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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q/A**

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

For the quarterly period ended September 30, 2003

or

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

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

Commission File No. 001-03040

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**QWEST CORPORATION**

*(Exact name of registrant as specified in its charter)*

**Colorado**

*(State or other jurisdiction of incorporation  
or organization)*

**84-0273800**

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

**1801 California Street, Denver, Colorado**

*(Address of principal executive offices)*

**80202**

*(Zip Code)*

**(303) 992-1400**

*(Registrant's telephone number, including area code)*

**N/A**

*(Former name, former address and former fiscal year, if changed since last report)*

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THE REGISTRANT, A WHOLLY OWNED SUBSIDIARY OF QWEST COMMUNICATIONS INTERNATIONAL INC., MEETS THE CONDITIONS SET FORTH IN GENERAL INSTRUCTIONS H(1)(a) AND (b) OF FORM 10-Q AND IS THEREFORE FILING THIS FORM WITH THE REDUCED DISCLOSURE FORMAT PURSUANT TO GENERAL INSTRUCTIONS H(2).

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

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

On December 31, 2003, one share of Qwest Corporation common stock was outstanding.

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

This Quarterly Report on Form 10-Q/A is being filed as an amendment to our Quarterly Report on Form 10-Q for the quarter ended September 30, 2003 to revise certain disclosures contained in the original Form 10-Q. Unless the passage of time has rendered incorrect as of the time of its original filing any other information contained in the original Form 10-Q, such information has not been updated in this Form 10-Q/A. To update all other information, we hereby incorporate by reference herein all information contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2003 and our Quarterly Reports on Form 10-Q for the quarters ended March 31, 2004, June 30, 2004 and September 30, 2004, other than the financial statements and related footnotes thereto contained in such Forms. Also, certain of our financial statements have been updated to reflect the discontinued operations of our wireless business, which we transferred to an affiliate in May 2004. These updated financial statements can be found in our Current Report on Form 8-K filed on August 11, 2004.

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**QWEST CORPORATION**

**FORM 10-Q/A**

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## Glossary of Terms

Our industry uses many terms and acronyms that may not be familiar to you. To assist you in reading this document, we have provided below definitions of some of these terms referred to in our document.

- *Access Lines.* Telephone lines reaching from the customer's premises to a connection with the public switched telephone network. When we refer to our access lines we mean all our consumer, wholesale and business access lines, including those used by us and our affiliates.
- *Asynchronous Transfer Mode (ATM).* A broadband, network transport service that provides a fast, efficient way to move large quantities of information.
- *Competitive Local Exchange Carriers (CLECs).* Telecommunications providers that compete with us in providing local voice services in our local service area.
- *Customer Premises Equipment (CPE).* Telecommunications equipment sold to a customer, usually in connection with our providing telecommunications services to that customer.
- *Dedicated Internet Access (DIA).* Internet access ranging from 128 kilobits per second to 2.4 gigabits per second.
- *Digital Subscriber Line (DSL).* A technology for providing high-speed data communications over telephone lines.
- *Frame Relay.* A switching technology that allows data to travel in individual packets of variable length.
- *Incumbent Local Exchange Carrier (ILEC).* A traditional telecommunications provider, such as Qwest Corporation, that, prior to the Telecommunications Act of 1996, had exclusive right and responsibility for providing local telecommunications services in its local service area.
- *Interexchange Carriers (IXCs).* Telecommunications providers that provide long-distance services to end-users by handling calls that are made from a phone exchange in one LATA to an exchange in another LATA or between exchanges within a LATA.
- *Integrated Services Digital Network (ISDN).* A telecommunications standard that uses digital transmissions technology to support voice, video and data communications applications over regular telephone lines.
- *InterLATA long-distance services.* Telecommunications services that cross LATA boundaries and "800" services.
- *Internet Dial Access.* Provides ISPs and business customers with a comprehensive, reliable and cost-effective dial-up network infrastructure.
- *Internet Protocol (IP).* A protocol for transferring information across the Internet in packets of data.
- *Internet Service Providers (ISPs).* Businesses that provide Internet access to retail customers.
- *IntraLATA long-distance services.* These services include calls that terminate outside a caller's local calling area but within their LATA and wide area telecommunications service or "800" services for customers with highly concentrated demand.
- *Local Access Transport Area (LATA).* A geographical area in which telecommunications providers may offer services. There are 163 LATAs in the United States and 27 in our local service area.

- *Local Calling Area.* A geographical area, usually smaller than a LATA, within which a customer can make telephone calls without incurring long-distance charges. Multiple local calling areas make up a LATA.
- *Private Lines.* Direct circuits or channels specifically dedicated to the use of an end-user organization for the purpose of directly connecting two or more sites.
- *Public Switched Telephone Network (PSTN).* The worldwide voice telephone network that is accessible to every person with a telephone and a dial tone.
- *Unbundled Network Elements (UNEs).* Discrete elements of our network that are sold or leased to competitive telecommunications providers.
- *Virtual Private Network (VPN).* A private network that operates securely within a public network (such as the Internet) by means of encrypting transmissions.
- *Voice over Internet Protocol (VoIP).* An application that provides real-time, two-way voice capability originating in the Internet protocol over a broadband connection.
- *Web Hosting.* The providing of space, power and bandwidth in data centers for hosting of customers' Internet equipment.

**PART I—FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**QWEST CORPORATION**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

**(DOLLARS IN MILLIONS)**

**(UNAUDITED)**

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2003</b>	<b>2002</b>	<b>2003</b>	<b>2002</b>
Operating revenues	\$ 2,649	\$ 2,834	\$ 8,064	\$ 8,712
Operating revenues—affiliates	173	114	455	306
Total operating revenues	2,822	2,948	8,519	9,018
Operating expenses:				
Cost of sales (exclusive of depreciation and amortization detailed below)	638	541	1,839	1,749
Cost of sales—affiliates	113	101	323	306
Selling, general and administrative	443	546	1,403	1,753
Selling, general and administrative—affiliates	363	368	1,023	958
Depreciation	615	640	1,844	2,022
Intangible assets amortization	92	81	264	221
Asset impairment charges	230	—	230	825
Restructuring, Merger-related and other charges (credits)	—	17	23	(13)
Total operating expenses	2,494	2,294	6,949	7,821
Operating income	328	654	1,570	1,197
Other expense (income):				
Interest expense—net	147	142	423	402
Interest expense—net—affiliates	40	33	114	124
Other expense (income)—net	—	(11)	2	(6)
Total other expense—net	187	164	539	520
Income before income taxes and cumulative effect of change in accounting principle	141	490	1,031	677
Income tax expense	(55)	(187)	(393)	(257)
Income before cumulative effect of change in accounting principle	86	303	638	420
Cumulative effect of change in accounting principle, net of taxes of \$0, \$0, \$139 and \$0, respectively	—	—	219	—
Net income	\$ 86	\$ 303	\$ 857	\$ 420

The accompanying notes are an integral part of these condensed consolidated financial statements.

**QWEST CORPORATION**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

**(DOLLARS IN MILLIONS)**

	September 30, 2003	December 31, 2002
	(unaudited)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 1,408	\$ 232
Restricted cash	12	26
Accounts receivable—net	1,171	1,494
Accounts receivable—affiliates	91	120
Deferred income taxes	80	133
Prepaid and other assets	245	323
Prepaid income taxes—QSC	57	255
	<hr/>	<hr/>
Total current assets	3,064	2,583
Property, plant and equipment—net	16,651	17,311
Intangible assets—net	1,159	1,275
Other assets	1,399	1,356
	<hr/>	<hr/>
Total assets	\$ 22,273	\$ 22,525
	<hr/>	<hr/>
<b>LIABILITIES AND STOCKHOLDER'S EQUITY</b>		
Current liabilities:		
Current borrowings	\$ 41	\$ 1,255
Current borrowings—affiliates	2,079	1,888
Accounts payable	568	587
Accounts payable—affiliates	433	331
Dividends payable—QSC	238	774
Accrued expenses and other current liabilities	987	952
Deferred revenue and customer deposits	517	595
	<hr/>	<hr/>
Total current liabilities	4,863	6,382
Long-term borrowings (net of unamortized debt discount of \$159 million and \$142 million, respectively—see Note 3)	7,724	6,016
Post-retirement and other post-employment benefit obligations	2,631	2,612
Deferred income taxes	2,437	2,181
Deferred credits and other	770	837
	<hr/>	<hr/>
Total liabilities	18,425	18,028
	<hr/>	<hr/>
Commitments and contingencies (Note 7)		
Stockholder's equity:		
Common stock—one share without par, owned by QSC	8,288	8,400
Note receivable—affiliate	(286)	(286)
Accumulated deficit	(4,154)	(3,617)
	<hr/>	<hr/>
Total stockholder's equity	3,848	4,497
	<hr/>	<hr/>
Total liabilities and stockholder's equity	\$ 22,273	\$ 22,525
	<hr/>	<hr/>

The accompanying notes are an integral part of these condensed consolidated financial statements.





**QWEST CORPORATION**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(DOLLARS IN MILLIONS)**

**(UNAUDITED)**

	Nine Months Ended September 30,	
	2003	2002
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 857	\$ 420
Adjustments to net income:		
Depreciation and amortization	2,108	2,243
Provision for bad debts	142	309
Cumulative effect of change in accounting principle—net	(219)	—
Asset impairment charges	230	825
Deferred income taxes	170	(173)
Income tax benefit distributed to QSC	(112)	(110)
Other non-cash items	12	(8)
Changes in operating assets and liabilities:		
Accounts receivable	181	(21)
Accounts receivable—affiliates	29	(61)
Prepays and other current assets	77	101
Prepaid income taxes—QSC	232	108
Accounts payable, accrued expenses and other current liabilities	16	(313)
Accounts payable—affiliates	102	292
Deferred revenue and customer deposits	(160)	(66)
Other long-term assets and liabilities	33	(90)
	<u>3,698</u>	<u>3,456</u>
Cash provided by operating activities		
<b>INVESTING ACTIVITIES</b>		
Expenditures for property, plant and equipment	(1,199)	(1,425)
Other	(32)	7
	<u>(1,231)</u>	<u>(1,418)</u>
Cash used for investing activities		
<b>FINANCING ACTIVITIES</b>		
Net repayments of current borrowings	—	(1,012)
Net proceeds from (repayments of) current borrowings—affiliates	191	(504)
Proceeds from long-term borrowings	1,729	1,476
Repayments of current portion of long-term borrowings	(1,245)	(205)
Dividends paid to QSC	(1,930)	(1,712)
Debt issuance costs	(36)	(36)
	<u>(1,291)</u>	<u>(1,993)</u>
Cash used for financing activities		
<b>CASH AND CASH EQUIVALENTS</b>		
Increase in cash	1,176	45
Beginning balance	232	150
	<u>\$ 1,408</u>	<u>\$ 195</u>
Ending balance		

The accompanying notes are an integral part of these condensed consolidated financial statements.

**QWEST CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2003**  
**(UNAUDITED)**

*Unless the context requires otherwise, references in this report to "Qwest," "we," "us," the "Company" and "our" refer to Qwest Corporation and its consolidated subsidiaries, and references to "QCI" refer to our ultimate parent company, Qwest Communications International Inc., and its consolidated subsidiaries.*

**Note 1: Basis of Presentation**

The condensed consolidated interim financial statements are unaudited. We prepared these condensed consolidated financial statements in accordance with the instructions for Form 10-Q. In compliance with those instructions, certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP") have been condensed or omitted.

We have revised this presentation to conform to our current year consolidated financial statements. These statements include all the adjustments necessary to fairly present our condensed consolidated results of operations, financial position and cash flows as of September 30, 2003 and for all periods presented. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements, included in our annual report on Form 10-K for the year ended December 31, 2002 (the "2002 Form 10-K"). The condensed consolidated results of operations for the three and nine month periods ended September 30, 2003 and the condensed consolidated statement of cash flows for the nine month period ended September 30, 2003 are not necessarily indicative of the results or cash flows expected for the full year.

We intend to transfer ownership of Qwest Wireless LLC ("Qwest Wireless") to an affiliate in the near future. After this transfer, we will no longer have significant wireless operations. This transfer will take place as soon as we have received all necessary regulatory approvals, perhaps as early as the first quarter of 2004.

*Related party transactions*

We record intercompany charges at the amounts billed to us by our affiliates. Regulatory rules require certain expenses to be billed by affiliates at estimated fair value or fully distributed cost as more fully described in Note 6—Related Party Transactions. Regulators periodically review our compliance with regulations. Adjustments to intercompany charges that result from these reviews are recorded in the period they become known. We purchase services such as marketing and advertising, information technology, product and technical services as well as general support services from affiliates. We provide to our affiliates telephony and data services, wireless as well as other services.

*Recently adopted accounting pronouncements and cumulative effect of adoption*

On January 1, 2003, we adopted Statement of Financial Accounting Standards ("SFAS") No. 143, "Accounting for Asset Retirement Obligations" ("SFAS No. 143"). This statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs, generally referred to as asset retirement obligations. SFAS No. 143 requires entities to record the fair value of a legal liability for an asset retirement obligation required to be settled under law or written or oral contract. If a reasonable estimate of fair value can be made, the fair value of the liability will be recognized in the period it is incurred, or if not, in the period a reasonable estimate of fair value can be made. This cost is initially capitalized and then

amortized over the estimated remaining useful life of the asset. We have determined that we have legal asset retirement obligations associated with the removal of a limited group of long-lived assets and recorded a cumulative effect of a change in accounting principle charge upon adoption of SFAS No. 143 of \$7 million (liability of \$12 million net of an asset of \$5 million) as of January 1, 2003.

Prior to the adoption of SFAS No. 143, we have included in our group depreciation rates estimated net removal costs (removal costs less salvage). These costs have historically been reflected in the calculation of depreciation expense and therefore recognized in accumulated depreciation. When the assets were actually retired and removal costs were expended, the net removal costs were recorded as a reduction to accumulated depreciation. While SFAS No. 143 requires the recognition of a liability for asset retirement obligations that are legally binding, it precludes the recognition of a liability for asset retirement obligations that are not legally binding. Therefore, upon adoption of SFAS No. 143, we reversed the net removal costs within accumulated depreciation for these fixed assets where the removal costs exceeded the estimated salvage value and we did not have a legal removal obligation. This resulted in income from the cumulative effect of a change in accounting principle of \$365 million pretax upon adoption of SFAS No. 143 on January 1, 2003. The net income impact for the nine months ended September 30, 2003 related to the adoption of SFAS No. 143 is \$219 million (\$365 million less the \$7 million charge disclosed above, net of income taxes of \$139 million).

On a going forward basis, the net costs of removal related to these assets will be charged to our consolidated statement of operations in the period in which the costs are incurred. As a result, the adoption of SFAS No. 143 is expected to decrease our depreciation expense on an annual basis by approximately \$33 million and increase operating expenses related to the accretion of the fair value of our legal asset retirement obligations by approximately \$1 million annually beginning January 1, 2003. Based on historical charges and activity through the nine months ended September 30, 2003, we believe that recurring removal costs will be approximately \$35 million to \$45 million annually which will be charged to our consolidated statement of operations as incurred.

In December 2002, the Financial Accounting Standards Board ("FASB") issued SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure—an amendment of FASB Statement No. 123," ("SFAS No. 148"), which is effective for financial statements related to periods ending after December 15, 2002. SFAS No. 148 requires the following expanded disclosure regarding stock-based compensation.

Our employees participate in the QCII stock incentive plans which is described more fully in the QCII annual report on Form 10-K for the year ended December 31, 2002 (the "QCII 2002 Form 10-K"). QCII's stock incentive plans, in which our employees participate, are accounted for using the intrinsic-value recognition and measurement principles of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." Under the intrinsic-value method, no compensation expense is recognized for options granted to employees when the strike price of those options equals or exceeds the value of the underlying security on the measurement date. In certain instances, the strike price has been established prior to the measurement date, in which event any excess of the stock price on the measurement date over the exercise price is recorded as deferred compensation and amortized over the service period during which the stock option award vests using the accelerated method described in FASB Interpretation No. 28, "Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans." QCII allocates to us, through a contribution, our share of the deferred compensation expense described herein based on options granted.

