 1997 in connection with his joining the Company. The payments were intended to replace the value of forfeited in-the-money vested stock options from his former employer. Also included in the amount shown for G.R. Thoman is a \$200,000 payment in lieu of continuation of life insurance benefits agreed to under the Letter Agreement entered into with Company in May 2000 in connection with his separation.
- (H) Resigned effective May 11, 2000.

Option Grants

The following table sets forth information concerning awards of stock options to the Named Officers under the Company's 1991 Plan during the fiscal year ended December 31, 2000. The amounts shown for potential realizable values are based upon arbitrarily assumed annualized rates of stock price appreciation of five and ten percent over the full ten-year term of the options, pursuant to SEC regulations. Based upon a ten-year option term, this would result in stock price increases of 63% and 159% respectively or \$35.479 and \$56.495 for the options with the \$21.7812 exercise price and \$43.980 and \$70.031 for the options with the \$27.0000 exercise price. The amounts shown as potential realizable values for all shareholders represent the corresponding increases in the market value of 668,576,389 shares outstanding held by all shareholders as of December 31, 2000. Any gains to the Named Officers and the shareholders will depend upon future performance of the common stock of the Company as well as overall market conditions.

Name	Individual Grants (1) (2)				Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term	
	Number of Securities Underlying Options Granted(#)	% of Total Options Granted to Employees in Fiscal Year	Exercise or Base Price (\$ /Sh)	Expiration Date	5% (\$)	10% (\$)
Paul A. Allaire...	200,000/(3)/ 250,000/(5)/	2.28%	\$21.7812 \$27.0000	12/31/09 12/31/09	\$ 2,739,616 \$ 4,245,039	\$ 6,942,725 \$ 10,757,762
Anne M. Mulcahy...	60,000/(4)/ 250,000/(5)/	1.57%	\$21.7812 \$27.0000	12/31/09 12/31/09	\$ 821,885 \$ 4,245,049	\$ 2,082,817 \$ 10,757,762
Barry D. Romeril..	50,000/(4)/ 100,000/(5)/	0.76%	\$21.7812 \$27.0000	12/31/09 12/31/09	\$ 684,904 \$ 1,698,015	\$ 1,735,681 \$ 4,303,105
William F. Buehler	50,000/(4)/ 100,000/(5)/	0.76%	\$21.7812 \$27.0000	12/31/09 12/31/09	\$ 684,904 \$ 1,698,015	\$ 1,735,681 \$ 4,303,105
Allan E. Dugan....	50,000/(4)/	0.25%	\$21.7812	12/31/09	\$ 684,904	\$ 1,735,681
G. Richard Thoman.	100,000/(4)/	0.51%	\$21.7812	12/31/09	\$ 1,369,808	\$ 3,471,362
All Shareholders..	N/A	N/A	N/A	N/A	\$1,944,646,456	\$4,928,115,928

- (1) Exercise price is based upon fair market value on the effective date of the award. Excludes grants of stock options made on January 1, 2001 under New LEEP as described in the Report of the Executive Compensation and Benefits Committee as follows: P.A. Allaire -- 350,000, A.M. Mulcahy -- 934,600, B.D. Romeril -- 467,300, A.E. Dugan -- 280,400.
- (2) Options may be accelerated as a result of a change in control as described under "Option Surrender Rights".
- (3) Exercisable 100% on January 1, 2001
- (4) Exercisable 100% of January 1, 2005
- (5) Exercisable 1/2 on January 1, 2001 and 1/2 on January 1, 2002

Option Exercises/Year-End Values

The following table sets forth for each of the Named Officers the number of shares underlying options and SARs exercised during the fiscal year ended December 31, 2000, the value realized upon exercise, the number of options/SARs unexercised at year-end and the value of unexercised in-the-money options/SARs at year-end.