Had compensation cost for our employees' participation in the QCII stock-based compensation plans been determined under the fair-value-method in accordance with the provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," our net income would have been changed to the pro forma amounts indicated below:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
	(Dollars in millions)			
Net income:				
As reported	\$ 86	\$ 303	\$ 857	\$ 420
Add: Stock-option-based employee compensation expense included in reported net income, net of related tax effects	—	—	—	—
Deduct: Total stock-option-based employee compensation expense determined under fair-value-based method for all awards, net of related tax effects	(10)	(12)	(38)	(31)
Pro forma	\$ 76	\$ 291	\$ 819	\$ 389

The pro forma amounts reflected above may not be representative of the effects on our reported net income or loss in future years because the number of future shares to be issued under these plans is not known and the assumptions used to determine the fair value can vary significantly.

## Note 2: Asset Impairment Charges

### 2003 Impairment Charge

In August 2003, we entered into a services agreement with a subsidiary of Sprint Corporation ("Sprint") that allows us to resell Sprint wireless services, including access to Sprint's nationwide personal communications service ("PCS") wireless network, to consumer and business customers, primarily within our local service area. We plan to begin offering these Sprint services under our brand name in early 2004. Our wireless customers who are currently being serviced through our proprietary wireless network will be transitioned onto Sprint's network. Due to the anticipated decrease in usage of our own wireless network following the transition of our customers onto Sprint's network, in the third quarter of 2003 we performed an evaluation of the recoverability of the carrying value of our long-lived wireless network assets.

In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"), we compared gross undiscounted cash flow projections to the carrying value of the long-lived wireless network assets and determined that certain asset groups were not expected to be recovered through future projected cash flows. For those asset groups that were not recoverable, we then estimated the fair value using recent selling prices for comparable assets. Our cell sites, switches, related tools and equipment inventory and certain information technology systems that support the wireless network were determined to be impaired by \$230 million. Estimating the fair value of the asset groups involved significant judgment and a variety of assumptions.

In accordance with SFAS No. 144, the fair value of the impaired assets becomes the new basis for accounting purposes. As such, approximately \$25 million in accumulated depreciation was eliminated in connection with the accounting for the impairments. The impact of the impairments will reduce our annual depreciation and amortization expense by approximately \$40 million, effective October 1, 2003.

### *2002 Impairment Charge*

Effective June 30, 2002, pursuant to SFAS No. 144, a general deterioration of the telecommunications market, downward revisions to our expected future results of operations and other factors indicated that our investments in long-lived assets may have been impaired at that date. In accordance with SFAS No. 144, we performed an evaluation of the recoverability of the carrying value of our long-lived assets using gross undiscounted cash flow projections. For impairment analysis purposes, we grouped our property, plant and equipment and projected cash flows by our traditional telephone network and our wireless network. Based on the gross undiscounted cash flow projections, we determined that our traditional telephone network was not impaired. However, we determined that our wireless network, which provided PCS in select markets in our local service area, was impaired at June 30, 2002. For the wireless network, we then estimated the fair value based on replacement cost. Based on our analysis, the estimated fair value of the wireless assets was less than our carrying amounts and we recorded an impairment charge of \$825 million as of June 30, 2002. Replacement cost was determined by using current cost adjusted for physical deterioration, functional obsolescence and economic obsolescence.

In accordance with SFAS No. 144, the fair value of the impaired assets becomes the new basis for accounting purposes. As such, approximately \$410 million in accumulated depreciation was eliminated in connection with the accounting for the impairments as of June 30, 2002. The impact of the impairments has reduced our estimated annual depreciation and amortization expense by approximately \$135 million, effective July 1, 2002.

### **Note 3: Borrowings**

Our borrowings, net of discounts and premiums, consisted of the following for the dates indicated:

	September 30, 2003	December 31, 2002
	<hr/>	
	(Dollars in millions)	
Current borrowings:		
Current borrowings—affiliates	\$ 2,079	\$ 1,888
Current portion of long-term borrowings	17	1,179
Current portion of capital lease obligations and other	24	76
	<hr/>	<hr/>
Total current borrowings	\$ 2,120	\$ 3,143
	<hr/>	<hr/>
Long-term borrowings:		
Long-term notes	\$ 7,711	\$ 5,995
Long-term capital lease obligations and other	13	21
	<hr/>	<hr/>
Total long-term borrowings	\$ 7,724	\$ 6,016
	<hr/>	<hr/>

Current borrowings—affiliates represent short-term borrowings on unsecured lines of credit (the "Affiliates Lines of Credit") by our wholly owned subsidiary, Qwest Wireless, from affiliates that are wholly owned by QCII. The Affiliates Lines of Credit mature in January 2005 and have an interest rate of 7.50% per annum. We expect that the maturities of these lines of credit will be extended by our affiliates as necessary. Qwest Corporation does not guarantee the borrowings of Qwest Wireless.

On June 9, 2003, we completed a senior term loan in two tranches for a total of \$1.75 billion principal amount of indebtedness. The term loan consists of a \$1.25 billion floating rate tranche, due in 2007, and a \$500 million fixed rate tranche, due in 2010. The term loan is unsecured and ranks equally with all of our current indebtedness. The floating rate tranche cannot be prepaid for two years and thereafter is subject to prepayment premiums through 2006. There are no mandatory prepayment requirements. The covenant and default terms are substantially the same as those associated with our other long-term debt. The net proceeds were used to refinance our debt due in 2003 and fund or refinance our investment in telecommunications assets.

The floating rate tranche bears interest at London Interbank Offered Rates plus 4.75% (with a minimum interest rate of 6.50%) and the fixed rate tranche bears interest at 6.95% per annum. The interest rate on the floating rate tranche was 6.50% at September 30, 2003. The lenders funded the entire principal amount of the loan subject to the original issue discount for the floating rate tranche of 1.00% and for the fixed rate tranche of 1.652%.

**Note 4: Restructuring Charges**

The restructuring reserves balances discussed below are included in our condensed consolidated balance sheet in the category of accrued expenses and other current liabilities for the current portion and deferred credits and other for the long-term portion.

*2003 Activities*

During the nine months ended September 30, 2003, QCII identified employee reductions in various functional areas. As a result, we established a reserve and recorded a charge to our condensed consolidated statement of operations of \$19 million to cover the costs associated with these actions as more fully described below.

An analysis of activity associated with our portion of the 2003 restructuring reserve for the nine months ended September 30, 2003 is as follows:

	2003 Provision	2003 Utilization	September 30, 2003 Balance
		(Dollars in millions)	
Severance and employee-related charges	\$ 19	\$ 13	\$ 6

The 2003 activities includes charges of \$19 million for severance benefits and other charges pursuant to established severance policies associated with a reduction in employees. We identified approximately 650 employees from various functional areas to be terminated as part of this reduction. Through September 30, 2003, approximately 600 of the planned reductions had been completed and \$13 million of the restructuring reserve had been used for severance payments and enhanced pension benefits.

Other charges classified as restructuring, primarily severance-related payments not associated with the specific plans, were \$4 million for the nine months ended September 30, 2003.

### *2002 Activities*

During 2002, in response to shortfalls in employee reductions planned as part of the 2001 restructuring plan (as discussed below), and due to continued declines in our revenue and general economic conditions, QCII identified employee reductions in various functional areas and permanently abandoned a number of operating and administrative facilities. In connection with that restructuring, we recorded a restructuring reserve and recorded a charge to our condensed consolidated statement of operations to cover the costs associated with these actions.

An analysis of activity associated with our 2002 restructuring plan for the nine months ended September 30, 2003 is as follows:

	January 1, 2003 Balance	2003 Utilization	September 30, 2003 Balance
(Dollars in millions)			
Severance and employee-related charges	\$ 37	\$ 27	\$ 10
Contractual settlements, legal contingencies and lease losses	23	4	19
Total	\$ 60	\$ 31	\$ 29

During 2002, QCII identified approximately 2,400 of our employees from various functional areas to be terminated as part of this reduction. As of September 30, 2003, approximately 2,350 of the reductions had been accomplished. We expect the remaining employee reductions to be essentially completed by December 31, 2003. For the nine months ended September 30, 2003, \$27 million of the restructuring reserve had been used for severance payments and enhanced pension benefits.

Also as part of the 2002 restructuring, we permanently abandoned 25 leased facilities and recorded a charge to restructuring and other charges in our condensed consolidated statement of operations. The abandonment costs include rental payments due over the remaining terms of the leases, net of estimated sublease rentals, and estimated costs to terminate the leases. For the nine months ended September 30, 2003, we utilized \$4 million of the established reserves primarily for payments of amounts due under the leases. We expect the balance of the reserve to be utilized over the remaining terms of the leases, which are up to five years.

### *2001 Activities*

During the fourth quarter of 2001, a plan was approved by QCII to reduce employee levels, consolidate and sublease facilities, abandon certain capital projects and terminate certain operating

leases as discussed in more detail below. An analysis of activity associated with our 2001 plan for the nine months ended September 30, 2003 is as follows:

	January 1, 2003 Balance	2003 Utilization	September 30, 2003 Balance
	(Dollars in millions)		
Severance and employee-related charges	\$ 10	\$ 1	\$ 9
Contractual settlements, legal contingencies and lease losses	11	7	4
<b>Total</b>	<b>\$ 21</b>	<b>\$ 8</b>	<b>\$ 13</b>

In 2001, QCII identified approximately 4,800 of our employees from various functional areas to be terminated as part of an employee reduction and we accrued a restructuring reserve for severance benefits for those employees. At September 30, 2003, approximately 3,700 employees had been terminated. For the nine months ended September 30, 2003, \$1 million of the 2001 restructuring reserve had been used for severance payments, enhanced pension benefits and other employee-related outlays. In 2002, in response to this shortfall in planned employee terminations, QCII reviewed our manpower complement in other functional areas and identified employees to be terminated as part of another staffing reduction. These planned reductions are discussed above in connection with our 2002 restructuring activities.

Due to our staffing reduction and consolidation of our operations, we accrued a restructuring reserve associated with the termination of nine operating lease agreements across the country. For the nine months ended September 30, 2003, we utilized \$7 million of the established reserve for payments associated with contract termination costs related to exiting these buildings.

#### *Subsequent event*

During the fourth quarter of 2003, as part of an ongoing effort of evaluating costs of operations, QCII further reduced employee levels in certain areas of our business. As a result, we plan to record a charge to our condensed statement of operations during the fourth quarter of 2003, primarily for estimated severance costs, ranging from \$35 million to \$55 million.

#### **Note 5: Contributions to QCII Segments**

Our operations are integrated into and are part of the segments of the QCII consolidated group. The chief operating decision maker ("CODM") for QCII makes resource allocation decisions and assessments of financial performance for the consolidated group based on wireline, wireless and other segmentation. For more information about QCII's reporting segments, see the QCII 2002 Form 10-K. Our business contributes to the segments reported by QCII, but the QCII CODM reviews our financial information only in connection with this filing. Consequently, we do not provide discrete financial information for Qwest Corporation to a CODM on a regular basis. However, for reporting purposes only, we have separated our operating activities for all periods presented into segments in a manner consistent with consolidated segment results regularly reviewed by QCII's CODM. This segment presentation excludes affiliate revenue and expenses that are eliminated in consolidation by QCII.



Revenue and expenses are based on the types of products and services described below. Direct administrative costs include sales, customer support, collections and marketing. Indirect administrative costs such as finance, information technology, real estate, legal, marketing services and human resources are included in the other services operating expenses. QCII manages indirect administrative services costs centrally; consequently, these costs are not allocated to wireline or wireless services. Similarly, depreciation, amortization, interest expense, interest income and other income (expense) are not allocated to either wireline or wireless services operating expenses.

Wireline services include revenue from the provision of voice services and data and Internet services. Voice services consist of local voice services (such as basic local exchange services, switching services, custom calling features, enhanced voice services, operator services, public telephone services, collocation services and revenue from the sales of customer premises equipment ("CPE")); IntraLATA long-distance voice services (long-distance services within our local service area); and access services (which are primarily wholesale switched access services). Access services revenue is generated principally from charges to interexchange carriers ("IXCs"), for use of our local network to connect their customers to their long-distance networks. An IXC is a telecommunications company that provides long-distance services to end-users by handling calls that are made from a phone exchange in one local access transport area ("LATA") to an exchange in another LATA or between exchanges within a LATA. Data and Internet services include data services (such as traditional private lines, wholesale private lines, integrated services digital network, frame relay, asynchronous transfer mode and related CPE) and Internet services (such as digital subscriber line, Internet dial access, professional services and related CPE). Depending on the product or service purchased, a customer may pay an up-front fee, a monthly fee, a usage charge or a combination of these fees and charges.

Our wireless services are provided through our wholly owned subsidiary, Qwest Wireless, which holds 10 Megahertz licenses to provide PCS in most markets in our local service area. We offer wireless services to residential and business customers providing them the ability to use the same telephone number for their wireless phone as for their home or business phone. In August 2003, we entered into a services agreement with a subsidiary of Sprint that allows us to resell Sprint wireless services, including access to Sprint's nationwide PCS wireless network, to consumer and business customers, primarily within our local service area. In the third quarter of 2003 we reviewed the carrying value of our wireless assets and determined that they were impaired. Accordingly, we recorded a charge of \$230 million to our consolidated statements of operations.

We intend to transfer ownership of Qwest Wireless to an affiliate in the near future. After this transfer, we will no longer have significant wireless operations. This transfer will take place as soon as we have received all necessary regulatory approvals, perhaps as early as the first quarter of 2004.

Other services revenue is predominately derived from subleases of some of our unused real estate assets, such as space in our office buildings, warehouses and other properties. Our other services expenses include unallocated corporate expenses for functions such as finance, information technology, real estate, legal, marketing services and human resources, which QCII centrally manages.

The revenue and expenses shown below are derived from transactions with external customers.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
	(Dollars in millions)			
Operating revenue:				
Wireline services	\$ 2,492	\$ 2,652	\$ 7,595	\$ 8,151
Wireless services	152	179	457	550
Other services	5	3	12	11
Total contribution to QCII segment revenue	\$ 2,649	\$ 2,834	\$ 8,064	\$ 8,712
Operating expenses:				
Wireline services	\$ 737	\$ 720	\$ 2,191	\$ 2,335
Wireless services	88	128	272	439
Other Services	256	239	779	728
Total contribution to QCII segment expenses	\$ 1,081	\$ 1,087	\$ 3,242	\$ 3,502
Contribution to QCII segment income (loss):				
Wireline services	\$ 1,755	\$ 1,932	\$ 5,404	\$ 5,816
Wireless services	64	51	185	111
Other services	(251)	(236)	(767)	(717)
Total contribution to QCII segment income	\$ 1,568	\$ 1,747	\$ 4,822	\$ 5,210
Capital expenditures:				
Wireline	\$ 357	\$ 278	\$ 985	\$ 1,097
Wireless	2	6	13	48
Other	87	61	208	300
Total contribution to QCII capital expenditures	\$ 446	\$ 345	\$ 1,206	\$ 1,445
Non-cash investing activities	(1)	—	(7)	(20)
Total contribution to QCII cash capital expenditures	\$ 445	\$ 345	\$ 1,199	\$ 1,425

The following table reconciles the segment information to net income for the three and nine months ended September 30, 2003 and 2002:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
	(Dollars in millions)			
Total contribution to QCII segment income	\$ 1,568	\$ 1,747	\$ 4,822	\$ 5,210
Add:				
Affiliate revenue	173	114	455	306
Cumulative effect of change in accounting principle, net of taxes	—	—	219	—
Deduct:				
Affiliate expenses	476	469	1,346	1,264
Depreciation	615	640	1,844	2,022
Intangible assets amortization	92	81	264	221
Asset impairment charges	230	—	230	825
Restructuring, Merger-related and other charges (credits)	—	17	23	(13)
Total other expense—net	187	164	539	520
Income tax expense	55	187	393	257
Net income	\$ 86	\$ 303	\$ 857	\$ 420

#### Note 6: Related Party Transactions

We purchase services from our affiliates, such as marketing and advertising, information technology, product and technical services as well as general support services. We provide to our affiliates telephony and data services, wireless and other services.

Our affiliates provide services and also contract services from third parties on our behalf. In the latter case, the third parties bill our affiliates who in turn charge us for our respective share of these third party expenses. Our affiliates charge us for services rendered by their employees applying a fully distributed costs ("FDC") methodology. FDC rates are determined using current salary rates including factors for taxes, employee benefits, including stock-based compensation, facilities and overhead costs. These salary rates are charged to us based on actual hours worked or charges are allocated to us based on estimates.

We charge our affiliates based on tariffed rates for telephony and data services. We bill prevailing third party rates for wireless services and for other services we bill either FDC or market rates.

We describe in further detail below the services provided by our affiliates.

##### *Marketing, Sales and Advertising*

Marketing, sales and advertising, which support preparation for joint marketing our services, include the development of marketing and advertising plans, sales unit forecasts, market research, sales training and compensation plans.

### *Information Technology Services*

Information technology services primarily include the labor cost of developing, testing and implementing the system changes necessary to support order entry, provisioning and billing of services, as well as the cost of improving, maintaining and operating our shared internal communications networks.

### *Product and Technical Services*

Product and technical services relate to forecasting demand volumes and developing plans around network utilization and optimization, developing and implementing plans for overall product development, provisioning and customer care.

### *General Support Services*

General support services include legal, regulatory, general finance and accounting, tax, human resources and executive support.

### *Other*

This category includes the costs of miscellaneous services, such as rental of office space, procurement and communications services.

## **Note 7: Commitments and Contingencies**

Throughout this section, when we refer to a class action as "putative" it is because a class has been alleged, but not certified in that matter. Until and unless a class has been certified by the court, it has not been established that the named plaintiffs represent the class of plaintiffs they purport to represent. When we refer to a derivative action as "purported," it is because the plaintiff alleges that he or it has brought the claim on our behalf and the court has not yet ruled that the complaint meets the requirements for a proper derivative case.

## **Legal Proceedings Involving Qwest**

### *Securities action*

On June 27, 2002, a putative class action was filed in the District Court for the County of Boulder against us, QCII, The Anschutz Family Investment Co., Philip Anschutz, Joseph P. Nacchio and Robin R. Szeliga on behalf of purchasers of QCII's stock between June 28, 2000 and June 27, 2002 and owners of U S WEST Inc. ("U S WEST") stock on June 28, 2000. The complaint alleges, among other things, that QCII and the individual defendants issued false and misleading statements and engaged in improper accounting practices in order to accomplish the U S WEST Merger, to make QCII appear successful and to inflate the value of QCII's stock. The complaint asserts claims under Sections 11, 12, 15 and 17 of the Securities Act of 1933, as amended, (the "1933 Act"). The complaint seeks unspecified monetary damages, disgorgement of illegal gains and other relief. On July 31, 2002, the defendants removed this state court action to federal district court in Colorado and subsequently moved to consolidate this action with the consolidated securities action identified below. The plaintiffs

have moved to remand the lawsuit back to state court. Defendants have opposed that motion, which is pending before the court.

### *Regulatory matters*

On February 14, 2002, the Minnesota Department of Commerce filed a formal complaint against us with the Minnesota Public Utilities Commission alleging that we, in contravention of federal and state law, failed to file interconnection agreements with the Minnesota Commission relating to certain of our wholesale customers, and thereby allegedly discriminated against other competitive local exchange carriers ("CLECs"). On October 21, 2002, the Minnesota Commission adopted in full a proposal by an administrative law judge that we committed 26 individual violations of federal law by failing to file, as required under Section 252 of the Telecommunications Act of 1996, 26 distinct provisions found in 12 separate agreements with individual CLECs for regulated services in Minnesota. The order also found that we agreed to provide and did provide to McLeodUSA Incorporated ("McLeod"), and Eschelon Telecom, Inc. ("Eschelon"), discounts on regulated wholesale services of up to 10% that were not made available to other CLECs, thereby unlawfully discriminating against them. The order found we also violated state law, that the harm caused by our conduct extended to both customers and competitors, and that the damages to CLECs would amount to several million dollars for Minnesota alone.

On February 28, 2003, the Minnesota Commission issued its initial, written decision imposing fines and penalties, which was later revised on April 8, 2003 to include a fine of nearly \$26 million and ordered us to:

- grant a 10% discount off all intrastate Minnesota wholesale services to all carriers other than Eschelon and McLeod; this discount would be applicable to purchases made by these carriers during the period beginning on November 15, 2000 and ending on May 15, 2002;
- grant all carriers other than Eschelon and McLeod monthly credits of \$13 to \$16 per unbundled network element platform line (subject to certain offsets) during the months of November 2000 through February 2001;
- pay all carriers other than Eschelon and McLeod monthly credits of \$2 per access line (subject to certain offsets) during the months of July 2001 through February 2002; and
- allow CLECs to opt-in to agreements the Minnesota Commission determined should have been publicly filed.

The Minnesota Commission issued its final, written decision imposing penalties described above on May 21, 2003. The Minnesota Commission decision would require a penalty payment to the state of approximately \$26 million and payments of carrier credits of approximately \$18 million. Of the \$18 million, about \$3 million has been released by the carriers in bankruptcy proceedings. On June 19, 2003, we appealed the Minnesota Commission's orders to the United States District Court for the District of Minnesota. On August 25, 2004, the District Court issued its order. The Court affirmed the Commission's order requiring Qwest to pay the \$26 million penalty. The Court reversed and vacated that portion ruling on the credits finding that the Commission did not have the authority to order such remedies. The Commission and carriers have appealed the credit issue to the United States Court of

Appeals for the Eighth Circuit, and Qwest has cross-appealed the penalty issue. The appeal is pending.

Arizona, Colorado, New Mexico, Washington, Iowa and South Dakota have also initiated formal proceedings regarding our alleged failure to file required agreements in those states. On July 25, 2003, we entered into a settlement with the staff of the Arizona Corporation Commission to settle this and several other proceedings. The proposed settlement, which must be approved by the Arizona Commission, requires that we provide approximately \$21 million in consideration in the form of a voluntary contribution to the Arizona State Treasury, contributions to certain organizations and/or infrastructure investments and refunds in the form of bill credits to CLECs. On December 1, 2003, an administrative law judge issued a recommended decision denying the proposed settlement. The judge also recommended final orders requiring us to pay approximately \$11 million in penalties and to issue credits to CLECs for a 24-month period from October 2000 to September 2002 equal to 10% of all wholesale intrastate services performed by us. We plan to file exceptions to the recommended decisions with the full Arizona Commission. New Mexico has issued an order providing its interpretation of the standard for filing these agreements, identified certain of our contracts as coming within that standard and opened a separate docket to consider further proceedings. Colorado has also opened an investigation into these matters. On June 26, 2003, we received from the Federal Communications Commission ("FCC") a letter of inquiry seeking information about these matters. We submitted our initial response to this inquiry on July 31, 2003. The proceedings and investigations in New Mexico, Colorado and Washington and at the FCC could result in the imposition of fines and other penalties against us that could be material. Iowa and South Dakota have concluded their inquiries resulting in no imposition of penalties or obligations to issue credits to CLECs in those states.

Illuminet, Inc. ("Illuminet"), a traffic aggregator, and several of its customers have filed complaints with regulatory agencies in Idaho, Nebraska, Iowa, North Dakota and New Mexico, alleging that they are entitled to refunds due to our purported improper implementation of tariffs governing certain signaling services we provide in those states. The commissions in Idaho and Nebraska have ruled in favor of Illuminet and awarded it \$1.5 million and \$4.8 million, respectively. We sought reconsideration in both states, which was denied, and subsequently perfected appeals in both states. The proceedings in the other states and in states where Illuminet has not yet filed complaints could result in agency decisions requiring additional refunds.

We have other regulatory actions pending in local regulatory jurisdictions, which call for price decreases, refunds or both. These actions are generally routine and incidental to our business.

#### *Other matters*

From time to time we receive complaints and become subject to investigations regarding "slamming" (the practice of changing long-distance carriers without the customer's consent), "cramming" (the practice of charging a consumer for goods or services that the consumer has not authorized or ordered) and other sales practices. Through December 2003, we resolved allegations and complaints of slamming and cramming with the Attorneys General for the states of Arizona, Colorado, Idaho, Oregon, Utah and Washington. In each of those states, we agreed to comply with certain terms governing our sales practices and to pay each of the states between \$200,000 and \$3.75 million. On December 11, 2003, we received a request for information from the FCC related to changes in certain customers' preferred carriers for interLATA or intraLATA long distance service. We may become

subject to other investigations or complaints in the future, and any such complaints or investigations could result in further legal action and the imposition of fines, penalties or damage awards.

We are subject to a number of environmental matters as a result of our prior operations as part of the Bell System. We believe that expenditures in connection with remedial actions under the current environmental protection laws or related matters will not be material to our business or financial condition.

## **Legal Proceedings Involving QCII**

QCII is involved in several investigations, securities actions and other matters that, if resolved against QCII, could have a material adverse effect on our business and financial condition. These matters are more fully described below.

### *Investigations*

On April 3, 2002, the Securities and Exchange Commission ("SEC") issued an order of investigation that made formal an informal investigation of QCII initiated on March 8, 2002. QCII is continuing in its efforts to cooperate fully with the SEC in its investigation. The investigation includes, without limitation, inquiry into several specifically identified QCII accounting practices and transactions and related disclosures that are the subject of the various adjustments and restatements described in the QCII 2002 Form 10-K. Some of those accounting practices and transactions and related disclosures also are the subject of various adjustments and restatements described in our 2002 Form 10-K. The investigation also includes inquiry into disclosure and other issues related to transactions between QCII and certain of its vendors and certain investments in the securities of those vendors by individuals associated with QCII.

On July 9, 2002, QCII was informed by the U.S. Attorney's Office for the District of Colorado of a criminal investigation of its business. QCII believes the U.S. Attorney's Office is investigating various matters that include the subjects of the investigation by the SEC. QCII is continuing in its efforts to cooperate fully with the U.S. Attorney's Office in its investigation.

During 2002, the United States Congress held hearings regarding QCII and matters that are similar to those being investigated by the SEC and the U.S. Attorney's Office. QCII cooperated fully with Congress in connection with those hearings.

While QCII is continuing in its efforts to cooperate fully with the SEC and the U.S. Attorney's Office in each of their respective investigations, QCII cannot predict the outcome of those investigations. QCII has engaged in discussions with the SEC staff in an effort to resolve the issues raised in the SEC's investigation of it. Such discussions are preliminary and QCII cannot predict the likelihood of whether those discussions will result in a settlement and, if so, the terms of such settlement. However, settlements typically involve, among other things, the SEC making claims under the federal securities laws in a complaint filed in United States District Court that, for purposes of the settlement, the defendant neither admits nor denies. Were such a settlement to occur, QCII would expect such claims to address many of the accounting practices and transactions and related disclosures that are the subject of the various restatements QCII has made as well as additional transactions. In addition, any settlement with the SEC may also involve, among other things, the imposition of a civil penalty, the amount of which could be material, and the entry of a court order that would require,

among other things, that QCII and its officers and directors comply with provisions of the federal securities laws as to which there have been allegations of prior violations.

In addition, as previously reported, the SEC has conducted an investigation concerning QCII's earnings release for the fourth quarter and full year 2000 issued on January 24, 2001. The release provided pro forma normalized earnings information that excluded certain nonrecurring expense and income items resulting primarily from QCII's Merger with U S WEST. On November 21, 2001, the SEC staff informed QCII of its intent to recommend that the SEC authorize an action against QCII that would allege it should have included in the earnings release a statement of its earnings in accordance with GAAP. As of January 13, 2004 (the date of the original filing of this Form 10-Q), no action had been taken by the SEC. However, QCII expects that if its current discussions with the staff of the SEC result in a settlement, such settlement will include allegations concerning the January 24, 2001 earnings release.

Also, as previously announced in July 2002 by the General Services Administration ("GSA"), the GSA is conducting a review of all contracts with QCII for purposes of determining present responsibility. On September 12, 2003, we were informed that the Inspector General of the GSA had referred to the GSA Suspension/Debarment Official the question of whether QCII (including us and its other subsidiaries) should be considered for debarment. QCII has been informed that the basis for the referral is last February's indictment against four former QCII employees in connection with a transaction with the Arizona School Facilities Board in June 2001 and a civil complaint filed the same day by the SEC against the same former employees and others relating to the Arizona School Facilities Board transaction and a transaction with Genuity Inc. ("Genuity") in 2000. QCII is cooperating fully with the GSA and believes that it and we will remain suppliers of the government; however, if it and we are not allowed to be suppliers to the government, it and we would lose the ability to expand the services we could provide to a purchaser of telecommunications services that has historically represented between 2% and 3% of QCII's consolidated annual revenue.

#### *Securities actions and derivative actions*

Since July 27, 2001, 13 putative class action complaints have been filed in federal district court in Colorado against QCII alleging violations of the federal securities laws. One of those cases has been dismissed. By court order, the remaining actions have been consolidated into a consolidated securities action, (the "consolidated securities action"). Plaintiffs in the consolidated securities action named as defendants in the Fourth Consolidated Amended Class Action Complaint (the "Fourth Consolidated Complaint"), which was filed on or about August 21, 2002, QCII, its former Chairman and Chief Executive Officer, Joseph P. Nacchio, its former Chief Financial Officers, Robin R. Szeliga and Robert S. Woodruff, other of its former officers and current directors and Arthur Andersen LLP. The Fourth Consolidated Complaint is purportedly brought on behalf of purchasers of QCII's publicly traded securities between May 24, 1999 and February 14, 2002, and alleges, among other things, that during the putative class period, QCII and certain of the individual defendants made materially false statements regarding the results of QCII's operations in violation of section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), that certain of the individual defendants are liable as control persons under section 20(a) of the Exchange Act, and that during the putative class period, certain of the individual defendants sold some of their shares of QCII's common stock in violation of section 20A of the Exchange Act. The Fourth Consolidated Complaint also alleges that QCII's financial results



during the putative class period and statements regarding those results were false and misleading due to the alleged: (i) overstatement of revenue, (ii) understatement of costs, (iii) manipulation of employee benefits in order to increase profitability and (iv) misstatement of certain assets and liabilities. The Fourth Consolidated Complaint further alleges that QCII and certain of the individual defendants violated Section 11 of the 1933 Act, and that certain of the individual defendants are liable as control persons under Section 15 of the 1933 Act by preparing and disseminating false registration statements and prospectuses for: (1) the registration of 897,907,706 shares of QCII's common stock to be issued to U S WEST shareholders dated June 21, 1999, as amended August 13, 1999 and September 17, 1999; (2) the exchange of \$3.25 billion of QCII's notes dated July 12, 2001; and (3) the exchange of \$3.75 billion of QCII's notes dated October 30, 2001. The Fourth Consolidated Complaint seeks unspecified compensatory damages and other relief. However, lead counsel for the plaintiffs has indicated that plaintiffs will seek damages in the billions of dollars. On September 20, 2002, both QCII and the individual defendants filed motions to dismiss the Fourth Consolidated Complaint. Those motions are currently pending before the court. On November 4, 2002, lead plaintiffs in the consolidated securities action filed a motion for a temporary restraining order and preliminary injunction seeking to enjoin QCII's sale of Qwest Dex, Inc. or, in the alternative, to place the proceeds of such sale in a constructive trust for the benefit of the plaintiffs. The court denied both motions.