AGGREGATE OPTION/SAR EXERCISES IN THE LAST FISCAL YEAR AND FISCAL YEAR-END OPTION/SAR VALUE

Name	Value of Underlying Options/SARs Exercised(#)	Value of Underlying Shares/ SARs Realized(\$)(A)	Number of Shares Underlying Unexercised Options/SARs at FY-End(#)		Value of Unexercised In-the-Money Options /SARs at FY End(\$)(B)	
			Exercisable	Unexercisable	Exercisable	Unexercisable
Paul A. Allaire...	0	\$0	2,042,033	771,111	\$0	\$0
Anne M. Mulcahy...	0	\$0	128,682	380,126	\$0	\$0
Barry D. Romeril..	0	\$0	217,305	309,490	\$0	\$0
William F. Buehler	0	\$0	153,687	304,232	\$0	\$0
Allan E. Dugan....	0	\$0	283,445	131,481	\$0	\$0
G. Richard Thoman.	0	\$0	777,170	1,052,060	\$0	\$0

- (A) The value realized is based upon the difference between the exercise price and the average of the high and low prices on the date of exercise.
- (B) Excludes grants of stock options made on January 1, 2001 under New LEEP (as described in the Report of the Executive Compensation and Benefits Committee as follows: P.A. Allaire -- 350,000, A.M. Mulcahy -- 934,600,

B.D. Romeril -- 467,300, A.E. Dugan -- 280,400.

(C) The value of unexercised options/SARs is based upon the difference between the exercise price and the average of the high and low prices on December 29, 2000 of \$4.75. Option/SARs may be accelerated as a result of a change in control as described under "Option Surrender Rights".

Retirement Plans

Retirement benefits are provided to the executive officers of the Company including the Named Officers primarily under unfunded executive supplemental plans and, due to Internal Revenue Code limitations, to a much lesser extent under the Company's Retirement Income Guarantee Plan. The table below shows, under the plans, the approximate annual retirement benefit which would accrue for the number of years of credited service at the respective salary rates. The earliest retirement age for benefit commencement is age 60. In the event of a change in control (as defined in the plans) there is no age requirement for eligibility. The benefit accrues generally at the rate of 1 2/3% per year of credited service, but for certain mid-career hire executives the rate is accelerated to 2 1/2%, including Barry D. Romeril, William F. Buehler and Allan E. Dugan. No additional benefits are payable for participation in excess of 30 years for those accruing benefits at the rate of 1 2/3% per year and 20 years for those accruing benefits at 2 1/2% per year.

Annual benefits for years of credited service indicated

Average annual compensation for five highest years	15 years	20 years	25 years	30 years
400,000.....	96,000	128,000	161,000	192,000
600,000.....	146,000	195,000	243,000	242,000
800,000.....	196,000	261,000	327,000	392,000
1,000,000.....	246,000	328,000	410,000	492,000
1,200,000.....	296,000	395,000	493,000	592,000
1,400,000.....	346,000	461,000	577,000	692,000
1,600,000.....	396,000	528,000	660,000	792,000
1,800,000.....	446,000	595,000	743,000	892,000
2,000,000.....	496,000	661,000	827,000	992,000
2,200,000.....	546,000	728,000	910,000	1,092,000
2,400,000.....	596,000	795,000	993,000	1,192,000
2,600,000.....	646,000	861,000	1,077,000	1,292,000
2,800,000.....	696,000	928,000	1,160,000	1,392,000
3,000,000.....	746,000	995,000	1,243,000	1,492,000
3,200,000.....	796,000	1,061,000	1,327,000	1,592,000
3,400,000.....	846,000	1,128,000	1,410,000	1,692,000
3,600,000.....	896,000	1,195,000	1,493,000	1,792,000
3,800,000.....	946,000	1,261,000	1,577,000	1,892,000

The maximum benefit is 50% of the five highest years' average annual compensation reduced by 50% of the primary social security benefit payable at age 65. The benefits shown are payable on the basis of a straight life annuity and a 50% survivor annuity for a surviving spouse. The plans provide a minimum benefit of 25% of defined compensation reduced by such social security benefit other than for the key executives accruing benefits at the accelerated rate.

The following individuals have the years of credited service for purposes of the plans as follows:

Name	Years of Credited Service (A)
Paul A. Allaire (B)...	30
Anne M. Mulcahy.....	24
Barry D. Romeril.....	11
William F. Buehler (C)	14
Allan E. Dugan.....	16

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- (A) Thirty years is the maximum permitted credited service under the plans. Credited service shown reflects the accelerated accrual for mid-career hire executives. The years credited service reflected can be applied to the annual benefit table above to determine the annual benefit. Under the agreement with the Company in connection with his resignation, G. Richard Thoman became entitled to a retirement benefit of \$800,000 per year beginning in May 2000.
- (B) Upon Mr. Allaire's death, Mr. Allaire's alternate payee will receive a full and unreduced 50% survivor benefit based on Mr. Allaire's accrued benefits under the plans.
- (C) In connection with his retirement, William F. Buehler became eligible for a retirement supplement payable in three equal installments of \$280,746 commencing January 1, 2002, or in a single lump sum of \$842,238 if he elects prior to December 31, 2001.