On October 22, 2001, an alleged derivative lawsuit was filed in the United States District Court for the District of Colorado, naming as defendants each of the then members of QCII's Board of Directors, (the "Board") and naming QCII as a nominal defendant. The derivative complaint is based upon the allegations made in the consolidated securities action and alleges, among other things, that the Board members intentionally or negligently breached their fiduciary duties to QCII by failing to oversee implementation of securities laws that prohibit insider trading. The derivative complaint also alleges that the Board members breached their fiduciary duties to QCII by causing or permitting it to commit alleged securities violations, thus (i) causing it to be sued for such violations, and (ii) subjecting it to adverse publicity, increasing its cost of raising capital and impairing earnings. The derivative complaint further alleges that certain directors sold shares between April 26, 2001 and May 15, 2001 using non-public information about QCII. On or about October 31, 2001, the court filed an order consolidating this derivative lawsuit with the consolidated securities action. In December 2001, the derivative lawsuit was stayed, pending further order of the court, based on the fact that the merits of the derivative lawsuit are intertwined with the resolution of the consolidated securities action. In March 2002, plaintiffs filed a first amended derivative complaint. The first amended derivative complaint adds allegations relating to the disclosures of QCII's consolidated financial results from April 2000 through February 2002. On or about November 5, 2002, plaintiffs filed a second amended derivative complaint. The second amended complaint adds as defendants to the lawsuit certain former officers, including Robin R. Szeliga, Robert S. Woodruff and others. The second amended complaint contains allegations in addition to those set forth in the prior complaints, stating, among other things, that (i) certain officers and/or directors traded QCII's stock while in the possession of inside information, and (ii) certain officers and/or directors caused the restatement of more than \$1 billion in revenue by concealing improper accounting practices. Plaintiffs seek, among other remedies, disgorgement of alleged insider trading profits. The lawsuit remains stayed.

On March 6, 2002, an alleged derivative lawsuit was filed in the District Court for the City and County of Denver, naming as defendants each of the then members of the Board, certain former officers of QCII and Arthur Andersen LLP. QCII is named as a nominal defendant. The derivative

complaint is based upon the allegations made in the consolidated securities action and alleges that the Board members intentionally or recklessly breached their fiduciary duties to QCII by causing or allowing it to issue financial disclosures that were false or misleading. Plaintiffs seek unspecified damages on QCII's behalf against the defendants. On July 2, 2002, this state court derivative lawsuit was stayed pending further order of the court. On or about August 1, 2003, the plaintiffs filed an amended derivative complaint, which does not contain claims against QCII's former officers and Arthur Andersen LLP, but continues to assert claims against the Board defendants. In the amended complaint, the plaintiffs allege, among other things, that the individual defendants abdicated their duty to implement and maintain an adequate internal accounting control system and thus allegedly violated (i) their fiduciary duties of loyalty and good faith; (ii) GAAP; and (iii) QCII's Audit Committee's charter (which requires, among other things, that QCII's Audit Committee serve as an independent and objective party to monitor QCII's financial reporting and internal control system). The amended complaint also states new claims against Mr. Nacchio for his alleged breach of fiduciary duties. Plaintiffs seek a court order requiring that Mr. Nacchio disgorge to QCII all of his 2001 compensation, including salary, bonus, long-term incentive payouts and stock options. In addition, the plaintiffs contend that Mr. Nacchio breached his fiduciary duties to QCII by virtue of his sales of its stock allegedly made using his knowledge of material non-public information. The plaintiffs seek the imposition of a constructive trust on any profits Mr. Nacchio obtained by virtue of these sales.

Since March 2002, seven putative class action suits were filed in federal district court in Colorado purportedly on behalf of all participants and beneficiaries of the Qwest Savings and Investment Plan and predecessor plans, (the "Plan"), from March 7, 1999 until the present. By court order, five of these putative class actions have been consolidated, and the claims made by the plaintiff in the sixth case were subsequently included in the Second Amended and Consolidated Complaint described below and referred to as the "consolidated ERISA action". QCII expects the seventh putative class action to be consolidated with the other cases since it asserts substantially the same claims. The consolidated amended complaint filed on July 5, 2002 names as defendants, among others, QCII, several former and current directors, officers and employees of QCII, Qwest Asset Management, the Plan's Investment Committee, and the Plan Administrative Committee of the pre-Merger QCII 401(k) Savings Plan. Plaintiffs filed a Second Amended and Consolidated Complaint on May 21, 2003, naming as additional defendants a former employee and QCII's Plan Design Committee. The consolidated ERISA action, which is brought under the Employee Retirement Income Security Act, ("ERISA"), alleges, among other things, that the defendants breached fiduciary duties to the Plan members by allegedly excessively concentrating the Plan's assets invested in QCII's stock, requiring certain participants in the Plan to hold the matching contributions received from QCII in the Qwest Shares Fund, failing to disclose to the participants the alleged accounting improprieties that are the subject of the consolidated securities action, failing to investigate the prudence of investing in QCII's stock, continuing to offer QCII's stock as an investment option under the Plan, failing to investigate the effect of the Merger on Plan assets and then failing to vote the Plan's shares against it, preventing plan participants from acquiring QCII's stock during certain periods and, as against some of the individual defendants, capitalizing on their private knowledge of QCII's financial condition to reap profits in stock sales. Plaintiffs seek equitable and declaratory relief, along with attorneys' fees and costs and restitution. Plaintiffs moved for class certification on January 15, 2003, and QCII has opposed that motion, which is pending before the court. Defendants filed motions to dismiss on August 22, 2002. Those motions are also pending before the court.

On August 9, 2002, an alleged derivative lawsuit was filed in the Court of Chancery of the State of Delaware, naming as defendants each of the then members of the Board and QCII current Chief Financial Officer, Oren G. Shaffer, and naming QCII as a nominal defendant. On or about September 16, 2002, an amended complaint was filed in the action, naming the same defendants except Mr. Shaffer, who is no longer a defendant in the action. A separate alleged derivative lawsuit was filed in the Court of Chancery of the State of Delaware on or about August 28, 2002. That lawsuit names as defendants QCII's former Chairman and Chief Executive Officer, Joseph P. Nacchio, QCII's former Chief Financial Officer, Robert S. Woodruff, former Board member, Marilyn Carlson Nelson, and each of the then members of the Board and names QCII as a nominal defendant. On October 30, 2002, these two alleged derivative lawsuits were consolidated, and an Amended Complaint (the "Second Amended Complaint") was later filed on or about January 23, 2003, and names as defendants the current members of the Board, former Board member Hank Brown, QCII's former Chief Executive Officer, Joseph P. Nacchio, and QCII's former Chief Financial Officer, Robert Woodruff, and names QCII as a nominal defendant. In the Second Amended Complaint, the plaintiffs allege, among other things, that the individual defendants (i) breached their fiduciary duties by allegedly engaging in illegal insider trading in QCII's stock; (ii) failed to ensure compliance with federal and state disclosure, anti-fraud and insider trading laws within QCII, resulting in exposure to it; (iii) appropriated corporate opportunities, wasted corporate assets and self-dealt in connection with investments in initial public offering securities through QCII's investment bankers; and (iv) improperly awarded severance payments of \$13 million to QCII's former Chief Executive Officer, Mr. Nacchio. The plaintiffs seek recovery of incentive compensation allegedly wrongfully paid to certain defendants, all severance payments made to Messrs. Nacchio and Woodruff, and all costs including legal and accounting fees. Plaintiffs have also requested, among other things, that the individual defendants compensate QCII for any insider trading profits. Plaintiffs likewise allege that QCII is entitled to contribution and indemnification by each of the individual defendants. Plaintiffs request that the court cancel all unexercised stock options awarded to Messrs. Nacchio and Woodruff to which they were not entitled, that the defendants return to QCII all salaries and other remuneration paid to them by it during the time they breached their fiduciary duties, and that the court order the defendants to enforce policies, practices and procedures on behalf of QCII designed to detect and prevent illegal conduct by its employees and representatives. On March 17, 2003, defendants moved to dismiss the Second Amended Complaint, or, in the alternative, to stay the action. That motion is pending before the court.

On November 22, 2002, plaintiff Stephen Weseley IRA Rollover filed a purported derivative lawsuit in Denver District Court, naming as defendants each of the then members of the Board, certain of QCII's former officers, Anschutz Company and QCII as a nominal defendant. Plaintiff alleges, among other things, that the director defendants breached their fiduciary duties to QCII and damaged QCII by deliberately in bad faith or recklessly (i) implementing a sham system of internal controls completely inadequate to ensure proper recognition of revenue; (ii) causing QCII to issue false and misleading statements and financial results to the market regarding its earnings, revenues, business and investments; (iii) exposing QCII to massive liability for securities fraud; (iv) damaging QCII's reputation; and (v) trading QCII's shares while in possession of material, non-public information regarding its true financial condition. The complaint purports to state causes of action for breach of fiduciary duty, gross negligence and unjust enrichment against some of QCII's former officers and breach of contract and breach of the duty of loyalty/insider trading against several of QCII's former officers and former and current directors. On or about January 7, 2003, plaintiff's counsel filed

a proposed amended complaint which substitutes a new plaintiff, Thomas R. Strauss, and adds another former officer as a defendant. In the amended complaint, plaintiff seeks (i) disgorgement of bonuses and other incentive compensation paid to certain defendants; (ii) disgorgement of any profits that certain defendants made by virtue of their alleged trading on material, inside information; and (iii) other damages. By order dated January 9, 2003, the court permitted the substitution and Strauss became the plaintiff in this lawsuit under the amended complaint.

On December 10, 2002, the California State Teachers' Retirement System, ("CalSTRS"), filed suit against QCII, certain of QCII's former officers and certain of QCII's current directors and several other defendants, including Arthur Andersen LLP and several investment banks, in the Superior Court of the State of California in and for the County of San Francisco. CalSTRS alleges that the defendants engaged in fraudulent conduct that caused CalSTRS to lose in excess of \$150 million invested in QCII's equity and debt securities. The complaint alleges, among other things, that in press releases and other public statements, defendants represented that QCII was one of the highest revenue producing telecommunications companies in the world, with highly favorable results and prospects. CalSTRS alleges that defendants were engaged, however, "in a scheme to falsely inflate QCII's revenues and decrease its expenses so that QCII would appear more successful than it actually was." The complaint purported to state causes of action against QCII for (i) violation of California Corporations Code Section 25400 et seq. (securities laws) (seeking, among other damages, the difference between the price at which CalSTRS sold QCII's notes and stock and their true value); (ii) violation of California Corporations Code Section 17200 et seq. (unfair competition); (iii) fraud, deceit and concealment; and (iv) breach of fiduciary duty. Among other requested relief, CalSTRS seeks compensatory, special and punitive damages, restitution, pre-judgment interest and costs. QCII and the individual defendants filed a demurrer, seeking dismissal of all claims. In response, the plaintiff voluntarily dismissed the unfair competition claim but maintained the balance of the complaint. The court denied the demurrer as to the California securities law and fraud claims, but dismissed the breach of fiduciary duty claim against QCII with leave to amend. The court also dismissed the claims against Robert S. Woodruff and Robin R. Szeliga on jurisdictional grounds. On or about July 25, 2003, plaintiff filed a First Amended Complaint. The material allegations remain largely the same, but plaintiff no longer alleges claims against Mr. Woodruff and Ms. Szeliga following the court's dismissal of the claims against them, and reasserted its claim against QCII for breach of fiduciary duty as an allegation of aiding and abetting breach of fiduciary duty. QCII filed a second demurrer to that claim, and on November 7, 2003, the court dismissed that claim without leave to amend.

On November 27, 2002, the State of New Jersey (Treasury Department, Division of Investment) ("New Jersey") filed a lawsuit similar to the CalSTRS action in New Jersey Superior Court, Mercer County. On October 17, 2003, New Jersey filed an amended complaint alleging, among other things, that QCII, certain of QCII's former officers and certain current directors and Arthur Andersen LLP caused QCII's stock to trade at artificially inflated prices by employing improper accounting practices, and by issuing false statements about QCII's business, revenues and profits. As a result, New Jersey contends that it incurred tens of millions of dollars in losses. New Jersey's complaint purports to state causes of action against QCII for: (i) fraud; (ii) negligent misrepresentation; and (iii) civil conspiracy. Among other requested relief, New Jersey seeks from the defendants, jointly and severally, compensatory, consequential, incidental and punitive damages. On November 17, 2003, QCII filed a motion to dismiss. That motion is pending before the court.

On January 10, 2003, the State Universities Retirement System of Illinois ("SURSI") filed a lawsuit similar to the CalSTRS and New Jersey lawsuits in the Circuit Court of Cook County, Illinois. SURSI filed suit against QCII, certain of QCII's former officers and certain current directors, and several other defendants, including Arthur Andersen LLP and several investment banks. On October 29, 2003, SURSI filed a second amended complaint, dropping (i) certain individual and corporate defendants and (ii) its claim under the Illinois Consumer Fraud and Deceptive Business Practices Act. The second amended complaint alleges that defendants engaged in fraudulent conduct that caused it to lose in excess of \$12.5 million invested in QCII's common stock and debt and equity securities. The complaint alleges, among other things, that in press releases and other public statements, defendants represented that QCII was one of the highest revenue producing telecommunications companies in the world, with highly favorable results and prospects. SURSI alleges that defendants were engaged, however, in a scheme to falsely inflate QCII's revenues and decrease its expenses by, among other allegations, improper conduct related to transactions with the Arizona School Facilities Board, Genuity, Calpoint LLC, KMC, KPNQwest and Koninklijke KPN, N.V. The complaint purports to state causes of action against QCII under: (i) the Illinois Securities Act; (ii) common law fraud; (iii) common law negligent misrepresentation; and (iv) Section 11 of the 1933 Act. SURSI seeks, among other relief, punitive and exemplary damages, costs, equitable relief including an injunction to freeze or prevent disposition of the defendants' assets and disbursement.

The consolidated securities action, the consolidated ERISA action and the CalSTRS, New Jersey and SURSI actions described above present material and significant risk to QCII. Some of the allegations in these lawsuits include many of the same subjects that the SEC and U.S. Attorney's Office are investigating. Moreover, the size, scope and nature of QCII's recent restatements of its financial statements for fiscal 2001 and 2000 affect the risks presented by these investigations and actions, as these matters involve, among other things, QCII's prior accounting practices and related disclosures. Plaintiffs in certain of the securities actions have alleged QCII's restatement of items in support of their claims. While QCII intends to defend against these matters vigorously, the ultimate outcomes of these cases are very uncertain, and QCII can give no assurance as to the impacts on its financial results or financial condition as a result of these matters. Each of these cases is in a preliminary phase. None of the plaintiffs or the defendants has advanced evidence concerning possible recoverable damages, and QCII has not yet conducted discovery on these and other relevant issues. QCII has disclosed that it is unable to estimate reasonably a range of loss that it would incur if the plaintiffs in one or more of these lawsuits were to prevail. QCII has engaged in discussions for the purposes of resolving these matters and continues to evaluate any possible range of loss. Any settlement of or judgment on one or more of these claims could be material, and QCII cannot give any assurance that it would have the resources available to pay such judgments. Also, in the event of an adverse outcome of one or more of these matters, QCII's ability to meet its debt service obligations and its financial condition could be materially and adversely affected. As a wholly owned subsidiary of OCII, our business operations and financial condition would be similarly affected.

#### *Other matters*

In January 2001, an amended purported class action complaint was filed in Denver District Court against QCII and certain current and former officers and directors on behalf of stockholders of U S WEST. The complaint alleges that QCII has a duty to pay a quarterly dividend to U S WEST stockholders of record as of June 30, 2000. Plaintiffs further claim that the defendants attempted to

avoid paying the dividend by changing the record date from June 30, 2000 to July 10, 2000. In September 2002, QCII filed a motion for summary judgment on all claims. Plaintiffs filed a cross-motion for summary judgment on their breach of contract claims only. On July 15, 2003, the court denied both summary judgment motions.

Several purported class actions relating to the installation of fiber optic cable in certain rights-of-way were filed in various courts against QCII on behalf of landowners in Alabama, California, Colorado, Georgia, Illinois, Indiana, Kansas, Louisiana, Mississippi, Missouri, North Carolina, Oregon, South Carolina, Tennessee and Texas. Class certification was denied in the Louisiana proceeding and, subsequently, summary judgment was granted in our favor. A new Louisiana class action complaint has recently been filed. Class certification was also denied in the California proceeding, although plaintiffs have filed a motion for reconsideration. Class certification was granted in the Illinois proceeding. Class certification has not been resolved yet in the other proceedings. The complaints challenge QCII's right to install its fiber optic cable in railroad rights-of-way and, in Colorado, Illinois and Texas, also challenge QCII's right to install fiber optic cable in utility and pipeline rights-of-way. In Alabama, the complaint challenges QCII's right to install fiber optic cable in any right-of-way, including public highways. The complaints allege that the railroads, utilities and pipeline companies own a limited property right-of-way that did not include the right to permit QCII to install its fiber optic cable on the plaintiff's property. The Indiana action purports to be on behalf of a national class of landowners adjacent to railroad rights-of-way over which QCII's network passes. The Alabama, California, Colorado, Georgia, Kansas, Louisiana, Mississippi, Missouri, North Carolina, Oregon, South Carolina, Tennessee and Texas actions purport to be on behalf of a class of such landowners in those states, respectively. The Illinois action purports to be on behalf of landowners adjacent to railroad rights-of-way over which QCII's network passes in Illinois, Iowa, Kentucky, Michigan, Minnesota, Nebraska, Ohio and Wisconsin. Plaintiffs in the Illinois action have filed a motion to expand the class to a nationwide class. The complaints seek damages on theories of trespass and unjust enrichment, as well as punitive damages. Together with some of the other telecommunication carrier defendants, in September 2002, QCII filed a proposed settlement of all these matters in the United States District Court for the Northern District of Illinois. On July 25, 2003, the court granted preliminary approval of the settlement and entered an order enjoining competing class action claims, except those in Louisiana. The settlement and the court's injunction are opposed by some, but not all, of the plaintiffs' counsel and are on appeal before the Seventh Circuit Court of Appeals. At this time, QCII cannot determine whether such settlement will be ultimately approved or the final cost of the settlement if it is approved.

#### **Note 8: Subsequent Events**

##### **Dividends**

For the nine months ended September 30, 2003, we have declared regular dividends amounting to \$1.034 billion. In addition, in August and November of 2003, we declared and paid dividends in the amount of \$360 million and \$719 million, respectively, relating to net income from prior periods that had not been declared or paid as dividends in those periods. We plan to declare and make additional dividend payments in the future until all net income from wireline entities from prior periods has been declared and remitted as dividends. We estimate that the incremental amount (in addition to the \$1.079 billion declared in 2003) of such dividends will be approximately \$1.3 billion.

## **QCII Purchase Agreement**

On December 18, 2003, QCII entered into an agreement to purchase certain telecommunications assets from Allegiance Telecom, Inc. ("Allegiance") for a purchase price consisting of \$300 million in cash, a convertible promissory note in the amount of \$90 million and the assumption of certain liabilities. The agreement is subject to approval by the U.S. Bankruptcy Court and certain other government regulatory agencies. The Bankruptcy Court has designated QCII as the stalking horse bidder in the sale process. Other interested potential bidders will have an opportunity to offer higher bids for the assets of Allegiance. If QCII is successful in the bidding process, it expects to consummate the transaction some time in 2004. In that event, it is possible that some portion of the Allegiance assets will be transferred to or purchased by us, although we have not yet determined the amount or the price we would pay for them.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*Unless the context requires otherwise, references in this report to "Qwest," "we," "us," the "Company" and "our" refer to Qwest Corporation and its consolidated subsidiaries, and references to "QCII" refer to our ultimate parent company, Qwest Communications International Inc., and its consolidated subsidiaries.*

Certain statements set forth below under this caption constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. See "Special Note Regarding Forward-Looking Statements" at the end of this Item 2 for additional factors relating to such statements as well as for a discussion of certain risk factors applicable to our business, financial condition and results of operations.

### Business Overview

We are wholly owned by Qwest Services Corporation, or QSC, which is wholly owned by QCII. We provide local telecommunications and related services, IntraLATA long-distance services and wireless, data and video services within our local service area, which consists of the 14-state region of Arizona, Colorado, Idaho, Iowa, Minnesota, Montana, Nebraska, New Mexico, North Dakota, Oregon, South Dakota, Utah, Washington and Wyoming. Our operations are included in the consolidated operations of our ultimate parent, QCII, and generally account for the majority of QCII's consolidated revenue. Our telecommunications products and services are provided through our traditional telephone network located within our local service area. In addition to our operations, QCII maintains a wireless business (comprised of the wireless operations we transferred to an affiliate in May 2004) and a national fiber optic network. Through its fiber optic network, QCII provides the following wireline products and services that we do not provide:

- InterLATA long-distance services;
- Dedicated Internet access;
- Virtual private network;
- Internet dial access;
- Web hosting; and
- Professional services

For certain other products and services we provide and for a variety of internal communications functions, we utilize QCII's fiber optic network to transport voice and data traffic. Also, through its fiber optic network, QCII provides nationally some data and Internet access services, including private line, ATM and Frame Relay, which are similar to what we provide within our local service area.

We intend to transfer ownership of Qwest Wireless LLC, to an affiliate in the near future. After this transfer, we will no longer have significant wireless operations. This transfer will take place as soon as we have received all necessary regulatory approvals, perhaps as early as the first quarter of 2004. Qwest Wireless will therefore be presented in discontinued operations after the date of transfer.

### Restatement of Prior Years' Consolidated Financial Statements

Our annual report on Form 10-K for fiscal 2002, or our 2002 Form 10-K, was filed in January 2004 and contains, among other things, our restated consolidated financial statements for the years ended December 31, 2001 and 2000. In connection with this restatement, we performed an analysis of our previously issued consolidated financial statements for 2001 and 2000 and for the quarter ended March 31, 2002 and identified a number of errors. This restatement resulted in, among other things, an



aggregate reduction in revenue of approximately \$335 million and an aggregate decrease in net income of approximately \$645 million, including the impact for the three months ended March 31, 2002. The net impact of the restatement is summarized as follows:

	Three Months Ended March 31, 2002		
	Revenue	Pre-tax Income	Net Income
	(Dollars in millions)		
Previously reported	\$ 3,049	\$ 637	\$ 391
<b>Restatement Adjustments, net:</b>			
Installation fees	19	19	11
PUC fine reclassification	(12)	—	—
Transactions with affiliates	9	29	18
Out-of-period expenses	—	(54)	(33)
Network labor costs	—	(22)	(13)
Settlement charges	—	22	14
Property tax accrual	—	(16)	(10)
Balance sheet reconciliations	—	15	9
Other	3	(29)	(17)
Net restatements	19	(36)	(21)
As restated	\$ 3,068	\$ 601	\$ 370

(Dollars in millions)	December 31, 2001		
	Revenue	Pre-Tax Income	Net Income
Previously reported	\$ 12,675	\$ 2,778	\$ 1,737
Net restatements	(138)	(533)	(330)
As restated	\$ 12,537	\$ 2,245	\$ 1,407

(Dollars in millions)	December 31, 2000		
	Revenue	Pre-Tax Income	Net Income
Previously reported	\$ 12,300	\$ 1,904	\$ 1,196
Net restatements	(216)	(258)	(294)
As restated	\$ 12,084	\$ 1,646	\$ 902

The restatements involve revenue recognition issues related to termination fees, wireless revenue and installation fees, and expense recognition, as well as other matters. A complete description of the nature and reason for the individually significant restatement items is included in Note 3 to our December 31, 2002 financial statements included in Item 8 of our 2002 Form 10-K and in Note 2 to our March 31, 2003 financial statements included in Item 1 of our Form 10-Q for the quarter ended March 31, 2003.

While our restatement of revenue and net income is attributable primarily to misinterpretations or misapplications of GAAP, we believe that many of the restatement adjustments were the result of certain ineffective internal control policies and procedures.

We have not amended our prior filings to reflect the restatement. As a result, the information previously filed in our annual reports on Form 10-K for fiscal years 2001 and 2000, our quarterly reports on Form 10-Q for the quarterly periods included in those fiscal years and for the quarter ended

March 31, 2002 and any current reports on Form 8-K, or other disclosures, containing fiscal years 2002, 2001 or 2000 information filed or made prior to the filing of our 2002 Form 10-K on January 13, 2004 should not be relied upon.

## Results of Operations

### Overview

We generate revenue from the provision of voice services, data and Internet services, wireless services, other services and services to our affiliates. Depending on the product or service purchased, a customer may pay an up-front fee, a monthly fee, a usage charge or a combination of these. A further description of each revenue category is as follows:

- *Voice services.* Voice services revenue includes local voice services revenue, IntraLATA long-distance voice services revenue and access services revenue. Local voice services revenue includes revenues from basic local exchange services, switching services, custom calling features, enhanced voice services, operator services, public telephone services, collocation services and customer premises equipment, or CPE. Local voice services revenue also includes revenue from the provision of, on a wholesale basis, network transport, billing services and access to our local network. IntraLATA long-distance voice services revenue includes revenues from IntraLATA long-distance services within our local service area. Access services revenue primarily includes revenue from switched access services.
- *Data and Internet services.* Data and Internet services revenue includes revenues from data services (such as traditional private lines, wholesale private lines, integrated services digital network, frame relay, asynchronous transfer mode and related CPE) and Internet services (such as digital subscriber line, Internet dial access, professional services and related CPE).
- *Wireless services.* Our wireless services are provided through our wholly owned subsidiary, Qwest Wireless, which holds 10 Megahertz licenses to provide personal communications services, or PCS, in select markets in our local service area. We offer wireless services to residential and business customers, providing them the ability to use the same telephone number for their wireless phone as for their home or business phone. In August 2003, we entered into a services agreement with a subsidiary of Sprint Corporation, that allows us to resell Sprint wireless services, including access to Sprint's nationwide PCS wireless network, to consumer and business customers, primarily within our local service area. We plan to begin offering these Sprint services under our brand name in early 2004. Our wireless customers who are currently being serviced through our proprietary wireless network will be transitioned onto Sprint's network.
- *Other services.* Other services revenue is predominately derived from subleases related to our unused real estate assets, such as space in our office buildings, warehouses and other properties.
- *Affiliate services.* Affiliate revenue is derived from telecommunications services provided to our affiliated entities. We generally provide the same products and services to our affiliated entities as we do in the marketplace. These services include both retail and wholesale products and services.

### Business Trends

Our results continue to be impacted by a number of factors influencing the telecommunications industry and our local service area. First, the weak economy in our local service area has continued to impact demand from both our consumer and business customers. The impacts include reduced demand for services resulting in loss of access lines, renegotiated commitments and loss of customers. We believe demand will continue to be affected because the economy's recovery in our local service area is expected to lag the national recovery. Second, technology substitution and competition are expected to

lead to continued access line loss. We expect industry-wide competitive factors to continue to impact our results and we have developed new strategies for offering complementary services such as satellite television and wireless. Third, our results continue to be impacted by regulatory responses to the competitive landscape for our local services.

## **Revenue**

In general, we expect to see a continued decrease in voice-related revenue as a result of a decrease in access lines and wireless subscribers. Access lines are expected to continue decreasing primarily because of technology substitution, including wireless and cable substitution for wireline telephony, and cable modem substitution for dial-up Internet access lines. In addition, our competitors have accelerated their use of unbundled network element platform, or UNE-P, to deliver voice services. The use of UNE-P is having an impact on our operations in 2003, resulting in incremental retail access line losses and is causing downward pressure on our revenue.

We have also begun to experience and expect increased competitive pressure from telecommunications providers either emerging from bankruptcy protection or reorganizing their capital structure to more effectively compete against us. As a result of these increased competitive pressures, we have been and may continue to be forced to respond with less profitable product offerings and pricing plans that allow us to retain and attract customers. These pressures could adversely affect our operating results and financial performance.

Starting in 2004, wireless offerings will be expanded through a new arrangement with Sprint. This arrangement will enable utilization of Sprint's nationwide digital wireless network to offer customers new voice and data capabilities.

We expect the pace of growth in affiliate revenue to accelerate. We continued to transition telecommunications traffic previously carried by third parties. In addition, our affiliates have expanded their data communications needs. During 2004, we expect affiliate revenue to rise due to an increase in access fees charged to our affiliates selling interexchange services in our region.

## **Expenses**

Our expenses continue to be impacted by shifting demand due to increased competition and the expansion of our product offerings. Expenses associated with our new product offerings tend to be more variable in nature. While existing products tend to rely upon our embedded cost structure, the mix of products we expect to sell, combined with regulatory and market pricing stresses may pressure operating margins.

We expect the pace of affiliate cost increases to slow and potentially stabilize as a result of the completion in 2003 of the bulk of functional consolidation and employee transfers.

Costs of both our pension plan and our healthcare plans are expected to continue to rise in the short and long term due to lower expected returns on plan assets based on our evaluation of current and expected market conditions and anticipated continuing double digit annual percentage increases in the overall cost of health care and prescription drugs.

Beginning in 2002, we reduced capital expenditures and expect to continue at a reduced level for the foreseeable future. Given the current business environment, as discussed in Item 1 of our 2002 Form 10-K, we believe that our current level of capital expenditures will sustain our business at existing levels and support our anticipated core growth requirements in areas such as in our DSL product.

## **Cumulative Effect of Change in Accounting Principle, Net of Taxes**

Our net income for the nine months ended September 30, 2003 was impacted by a \$219 million net increase related to the adoption of SFAS No. 143 on January 1, 2003. See further discussion in Note 1—Basis of presentation to our condensed consolidated financial statements in Item 1 of this report.

### ***Presentation***

The analysis is organized in a way that provides the information required, while highlighting the information that we believe will be instructive for understanding the relevant trends going forward. In addition to the discussion of the historical information that reviews the current reporting presentation of our condensed consolidated financial statements, an overview of the operational results is provided below. Our financial results in this section are prepared in accordance with generally accepted accounting principles in the United States of America, or GAAP.

Our operations are integrated into and are a part of the segments of the QCII consolidated group. The chief operating decision maker, or CODM, for QCII makes resource allocation decisions and assessments of financial performance for the consolidated group based on wireline, wireless and other segmentation. For more information about QCII's reporting segments, see QCII's annual report on Form 10-K for the year ended December 31, 2002, the QCII 2002 Form 10-K. Our business contributes to the segments reported by QCII, but the QCII CODM reviews our financial information only in connection with this filing. Consequently, we do not provide discrete financial information for Qwest Corporation to a CODM on a regular basis. See further discussion in Note 5—Contributions to QCII segments to our condensed consolidated financial statements in Item 1 of this report.