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Compensation under the plans includes the amounts shown in the salary and bonus columns under the Summary Compensation Table other than payments under the 1991 Plan to the extent included in the bonus column.

The five highest years average compensation for purposes of the plans as of the end of the last fiscal year for the Named Officers is P. A. Allaire \$2,377,485; A. M. Mulcahy \$550,336; B. D. Romeril \$875,100; W. F. Buehler \$817,451; and A. E. Dugan \$673,651.

Certain Transactions

Severance Agreements

In October, 2000, with the approval of the Executive Compensation and Benefits Committee and the Board, the Company entered into agreements with five of its executive officers, including Paul A. Allaire, Anne M. Mulcahy, Barry D. Romeril, and William F. Buehler, which provide severance benefits in the event of termination of employment under certain circumstances following a change in control of the Company (as defined). The circumstances are termination by the Company, other than because of death or disability, commencing prior to a potential change in control (as defined), or for cause (as defined), or by the officers for good reason (as defined). The officer would be entitled to receive a lump sum severance payment equal to three times the sum of:

- . the greater of (1) the officer's annual rate of base salary on the date notice of termination is given and (2) his/her annual rate of base salary in effect immediately prior to the change in control and
- . the greater of (1) the annual target bonus applicable to such officer for the year in which such notice is given and (2) the annual target bonus applicable to such officer for the year in which the change in control occurs.

"Cause" for termination by the Company is the:

- (i) willful and continued failure of the officer to substantially perform his/her duties,
- (ii) willful engagement by the officer in materially injurious conduct to the Company, or
- (iii) conviction of any crime which constitutes a felony.

"Good reason" for termination by the officer includes, among other things:

- (i) the assignment of duties inconsistent with the individual's status as an executive or a substantial alteration in responsibilities (including ceasing to be an executive officer of a public company),
- (ii) a reduction in base salary and/or annual bonus,
- (iii) the relocation of the officer's principal place of business, and
- (iv) the failure of the Company to maintain compensation plans in which the officer participates or to continue providing certain other existing employment benefits.

The agreements provide for the continuation of certain welfare benefits for a period of 36 months following termination of employment and contain a gross-up payment (as defined) if the total payments (as defined) are subject to excise tax imposed under Section 4999 of the Internal Revenue Code of 1986, as amended.

The agreements also provide that in the event of a potential change in control (as defined) each officer, subject to the terms of the agreements, will remain in the employ of the Company for nine months following the occurrence of any such potential change in control.

The agreements are automatically renewed annually unless the Company gives notice that it does not wish to extend them. In addition, the agreements will continue in effect for two years after a change in control of the Company.

The Company has also entered into agreements with 40 other officers or other key executives, including Allan E. Dugan, that provide identical benefits described above, except that these officers and key executives would be entitled to receive a lump-sum severance payment equal to two times their annual compensation and they would receive welfare benefits continuance for a period of 24 months.

Termination Arrangements

In connection with his resignation as President and Chief Executive Officer and as a Director of the Company in May, 2000, G. Richard Thoman received certain benefits that had been approved by the Committee. These included payment of prorated 2000

bonus, a cash payment in lieu of continuation of life insurance (which are reflected in the Summary Compensation Table above) and approved an annual retirement benefit (see note to the table under Retirement Plans above). All of Mr. Thoman's outstanding options were amended to be exercisable for the life of the options (see "Aggregate Options/SAR Exercises in the Last Fiscal Year and Fiscal Year-End Options/SAR Value" above) subject to Mr. Thoman not making any derogatory remarks about the Company and not disclosing confidential information. The Company also agreed to provide Mr. Thoman with an office and administrative support until May 14, 2002.

In connection with his retirement and consistent with prior practice, the Company entered into an agreement with William F. Buehler, Vice Chairman of the Board and a director. The agreement was approved by the Executive Compensation

and Benefits Committee. Among other things, the agreement provides for salary continuance for twelve months commencing January 15, 2001 at the rate of \$56,250 per month and a retirement supplement payable in three equal installments of \$280,746 commencing on January 1, 2002, or in a single lump sum of \$842,238, if he elects prior to December 31, 2001.