## Results of Operations

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2003	2002	Increase/ (Decrease)	%	2003	2002	Increase/ (Decrease)	%
(Dollars in millions)								
Operating revenues	\$ 2,822	\$ 2,948	\$ (126)	(4)%	\$ 8,519	\$ 9,018	\$ (499)	(6)%
Operating expenses:								
Cost of sales (exclusive of depreciation and amortization detailed below)	751	642	109	17 %	2,162	2,055	107	5 %
Selling, general and administrative	806	914	(108)	(12)%	2,426	2,711	(285)	(11)%
Depreciation	615	640	(25)	(4)%	1,844	2,022	(178)	(9)%
Intangible assets amortization	92	81	11	14 %	264	221	43	19 %
Asset impairment charges	230	—	230	nm	230	825	(595)	(72)%
Restructuring, merger-related and other charges (credits)	—	17	(17)	nm	23	(13)	36	nm
Operating income	\$ 328	\$ 654	\$ (326)	(50)%	\$ 1,570	\$ 1,197	\$ 373	31 %
Other expense (income):								
Interest expense—net	187	175	12	7 %	537	526	11	2 %
Other (income) expense—net	—	(11)	11	nm	2	(6)	8	nm
Total other expense—net	187	164	23	14 %	539	520	19	4 %
Income before income taxes and cumulative effect of change in accounting principle	141	490	(349)	(71)%	1,031	677	354	52 %
Income tax expense	(55)	(187)	132	(71)%	(393)	(257)	(136)	53 %
Income before cumulative effect of change in accounting principle	86	303	(217)	(72)%	638	420	218	52 %
Cumulative effect of change in accounting principle, net of taxes	—	—	—	—	219	—	219	nm
Net income	\$ 86	\$ 303	\$ (217)	(72)%	\$ 857	\$ 420	\$ 437	104 %

nm—not meaningful

## Operating Revenues

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2003	2002	Increase/ (Decrease)	%	2003	2002	Increase/ (Decrease)	%
(Dollars in millions)								
Voice services	\$ 1,966	\$ 2,114	\$ (148)	(7)%	\$ 5,990	\$ 6,515	\$ (525)	(8)%
Data and Internet services	526	538	(12)	(2)%	1,605	1,636	(31)	(2)%
Wireless	152	179	(27)	(15)%	457	550	(93)	(17)%
Other services	5	3	2	67 %	12	11	1	9 %
Affiliate services	173	114	59	52 %	455	306	149	49 %
Total operating revenues	\$ 2,822	\$ 2,948	\$ (126)	(4)%	\$ 8,519	\$ 9,018	\$ (499)	(6)%

For a description of the products and services included in each revenue line item, see "Overview" above.



## *Voice Services*

### *Voice Services—Three months ended September 30, 2003 as compared to the three months ended September 30, 2002*

Voice services revenue decreased \$148 million, or 7%, for the three months ended September 30, 2003 as compared to the same period in 2002. The voice services revenue decrease was the result of access line losses and pricing declines driven by competitive pressures.

For the three months ended September 30, 2003 as compared to the same period in 2002, local voice revenue declined \$129 million associated with the loss of approximately 842,000 access lines, with pricing declines driven by competitive pressures. The access line losses were driven by a weak demand in our local service area, technology substitution to wireless and broadband services and competition. We are experiencing competition in both the business and consumer markets from both facility and non facility-based providers such as cable companies providing telephony services, competitive local exchange carriers and other telecommunications providers reselling our services. Partially offsetting these declines was growth in UNE-P revenue.

In addition to the revenue decreases above, voice services declined \$19 million for the three months ended September 30, 2003 as compared to the same period in 2002 primarily due to declines in IntraLATA long-distance and demand for services such as collocation, public telephone services and directory assistance. The declines were primarily driven by the soft telecommunications market, wireless substitution of public telephones and deteriorating economic conditions.

### *Voice Services—Nine months ended September 30, 2003 as compared to the nine months ended September 30, 2002*

Voice services revenue decreased \$525 million, or 8%, for the nine months ended September 30, 2003 as compared to the same period in 2002 primarily as a result of access line losses, pricing declines and a reduction in access services revenue.

We experienced a decline in local voice services revenue of \$368 million for the nine months ended September 30, 2003 as compared to the same period in 2002 associated with the loss of access lines and pricing declines driven by competitive pricing pressures. Partially offsetting these declines is growth in UNE-P revenue.

We also experienced a revenue decline of \$72 million in access services revenue for the nine months ended September 30, 2003 as compared to the same period in 2002. The access services revenue declines were due primarily to the same regulatory and industry effects described above. In addition to the revenue decreases above, voice services declined \$85 million for the nine months ended September 30, 2003 as compared to the same period in 2002 primarily due to declines in IntraLATA long-distance and demand for services such as collocation, public telephone services and directory assistance. The declines were primarily driven by the soft telecommunications market, wireless substitution of public telephones and deteriorating economic conditions.

## *Data and Internet Services*

Data and Internet services revenue declined \$12 million, or 2%, for the three months ended September 30, 2003 as compared to the same periods in 2002, and declined \$31 million, or 2%, for the nine months ended September 30, 2003 as compared to the same periods in 2002. Data services revenue declines are mainly the result of the bankruptcy of large customers, primarily in 2002, such as Touch America, Inc., MCI and Genuity, Inc.

## Wireless

Wireless services revenue decreased \$27 million, or 15%, for the three months ended September 30, 2003 as compared to the same period in 2002 and decreased \$93 million, or 17%, for the nine months ended September 30, 2003 as compared to the same period in 2002. The decrease is due to our prior strategic decision to de-emphasize marketing of wireless services on a stand-alone basis coupled with intense industry competition, resulting in a customer decline of 172,000, or 16%.

## Affiliate Services

Affiliate services revenue consists of telecommunications services provided to affiliated enterprises. Affiliate services revenue increased \$59 million, or 52%, and \$149 million, or 49%, for the three and nine months ended September 30, 2003, respectively, as compared to the same periods in 2002. The increases were caused by a migration of telecommunications services from third-party providers onto our networks.

## Operating Expense

The following table provides further detail regarding our operating expenses for the periods as specified:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2003	2002	Increase/ (Decrease)	%	2003	2002	Increase/ (Decrease)	%
(Dollars in millions)								
Operating expenses:								
Cost of sales	\$ 751	\$ 642	\$ 109	17 %	\$ 2,162	\$ 2,055	\$ 107	5 %
Selling, general and administrative ("SG&A")	806	914	(108)	(12)%	2,426	2,711	(285)	(11)%
Depreciation	615	640	(25)	(4)%	1,844	2,022	(178)	(9)%
Intangible assets amortization	92	81	11	14 %	264	221	43	19 %
Asset impairment charges	230	—	230	nm	230	825	(595)	(72)%
Restructuring, Merger-related and other charges (credits)	—	17	(17)	nm	23	(13)	36	nm
Total operating expenses	\$ 2,494	\$ 2,294	\$ 200	9 %	\$ 6,949	\$ 7,821	\$ (872)	(11)%

nm—not meaningful

## Cost of Sales

The following table shows a breakdown of cost of sales by major component for the three and nine months ended September 30, 2003 and 2002:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2003	2002	Increase/ (Decrease)	%	2003	2002	Increase/ (Decrease)	%
(Dollars in millions)								
Employee and service-related costs	\$ 442	\$ 398	\$ 44	11%	\$ 1,288	\$ 1,231	\$ 57	5 %
Network costs	91	76	15	20%	244	254	(10)	(4)%
Non-employee related costs	105	67	38	57%	307	264	43	16 %
Affiliate costs	113	101	12	12%	323	306	17	6 %
Total cost of sales	\$ 751	\$ 642	\$ 109	17%	\$ 2,162	\$ 2,055	\$ 107	5 %

Cost of sales includes salaries and wages, benefits, network costs, materials and supplies, contracted engineering services, computer systems support and the cost of CPE sold.





*Cost of Sales—Three months ended September 30, 2003 as compared to the three months ended September 30, 2002*

Total cost of sales increased \$109 million, or 17%, for the three months ended September 30, 2003 as compared to the same period in 2002. Cost of sales, as a percent of revenue, was 27% for the three months ended September 30, 2003 as compared to 22% for the three months ended September 30, 2002. Cost of sales increased primarily due to a decreased net pension credit, higher retiree healthcare costs and regulatory-related fees.

Employee and service-related costs, such as salaries and wages, benefits, commissions, overtime and third-party customer service increased \$44 million, or 11%, for the three months ended September 30, 2003 as compared to the same period in 2002. The increase is primarily due to a decreased net pension credit and higher retiree healthcare costs.

Our network costs increased \$15 million, or 20%, for the three months ended September 30, 2003 as compared to the same period in 2002. In July 2003, we amended our agreement with Microsoft so that we are responsible for providing broadband services to end users. Previously, these services were provided to Microsoft on a wholesale basis. This change required that we become responsible for all costs associated with providing this service to end users. As a result, the associated revenue and costs increased.

Non-employee related costs, such as real estate, cost of CPE sold, and regulatory-related fees increased \$38 million, or 57%, for the three months ended September 30, 2003 as compared to the same period in 2002. The increase is primarily attributable to a \$28 million increase in regulatory-related fees.

Affiliate costs, such as services for corporate administration, information technology, advertising, and technical support, increased \$12 million, or 12%, for the three months ended September 30, 2003 as compared with the same period in 2002. The increases were due to higher costs for technical support and sales.

*Cost of Sales—Nine months ended September 30, 2003 as compared to the nine months ended September 30, 2002*

Total cost of sales increased \$107 million, or 5% for the nine months ended September 30, 2003 as compared to the same period in 2002. Cost of sales, as a percent of revenue, was 25% for the nine months ended September 30, 2003 as compared to 23% for the same period in 2002. Cost of sales increased primarily due to decreased net pension credit and higher retiree healthcare costs and regulatory-related fees.

Employee and service-related costs increased \$57 million, or 5%, for the nine months ended September 30, 2003 as compared to the same period in 2002. The increase is primarily due to a decreased net pension credit and higher retiree healthcare costs. Partially offsetting the increases were lower staffing costs and other employee costs resulting from prior restructuring efficiencies and lower professional fees due to decreased use of third-party vendors.

Non-employee related costs increased \$43 million, or 16%, for the nine months ended September 30, 2003 as compared to the same period in 2002. The increase is primarily attributable to a \$29 million increase in regulatory-related fees.

Affiliate costs increased \$17 million, or 6%, for the nine months ended September 30, 2003 as compared with the same period in 2002. The increases were due to higher costs for technical support and sales.

## Selling, General and Administrative (SG&A) Expense

The following table shows a breakdown of SG&A by major component for the three and nine months ended September 30, 2003 and 2002:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2003	2002	Increase/ (Decrease)	%	2003	2002	Increase/ (Decrease)	%
(Dollars in millions)								
Employee and service-related costs	\$ 192	\$ 229	\$ (37)	(16)%	\$ 601	\$ 699	\$ (98)	(14)%
Bad debt	46	77	(31)	(40)%	142	309	(167)	(54)%
Property and other taxes	100	108	(8)	(7)%	314	350	(36)	(10)%
Non-employee related costs	105	132	(27)	(20)%	346	395	(49)	(12)%
Affiliate costs	363	368	(5)	(1)%	1,023	958	65	7 %
Total SG&A	\$ 806	\$ 914	\$ (108)	(12)%	\$ 2,426	\$ 2,711	\$ (285)	(11)%

### SG&A—Three months ended September 30, 2003 as compared to the three months ended September 30, 2002

SG&A expenses include taxes other than income taxes, bad debt charges, salaries and wages not directly attributable to the provision of products or services, benefits, sales commissions, rent for administrative space, advertising, professional service fees and computer systems support.

Total SG&A decreased \$108 million, or 12%, for the three months ended September 30, 2003 as compared to the same period in 2002. SG&A, as a percent of revenue, was 28% for the three months ended September 30, 2003 compared to 31% for the same period in 2002. Decreases in employee costs, professional fees, bad debt, and marketing and advertising were the primary causes of the decline.

Employee and service-related costs, such as salaries and wages, benefits, sales commissions, overtime and professional fees (such as telemarketing, and customer service costs), decreased \$37 million, or 16%, for the three months ended September 30, 2003 as compared to the same period in 2002. The decline is primarily due to an increase in expenses that are eligible for capitalization, reduced professional fees due to decreased use of third-party vendors and lower internal commissions partially offset by decreases in the net pension credit and higher retiree healthcare costs.

Bad debt expense decreased \$31 million, or 40%, for the three months ended September 30, 2003 as compared to the same period in 2002. This decrease was primarily related to improved collections practices and tighter credit policies.

Non-employee related costs, such as marketing and advertising, rent for administrative space and software related expense, decreased \$27 million, or 20%, for the three months ended September 30, 2003 as compared to the same period in 2002. The decrease was primarily driven by a decrease of \$23 million in marketing and advertising expenses due to third quarter cost reduction efforts.

### SG&A—Nine months ended September 30, 2003 as compared to the nine months ended September 30, 2002

SG&A, as a percent of revenue, was 28% for the nine months ended September 30, 2003 compared to 30% for the same period in 2002. Total SG&A decreased \$285 million, or 11%, for the nine months ended September 30, 2003 as compared to the same period in 2002. The decrease relates primarily to lower professional fees, lower bad debt, and lower marketing and advertising costs, offset by a decreased net pension credit and higher retiree healthcare costs.

Employee and service-related costs decreased \$98 million, or 14%, for the nine months ended September 30, 2003 as compared to the same period in 2002. The decrease was primarily related to lower professional fees paid to third-party service providers and other related costs as we shifted certain previously outsourced customer service and sales functions to employees; partially offset by decreases in the net pension credit and higher retiree healthcare costs.

Bad debt expense decreased \$167 million, or 54%, for the nine months ended September 30, 2003 as compared to the same period in 2002. Bad debt also decreased as a percentage of revenue to 2% for the nine months ended September 30, 2003 from 3% for the same period in 2002. Bad debt declined across the business as a result of fewer customer bankruptcy filings, improved collections practices and tighter credit policies.

Property and other taxes decreased \$36 million, or 10%, for the nine months ended September 30, 2003 as compared to the same period in 2002. Reduced property and other taxes are attributable to changes in estimates of property tax liabilities.

Non-employee related costs decreased \$49 million, or 12%, for the nine months ended September 30, 2003 as compared to the same period in 2002. The decrease was driven by third quarter cost reduction efforts of \$168 million, which reduced marketing and advertising, real estate and equipment rental and maintenance. These cost reductions were offset by a \$138 million shift in information technology resources to maintenance activities from development activities that were eligible for capitalization.

Affiliate expenses, such as services for corporate administration, information technology, advertising and technical support, increased \$65 million, or 7%, for the nine months ended September 30, 2003 as compared to the same period in 2002. The increases were due to higher administrative costs, which includes costs resulting from our accounting restatement.

### ***Combined Pension and Post-Retirement Benefits***

Our employees participate in the QCII pension, post-retirement and other post-employment benefit plans. Our results include post-retirement benefit expenses allocated to us by QCII, net of pension credits, of \$54 million in the third quarter of 2003, a pension credit, net of post-retirement benefits expenses, of \$5 million in the third quarter of 2002, post-retirement benefit expenses, net of pension credits, of \$163 million in the nine months ended September 30, 2003 and a pension credit, net of post-retirement expenses, of \$17 million in the nine months ended September 30, 2002. Absent these expenses or credits, our net income in the applicable period would have been higher or lower by these amounts. The net pension expense or credit is a function of the amount of pension and post-retirement benefits earned, interest on projected benefit obligations, amortization of costs and credits from prior benefit changes and the expected return on the assets held in the various plans. The net pension expense or credit is allocated partially to cost of sales with the remaining balance included in SG&A.

The change to a net benefit expense in the three and nine months ended September 30, 2003 from a net pension credit in the three and nine months ended September 30, 2002 is primarily due to decreased returns on investments and increased medical costs for plan participants. Costs of both our pension plan and our healthcare plans are expected to continue to rise in the short and long term due to lower expected returns on plan assets based on our evaluation of current and expected market conditions and anticipated continuing double digit annual percentage increases in the overall cost of health care and prescription drugs.

### **Depreciation**

Depreciation expense decreased \$25 million, or 4%, for the three months ended September 30, 2003 compared to the same period in 2002. The decrease was the result of certain assets becoming fully

depreciated in 2002 and the completion of certain capitalized lease agreements in the three months ended September 30, 2002. The decrease was the result of the \$825 million impairment we recorded as of June 30, 2002 and the resulting decrease in the depreciable basis of our fixed assets discussed below; certain assets becoming fully depreciated in 2002; and the completion of certain capitalized lease agreements in the nine month period ended September 30, 2002.

Depreciation expense decreased \$178 million, or 9%, for the nine months ended September 30, 2003 as compared to the same period in 2002.

### **Intangible Assets Amortization**

Amortization expense increased \$11 million, or 14%, for the three months ended September 30, 2003 compared to the same period of 2002. The increase was attributed to increases in capitalized software costs. For the nine months ended September 30, 2003, amortization expense increased \$43 million, or 19%, compared to the same period of 2002. The increase was attributed to increases in capitalized software costs partially offset by an impairment of certain of our intangible assets recorded on June 30, 2002, which reduced our annual amortization by \$10 million.

### **Asset Impairment Charges**

In August 2003, we entered into a services agreement with a subsidiary of Sprint that allows us to resell Sprint wireless services, including access to Sprint's nationwide PCS wireless network, to consumer and business customers, primarily within our local service area. We plan to begin offering these Sprint services under our brand name in early 2004. Our wireless customers who are currently being serviced through our proprietary wireless network will be transitioned onto Sprint's network. Due to the anticipated decrease in usage of our own wireless network following the transition of our customers onto Sprint's network, in the third quarter of 2003 we performed an evaluation of the recoverability of the carrying value of our long-lived wireless network assets.

In accordance with Statement of Financial Accounting Standards, or SFAS, No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," or SFAS No. 144, we compared gross undiscounted cash flow projections to the carrying value of the long-lived wireless network assets and determined that certain asset groups were not expected to be recovered through future projected cash flows. For those asset groups that were not recoverable, we then estimated the fair value using recent selling prices for comparable assets. Our cell sites, switches, related tools and equipment inventory and certain information technology systems that support the wireless network were determined to be impaired by \$230 million.

Effective June 30, 2002, pursuant to SFAS, No. 144, a general deterioration of the telecommunications market, downward revisions to our expected future results of operations and other factors indicated that our investments in long-lived assets may have been impaired at that date. In accordance with SFAS No. 144, we performed an evaluation of the recoverability of the carrying value of our long-lived assets using gross undiscounted cash flow projections. For impairment analysis purposes, we grouped our property, plant and equipment and projected cash flows by our traditional telephone network and our wireless network. Based on the gross undiscounted cash flow projections, we determined that our traditional telephone network was not impaired at June 30, 2002. However, we determined that the value of our wireless network, which provides PCS in select markets in our local service area, was impaired at June 30, 2002. For the wireless network, we then estimated the fair value based on replacement costs. Based on our analysis, the estimated fair value of the wireless assets was less than our carrying amounts and we recorded an impairment charge of \$825 million as of June 30, 2002. Replacement cost was determined by using current cost adjusted for physical deterioration, functional obsolescence and economic obsolescence.

In accordance with SFAS No. 144, the fair value of the impaired assets becomes the new basis for accounting purposes. As such, approximately \$410 million in accumulated depreciation was eliminated in connection with the accounting for the impairments. The impact of the impairments reduced our annual depreciation and amortization expense by approximately \$135 million, effective July 1, 2002. Additionally, the 2003 impairment will reduce our annual depreciation and amortization expense by approximately \$40 million, effective October 1, 2003.

### Restructuring, Merger-Related and Other Charges (Credits)

A summary of restructuring, Merger-related and other charges (credits), which includes the reversal of Merger-related reserves in 2002, recorded to our condensed consolidated statements of operations for the three and nine months ended September 30, 2003 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
	(Dollars in millions)			
2003 restructuring	\$ —	\$ —	\$ 19	\$ —
2002 restructuring plan charges	—	74	—	74
2001 restructuring plan reversals	—	(64)	—	(64)
Other restructuring costs	—	7	4	7
Other Merger-related reversals	—	—	—	(30)
Total restructuring and Merger-related charges (credits)	\$ —	\$ 17	\$ 23	\$ (13)

### 2003 Activities

During the nine months ended September 30, 2003, QCII identified planned employee reductions in various functional areas. As a result, we established a reserve and recorded a charge of \$19 million to our condensed consolidated statement of operations to cover the costs associated with these actions.

The charge of \$19 million relates to severance benefits and other charges pursuant to established severance policies associated with a reduction in employees. We identified approximately 650 employees from various functional areas to be terminated as part of this reduction. Through September 30, 2003, we completed approximately 600 of the planned reductions, and used \$13 million of the restructuring reserve for severance payments and enhanced pension benefits.

Other severance related charges not associated with the specific restructuring plans were \$4 million for nine months ended September 30, 2003.

As a result of these restructuring activities, we expect to realize reduced employee and related expenses of approximately \$38 million per annum.

### 2002 Activities

During 2002, in response to shortfalls in employee reductions planned as part of the 2001 restructuring plan (as discussed below), and due to the continued declines in our revenue and general economic conditions, QCII identified planned reductions in employees from various functional areas and permanently abandoned a number of operating and administrative facilities. These activities included charges of \$49 million for the three and nine months ended September 30, 2002, for severance benefits and employee-related matters pursuant to established severance policies triggered by a reduction in employees, which we recorded directly to restructuring and other charges in our condensed consolidated statement of operations. QCII identified approximately 2,400 of our employees from various functional areas to be separated from Qwest as part of the staffing reduction. The affected

employees are entitled to receive severance benefits pursuant to established severance policies. As of September 30, 2002, we completed approximately 1,600 of the planned reductions resulting in the utilization of \$17 million for cash payments and enhanced pension benefits. At September 30, 2003, our restructuring activities under this plan were substantially complete. For the nine months ended September 30, 2003, we used \$27 million of the restructuring reserve for severance payments and enhanced pension benefits.

In conjunction with the staffing reductions, we permanently abandoned 25 real estate facilities and recorded a charge of \$25 million for the three and nine months ended September 30, 2002 related to the rental payments due under the leases, net of estimated subleases rentals, and estimates of amounts to terminate the leases. For the nine months ended September 30, 2003, we utilized \$4 million of the established reserves primarily for payments of amounts due under the leases. We expect that the remaining reserve will be utilized over the remaining term of the leases, which are up to five years.

In addition, other severance-related charges not associated with the specific restructuring plans were \$7 million for the three and nine months ended September 30, 2003.

As a result of these restructuring activities, we realized a cost savings of \$42M for the nine months ended September 30, 2003.

#### *2001 Activities*

During the fourth quarter of 2001, in order to streamline our business and consolidate operations in response to lower customer demand resulting from a decline in economic conditions, QCII implemented plans to reduce the number of our employees, consolidate and sublease facilities, abandon certain capital projects and terminate certain operating leases. During the three and nine months ended September 30, 2003 we utilized none and \$8 million of the reserve, respectively.

As a result of the shortfall in actual terminations we reversed \$64 million of the severance accruals established in 2001, which we recorded as a reduction in restructuring charges in our three and nine months ended September 30, 2002, condensed consolidated statement of operations.

#### *Subsequent event*

During the fourth quarter of 2003, as part of an ongoing effort of evaluating costs of operations, QCII further reduced employee levels in certain areas of our business. As a result, we plan to record a charge to our condensed consolidated statement of operations during the fourth quarter of 2003, primarily for estimated severance costs ranging from \$35 to \$55 million.

#### *Merger-Related Charges*

During the nine months ended September 30, 2002, we reversed \$30 million of the Merger-related accrual. The reversal resulted from favorable developments in the matters underlying contractual settlements and legal contingencies.

## Total Other Expense—Net

Other expense—net includes interest expense, net of capitalized interest and other income—net which includes interest income. Components of other expense—net for the three months and nine months ended September 30 are as follows:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2003	2002	Change	%	2003	2002	Change	%
(Dollars in millions)								
Interest expense—net	\$ 187	\$ 175	\$ 12	7%	\$ 537	\$ 526	\$ 11	2%
Other expense (income)—net	—	(11)	11	nm	2	(6)	8	nm
Total other expense—net	\$ 187	\$ 164	\$ 23	14%	\$ 539	\$ 520	\$ 19	4%

nm—not meaningful

*Interest expense—net.* Interest expense—net, was \$187 million and \$175 million for the three months ended September 30, 2003 and 2002 respectively. Interest expense—net, was \$537 million and \$526 million for the nine months ended September 30, 2003 and 2002 respectively. The increase in expense was the result of a decrease in the amount of interest that was capitalized for the nine months ended September 30, 2003. This decrease in capitalized interest was due primarily to a decrease in network buildout for the nine months ended September 30, 2003 as compared to the same period ended 2002.

*Other expense (income)—net.* Other expense (income)—net was \$0 for the three months ended September 30, 2003 compared to (\$11) million for the same period ended September 30 2002. Other expense (income)—net was \$2 million for the nine months ended September 30, 2003 compared to \$(6) million the same period ended September 30, 2002. These increases were primarily the result of an increase in abandoned projects in 2003.

## Income Tax Expense

The effective income tax rate is the provision for income taxes as a percentage of pre-tax income. Our effective income tax rate has remained relatively flat for all comparative periods.

## Liquidity and Capital Resources

We are a wholly owned subsidiary of QSC, which is wholly owned by QCII. As such, factors relating to or affecting QCII's liquidity and capital resources could have material impacts on us, including changes in the market's perception of us and impacts on our credit ratings.

## Financial Position

QCII has cash management arrangements between certain of its subsidiaries that includes lines of credit, intercompany obligations, capital contributions and dividends. As part of these cash management arrangements, affiliates provide lines of credit to certain other affiliates. Amounts outstanding under these lines of credit and intercompany obligations vary from time to time and are classified as short-term borrowings.

Our working capital deficit, or current assets less current liabilities, was \$1.8 billion and \$3.8 billion as of September 30, 2003 and December 2002, respectively. Our current working capital deficit is primarily due to borrowings from affiliates, by our wholly owned subsidiary, Qwest Wireless, amounting to \$2.079 billion as of September 30, 2003. These borrowings mature on January 15, 2005. We expect that the maturities of these borrowings will be extended by our affiliates as necessary.



The improvement of \$2.0 billion in working capital deficit during 2003 was due to a combination of an increase in cash and cash equivalents, our decision to reduce capital expenditures and our refinancing of current borrowings with long-term debt. The increase in cash was primarily due to a \$1.75 billion senior term loan that we entered into in June of 2003, of which a significant portion was used to refinance our short-term borrowings to long-term.

As of September 30, 2003 and December 31, 2002, our consolidated debt was approximately \$9.8 billion and \$9.2 billion, respectively, including borrowings from affiliates. In addition, our unrestricted cash balances were approximately \$1.4 billion and \$232 million, as of the same dates. We expect to use our cash primarily to invest in telecommunications assets, redeem indebtedness and pay dividends to QSC. To preserve capital and maintain liquidity, we invest with financial institutions deemed to be of sound financial condition and in high quality and relatively risk-free investment products. Our cash investment policy limits the concentration of investments with specific financial institutions or among certain products and includes criteria related to credit worthiness of any particular investment. Recently we have taken the following measures to improve our near-term liquidity and our capital structure and generally reduce financial risk:

- reduced capital investment and continued to manage working capital; and
- refinanced (in June 2003) our debt due in 2003 with debt that has maturities in 2007 and 2010.

We believe that cash flows from operations, our current cash position and continued access to capital markets will allow us to meet our business requirements, including debt service, dividends and capital expenditures for the foreseeable future.

*Operating activities.* We generated cash from operating activities of \$3.698 billion and \$3.456 billion, for the nine months ended September 30, 2003 and September 30, 2002, respectively.

The \$242 million increase in cash provided by operating activities for the nine months ended September 30, 2003 as compared to the same period in 2002 was primarily the result of cash management improvements of approximately \$600 million offset by reduced cash flows related to a \$499 million decrease in revenues. The cash management improvements between these periods were primarily a result of increases in collections of revenues and reductions in cash outlays for operating expenses, offset by increased cash payments for prepaid taxes. Revenue decreased as a result of access line losses, pricing declines and a reduction in access services revenue.

*Investing activities.* Cash used in investing activities decreased \$187 million to \$1.231 billion for the nine months ended September 30, 2003, from \$1.418 billion, for the nine months ended September 30, 2002. The decrease was primarily due to a decrease in capital expenditures of \$226 million. This decrease in capital expenditures was the result of our decision to reduce our expansion efforts as a result of the general economic downturn and the completion of many of our major capital projects. Given our current business environment, as discussed in Item 1 of our 2002 Form 10-K, we expect to continue at a reduced level for the foreseeable future. We believe that our current level of capital expenditures will sustain our business at existing levels and support our anticipated core growth requirements in areas such as in our DSL product.

Capital expenditures for the nine months ended September 30, 2003 and 2002 were \$1.199 billion and \$1.425 billion, respectively.

*Financing activities.* Cash used for financing activities was \$1.291 billion through September 30, 2003 and \$1.993 billion for the same period ended 2002. At September 30, 2003, we were in compliance with all provisions and covenants of our borrowings. Some of QSC's loan documents contain financial reporting covenants that require delivery of our annual and quarterly periodic reports. A waiver has been obtained for non-compliance to provide certain annual and quarterly financial

information to the lenders. The waiver extended the compliance date to provide the financial information to January 31, 2004.

### **Financing Activities for the Nine Months Ended September 30, 2003**

On June 9, 2003, we entered into a senior term loan with two tranches for a total of \$1.75 billion principal amount of indebtedness. The term loan consists of a \$1.25 billion floating rate tranche, due in 2007, and a \$500 million fixed rate tranche, due in 2010. The term loan is unsecured and ranks equally with all of our current indebtedness. The floating rate tranche cannot be prepaid for two years and thereafter is subject to prepayment premiums through 2006. There are no mandatory prepayment requirements. The covenant and default terms are substantially the same as those associated with our other long-term debt. The net proceeds were used to refinance debt due in 2003 and fund or refinance our investment in telecommunications assets.

The floating rate tranche bears interest at London Interbank Offered Rates plus 4.75% (with a minimum interest rate of 6.50%) and the fixed rate tranche bears interest at 6.95% per annum. The interest rate on the floating rate tranche was 6.50% at September 30, 2003. The lenders funded the entire principal amount of the loan subject to the original issue discount for the floating rate tranche of 1.00% and for the fixed rate tranche of 1.652%.

Affiliate borrowings of our wholly owned subsidiary, Qwest Wireless, in the form of short-term unsecured lines of credit, were \$2.079 billion and \$1.888 billion at September 30, 2003 and December 31, 2002, respectively. These affiliate borrowings fluctuate based on operating needs of Qwest Wireless and mature on January 15, 2005.

Our dividends during 2003 were \$1.930 billion, which were paid to QSC, our parent.

### **Recent Developments Impacting Liquidity and Capital Resources**

For the nine months ended September 30, 2003 we have declared regular dividends amounting to \$1.034 billion. In addition, in August and November of 2003, we declared and paid dividends in the amount of \$360 million and \$719 million, respectively, relating to net income from prior periods that had not been declared or paid as dividends in those periods. We plan to declare and make additional dividend payments in the future until all net income from wireline entities from prior periods has been declared and remitted as dividends. We estimate that the incremental amount (in addition to the \$1.079 billion declared in 2003) of such dividends will be approximately \$1.3 billion.

On December 18, 2003, QCII entered into an agreement to purchase certain telecommunications assets from Allegiance Telecom, Inc. for a purchase price consisting of \$300 million in cash, a convertible promissory note in the amount of \$90 million and the assumption of certain liabilities. The agreement is subject to approval by the U.S. Bankruptcy Court and certain other government regulatory agencies. Allegiance has filed a motion with the Bankruptcy Court to begin a sale process in which QCII will be designated as the stalking horse bidder and other interested potential bidders will have an opportunity to offer higher bids for the assets of Allegiance. If QCII is successful in the bidding process, it expects to consummate the transaction sometime in 2004. In that event, it is likely that some portion of the Allegiance assets will be transferred to or purchased by us, although we have not yet determined the amount or the price we would pay for them.

### **Risk Management**

We are exposed to market risks arising from changes in interest rates. The objective of our interest rate risk management program is to manage the level and volatility of our interest expense. We may employ derivative financial instruments to manage our interest rate risk exposure. We may also employ financial derivatives to hedge foreign currency exposures associated with particular debt.