Employment Arrangement

In connection with his continued employment, the Company entered into an agreement with Carlos Pascual, Executive Vice President. The agreement was authorized by the Executive Compensation and Benefits Committee. The agreement arises out of changes made to Xerox Spain's pension plans consistent with proposed Spanish law requirements. It is designed to mitigate the potential impact of U.S. income tax on Mr. Pascual's retirement benefit, if any, as a result of the change in Spanish law. Subject to certain conditions in the Agreement, the Company has agreed to indemnify Mr. Pascual for U.S. income tax on his Spanish pension, if necessary. The Agreement also provides that for a period of three years following Mr. Pascual's employment with the Company he will be provided with salary continuance at a rate of Spanish Pesetas 4,389,600 per month (approximately \$23,100 at current exchange rates) as he serves in the capacity of Chairman of Xerox Espana, S.A. at the discretion of the CEO of the Company. He will also be provided with relocation assistance in an amount not to exceed \$100,000. A copy of the Agreement is filed as Exhibit 10(s) to this Form 10-K Report.

Option Surrender Rights

All non-qualified options under the 1991 and the 1998 Plans are accompanied by option surrender rights. If there is a change in control, as defined in the plans, all such rights which are in the money become payable in cash based upon a change in control price as defined in the plans. The 1991 Plan also provides that upon the occurrence of such an event, all incentive stock rights and performance unit rights become payable in cash. In the case of rights payable in shares, the amount of cash is based upon such change in control price and in the case of rights payable in cash, the cash value of such rights. Rights payable in cash but which have not been valued at the time of such an event are payable at the maximum value as determined by the Executive Compensation and Benefits Committee at the time of the award. Upon accelerated payment, such rights and any related non-qualified stock options will be canceled.

Grantor Trusts

The Company has established grantor trusts with a bank for the purpose of paying amounts due under the deferred compensation plan and the severance agreements described above, and the unfunded supplemental retirement plans described above. The trusts are presently unfunded, but the Company would be required to fund the trusts upon the occurrence of certain events.

Legal Services

The law firm of Akin, Gump, Strauss, Hauer & Feld, of which Vernon E. Jordan, Jr. is of counsel, was retained by and rendered services to the Company in 2000.

Ten-Year Performance Comparison

The graph below provides a comparison of Xerox cumulative total shareholder return with the Standard & Poor's 500 Composite Stock Index and the Business Week Computers and Peripherals Industry Group, excluding Xerox (Peer Group).

[CHART]

Company/Index Name	Base Period				
	Dec 90	Dec 91	Dec 92	Dec 93	Dec 94
XEROX CORPORATION	\$100	\$203	\$244	\$286	\$326
S&P 500	100	131	141	155	157
BUSINESS WEEK COMPUTERS & PERIPHERALS	100	97	83	92	118

Company/Index Name	Dec 95	Dec 96	Dec 97	Dec 98	Dec 99	Dec 00
XEROX CORPORATION	\$463	\$546	\$781	\$1286	%550	\$105
S&P 500	215	265	353	454	496	499
BUSINESS WEEK COMPUTERS & PERIPHERALS	161	226	304	554	805	570

The Peer Group consists of the following companies as of December 31, 2000: Apple Computer, Compaq Computer, Data General, Dell Computer, EMC, Gateway, Hewlett-Packard, International Business Machines, Iomega, Lexmark International Group, Micron Electronics, NCR, Quantum, Seagate Technology, Sequent, Silicon Graphics, Storage Technology, Sun Microsystems, Unisys and Western Digital.

This graph assumes the investment of \$100 on December 31, 1990 in Xerox Common Stock, the S&P 500 Index and the Peer Group Common Stock, and reinvestment of quarterly dividends at the monthly closing stock prices. The returns of each company have been weighted annually for their respective stock market capitalizations in computing the S&P 500 and Peer Group indices.

Section 16(a) Beneficial Ownership Reporting Compliance

There was a failure to file Form 3, Beneficial Ownership Report, on a timely basis with the SEC as required under Section 16(a) of the Securities Exchange Act of 1934 on behalf of Herve J. Gallaire and Rafik O. Loutfy with respect to Incentive Stock Rights which were part of each of their respective initial holdings, and on behalf of Thomas J. Dolan with respect to his initial position in the Xerox Stock Fund. An amended Form 3 was filed as soon as the omissions were discovered; for Mr. Gallaire and Mr. Loutfy on March 8, 2000 and for Mr. Dolan on August 9, 2000.