As of September 30, 2003 and December 31, 2002, approximately \$1.25 billion and \$0, respectively, of floating rate debt was exposed to changes in interest rates. This exposure is linked to LIBOR after LIBOR equals 1.75%. A hypothetical increase of one percentage point in LIBOR rates would increase annual pre-tax interest expense by \$12.5 million. As of September 30, 2003 and December 31, 2002, we also had \$0 and \$1.2 billion, respectively, of long-term fixed rate debt obligations maturing in the following twelve months. Any new debt obtained to refinance this debt would be exposed to changes in interest rates. A hypothetical 10% change in the interest rates on this debt would not have had a material effect on our earnings. We had \$6.6 billion and \$6.1 billion of long-term fixed-rate debt at September 30, 2003 and December 31, 2002, respectively. A 100 basis point increase in the interest rates on this debt would result in a decrease in the fair value of these instruments of approximately \$400 million and \$300 million at September 30, 2003 and December 31, 2002, respectively. A 100 basis point decrease in the interest rates on this debt would result in an increase in the fair value of these instruments of approximately \$500 million and \$400 million as of September 30, 2003 and December 31, 2002, respectively.

As of September 30, 2003, we had \$1.408 billion of cash invested in money market and other short-term investments. Most cash investments are invested at floating rates. As interest rates change, so will the interest income derived from these accounts.

## SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Form 10-Q/A contains or incorporates by reference "forward-looking statements," as that term is used in federal securities laws, about our financial condition, results of operations and business. These statements include, among others:

- statements concerning the benefits that we expect will result from our business activities and certain transactions we have completed, such as increased revenues, decreased expenses and avoided expenses and expenditures; and
- statements of our expectations, beliefs, future plans and strategies, anticipated developments and other matters that are not historical facts.

These statements may be made expressly in this document or may be incorporated by reference to other documents we will file with the Securities and Exchange Commission, or SEC. You can find many of these statements by looking for words such as "believes," "expects," "anticipates," "estimates," or similar expressions used in this report or incorporated by reference in this report.

These forward-looking statements are subject to numerous assumptions, risks and uncertainties that may cause our actual results to be materially different from any future results expressed or implied by us in those statements. Some of these risks are described below under "Risk Factors". These risk factors should be considered in connection with any subsequent written or oral forward-looking statements that we or persons acting on our behalf may issue. We do not undertake any obligation to review or confirm analysts' expectations or estimates or to release publicly any revisions to any forward-looking statements to reflect events or circumstances after the date of this report or to reflect the occurrence of unanticipated events. Further, the information contained in this document is a statement of our intention as of the date of this filing and is based upon, among other things, the existing regulatory environment, industry conditions, market conditions and prices, the economy in general and our assumptions as of such date. We may change our intentions, at any time and without notice, based upon any changes in such factors, in our assumptions or otherwise.

## RISK FACTORS

### Risks Affecting Our Business

#### *Continued downturn in the economy in our local service area could affect our operating results.*

Our operations in our local service area of Arizona, Colorado, Idaho, Iowa, Minnesota, Montana, Nebraska, New Mexico, North Dakota, Oregon, South Dakota, Utah, Washington and Wyoming have been impacted by the continuing weakness in that region's economy. Because customers have less discretionary income, demand for second lines or additional services has declined. This economic downturn in our local service area has also led to an increased customer disconnection rate. In addition, several of the companies with which we do business appear to be in financial difficulty or have filed for bankruptcy protection. Some of these have requested renegotiation of long-term agreements with us because of their financial circumstances and because they believe the terms of these agreements are no longer appropriate for their needs. Our revenue has been and is likely to continue to be adversely affected by the loss or reduction of business with many of our customers as a result of this downturn and our continued efforts to accommodate our customers' needs in this changing business environment.

We believe that our local service area's economy lagged the national economy in entering the downturn and may follow the national economy in recovery by an indeterminate period. This continued economic slowdown will affect demand for our products and services within our local service area.

#### *We face pressure on profit margins as a result of increasing competition, including product substitution, which could adversely affect our operating results and financial performance.*

We compete in a rapidly evolving and highly competitive market, and we expect competition to intensify. We have faced greater competition in our core local business from cable companies, wireless providers (including ourselves), facilities-based providers using their own networks as well as those leasing parts of our network (unbundled network elements) and resellers. Regulatory developments have generally increased competitive pressures on our business, such as the recent decision allowing for number portability from wireline to wireless phones.

One of the primary reasons we continue to experience loss of access lines is the intense competition from cable and wireless providers offering a substitute for our traditional voice and data services. We are implementing new strategies for enhancing our video and wireless offerings. However, it will be difficult to effectively execute our strategy in the face of increasing competition. For example, our recently announced wireless strategy of reselling Sprint wireless services to our customers is untested. We may not be able to effectively integrate Sprint's services into our product offerings and it may require greater resources than we anticipate to operate as a wireless reseller. Also, while we recently entered into strategic marketing arrangements with Echostar and DIRECTV to bundle their satellite television products and services with our traditional telecommunications, data and Internet offerings, our video offering remains limited to select markets in our local service area. If we are unable to effectively implement our strategy for improving video and wireless solutions, both our wireless and our traditional telephone businesses may be adversely affected.

We have also begun to experience and expect further increased competitive pressure from telecommunications providers either emerging from bankruptcy protection or reorganizing their capital structure to more effectively compete against us. As a result of these increased competitive pressures, we have been and may continue to be forced to respond with lower profit margin product offerings and pricing schemes that allow us to retain and attract customers. These pressures could adversely affect our operating results and financial performance.

***Rapid changes in technology and markets could require substantial expenditure of financial and other resources in excess of contemplated levels, and any inability to respond to those changes could reduce our market share.***

The telecommunications industry is experiencing significant technological changes, and our ability to execute on our business plans and compete depends upon our ability to develop new products and accelerate the deployment of advanced new services, such as broadband data, wireless and video services and Voice over Internet Protocol, services. The development and deployment of new products could require substantial expenditure of financial and other resources in excess of contemplated levels. If we are not able to develop new products to keep pace with technological advances, or if such products are not widely accepted by customers, our ability to compete could be adversely affected and our market share could decline. Any inability to keep up with changes in technology and markets could also adversely affect the trading price of our securities and our ability to service our debt.

***If we are not able to stem the loss of our access lines or grow other areas of our business to compensate for these losses, our revenue will continue to decline.***

Our revenue decline over the past few years is largely attributable to our continued loss of access lines, which is a result of increased competition and technology substitution (such as wireless and cable substitution for wireline telephony). We are seeking to improve our competitive position through product bundling and other sales and marketing initiatives. However, we may not be successful in these efforts. If we are not successful and our revenue declines materially without corresponding cost reductions, this will cause a material deterioration to our results of operations and financial condition and adversely affect our ability to service debt and pay other obligations.

### **Risks Relating to Legal and Regulatory Matters**

***Any adverse outcome of investigations of QCII currently being conducted by the SEC and the U.S. Attorney's Office or the assessment being undertaken by the General Services Administration, or GSA, could have a material adverse impact on us, on the trading price for our debt and on our ability to access the capital markets.***

On April 3, 2002, the SEC issued an order of investigation that made formal an informal investigation of QCII initiated on March 8, 2002. QCII is continuing in its efforts to cooperate fully with the SEC in its investigation. The investigation includes, without limitation, inquiry into several specifically identified QCII accounting practices and transactions and related disclosures that are the subject of the various adjustments and restatements described in the QCII 2002 Form 10-K. The investigation also includes inquiry into disclosure and other issues related to transactions between QCII and certain of its vendors and certain investments in the securities of those vendors by individuals associated with QCII.

On July 9, 2002, QCII was informed by the U.S. Attorney's Office for the District of Colorado of a criminal investigation of QCII. QCII believes the U.S. Attorney's Office is investigating various matters that include the subjects of the investigation by the SEC.

While QCII is continuing in its efforts to cooperate fully with the SEC and the U.S. Attorney's Office in each of their respective investigations, QCII cannot predict the outcome of those investigations. QCII has engaged in discussions with the SEC staff in an effort to resolve the issues raised in the SEC's investigation of it. Such discussions are preliminary and QCII cannot predict the likelihood of whether those discussions will result in a settlement and, if so, the terms of such settlement. However, settlements typically involve, among other things, the SEC making claims under the federal securities laws in a complaint filed in United States District Court that, for purposes of the settlement, the defendant neither admits nor denies. Were such a settlement to occur, QCII would expect such claims to address many of the accounting practices and transactions and related disclosures that are the subject of the various restatements QCII has made as well as additional transactions. In

addition, any settlement with the SEC may also involve, among other things, the imposition of a civil penalty, the amount of which could be material, and the entry of a court order that would require, among other things, that QCII and its officers and directors comply with provisions of the federal securities laws as to which there have been allegations of prior violations.

In addition, as previously reported, the SEC has conducted an investigation concerning QCII's earnings release for the fourth quarter and full year 2000 issued on January 24, 2001. The release provided pro forma normalized earnings information that excluded certain nonrecurring expense and income items resulting primarily from QCII's merger with U S WEST. On November 21, 2001, the SEC staff informed QCII of its intent to recommend that the SEC authorize an action against QCII that would allege it should have included in the earnings release a statement of its earnings in accordance with GAAP. As of January 13, 2004 (the date of the original filing of this Form 10-Q), no action had been taken by the SEC. However, QCII expects that if its current discussions with the staff of the SEC result in a settlement, such settlement would include allegations concerning the January 24, 2001 earnings release.

Also, the GSA is conducting a review of all contracts with QCII for purposes of determining present responsibility. On September 12, 2003, we were informed that the Inspector General of the GSA had referred to the GSA Suspension/Debarment Official the question of whether QCII (including us and its other subsidiaries) should be considered for debarment. QCII is cooperating fully with the GSA and believes that it and we will remain suppliers of the government; however, if it and we are not allowed to be suppliers to the government, it and we would lose the ability to expand the services we could provide to a purchaser of telecommunications services that has historically represented between 2% and 3% of QCII's consolidated annual revenue.

An adverse outcome with respect to one or more of the SEC investigations, the U.S. Attorney's Office investigation or the GSA evaluation could have material and significant adverse impact upon us.

***Major lawsuits have been brought against QCII involving its accounting practices and other matters. The outcomes of these lawsuits and other lawsuits affecting us may have a material adverse effect on our business, financial condition and operating results.***

Several lawsuits have been filed against QCII as well as certain of QCII's past and present officers and directors. These lawsuits include putative class action lawsuits in which the plaintiffs allege numerous violations of securities laws. In one of these actions, lead counsel for the plaintiffs has indicated that plaintiffs will seek damages in the billions of dollars. For a description of these legal actions, please see Note 7—Commitments and Contingencies to our condensed consolidated financial statements in Item 1 of this report.

The consolidated securities action, the consolidated ERISA action and the California State Teachers' Retirement System, State of New Jersey (Treasury Department, Division of Investment) and State Universities Retirement System of Illinois actions described in Note 7—Commitments and Contingencies to our condensed consolidated financial statements in Item 1 of this report present material and significant risk to QCII. Some of the allegations in these lawsuits include many of the same subjects that the SEC and U.S. Attorney's Office are investigating. Moreover, the size, scope and nature of QCII's recent restatements of its financial statements for fiscal 2001 and 2000 affect the risk presented by these investigations and actions, as these matters involve, among other things, QCII's prior accounting practices and related disclosures. Plaintiffs in certain of the securities actions have alleged QCII's restatement of items in support of their claims. While QCII intends to defend against these matters vigorously, the ultimate outcomes of these cases are very uncertain, and QCII can give no assurance as to the impacts on its financial results or financial condition as a result of these matters. Each of these cases is in a preliminary phase. None of the plaintiffs or the defendants has advanced evidence concerning possible recoverable damages, and QCII has not yet conducted discovery on these and other relevant issues. QCII has disclosed that it is unable to estimate reasonably

a range of loss that it would incur if the plaintiffs in one or more of these lawsuits were to prevail. QCII has engaged in discussions for the purpose of resolving these matters and continues to evaluate any possible range of loss. Any settlement of or judgment on one or more of these claims could be material, and QCII cannot give any assurance that it would have the resources available to pay such judgments. Also, in the event of an adverse outcome of one or more of these matters, QCII's ability to meet its debt service obligations and its financial condition could be materially and adversely affected. As a wholly owned subsidiary of QCII, our business operations and financial condition would be similarly affected.

Further, given the size and nature of QCII's and our business, QCII and we are subject from time to time to various other lawsuits which, depending on their outcome, may have a material adverse effect on our financial position. Thus, we can give no assurances as to the impacts on our financial results or financial condition as a result of these matters.

***Increased scrutiny of financial disclosure, particularly in the telecommunications industry in which we operate, could reduce investor confidence and affect our business opportunities, and any restatement of our earnings as stated in this filing could limit our ability to access the capital markets and could increase litigation risks.***

As a result of our and QCII's accounting issues and the increased scrutiny of financial disclosure, investor confidence in us has suffered and could suffer further. Congress, the SEC, other government authorities and the media are intensely scrutinizing a number of financial reporting issues and practices.

In addition to the SEC investigation discussed earlier, QCII has reported that the SEC has investigated QCII's earnings release for the fourth quarter and full year 2000 and that the staff of the SEC has decided to recommend an action against QCII alleging that it should also have included in the earnings release a statement of its GAAP earnings. Although all businesses face uncertainty with respect to how the U.S. financial disclosure regime may impact their financial statements, particular attention has been focused recently on the telecommunications industry. Congressional hearings held in 2002, for example, related to the telecommunications industry practice of accounting for indefeasible rights of use, or IRUs, as well as the appropriateness and consistency of pro forma financial information disclosure. Some of our former and current officers and directors have testified at these hearings concerning IRUs and other matters.

The existence of this heightened scrutiny and these pending investigations could adversely affect investor confidence and cause the trading price for our securities to decline.

***We operate in a highly regulated industry, and are therefore exposed to restrictions on our manner of doing business and a variety of claims relating to such regulation.***

Our operations are subject to extensive federal regulation, including the Communications Act of 1934, as amended, and Federal Communications Commission, or FCC, regulations thereunder. We are also subject to the applicable laws and regulations of various states, including regulation by Public Utility Commissions and other state agencies. Federal laws and FCC regulations apply to interstate telecommunications (including international telecommunications that originate or terminate in the United States), while state regulatory authorities have jurisdiction over telecommunications that originate and terminate within the same state. Generally, we must obtain and maintain certificates of authority from regulatory bodies in most states where we offer intrastate services and must obtain prior regulatory approval of tariffs for our intrastate services in most of these jurisdictions. Our business is subject to numerous, and often quite detailed, requirements under federal, state and local laws, rules and regulations. Accordingly, we cannot ensure that we are always in compliance with all of these requirements at any single point in time.

Regulation of the telecommunications industry is changing rapidly, and the regulatory environment varies substantially from state to state. All of our operations are also subject to a variety of environmental, safety, health and other governmental regulations. There can be no assurance that



future regulatory, judicial or legislative activities will not have a material adverse effect on our operations, or that domestic or international regulators or third parties will not raise material issues with regard to our compliance or noncompliance with applicable regulations.

We monitor our compliance with federal, state and local regulations governing the discharge and disposal of hazardous and environmentally sensitive materials, including the emission of electromagnetic radiation. Although we believe that we are in compliance with such regulations, any such discharge, disposal or emission might expose us to claims or actions that could have a material adverse effect on our business, financial condition and operating results.

### **Risks Affecting Our Liquidity**

***QCII's high debt levels and the restrictive terms of their debt instruments pose risks to our viability and may make us more vulnerable to adverse economic and competitive conditions, as well as other adverse developments.***

Our ultimate parent, QCII, is highly leveraged on a consolidated basis. As of September 30, 2003, our consolidated debt was \$9.8 billion which is included in QCII's total consolidated debt of \$21.3 billion. A significant amount of our and QCII's debt obligations come due over the next few years. While we currently believe we, together with QCII, will have the financial resources and access to capital markets to meet our obligations when they come due, we cannot anticipate what our or QCII's future condition will be. We may have unexpected costs and liabilities and we may have limited access to financing.

We will likely need to obtain additional financing to meet our debt service and dividend obligations if our and QCII's operations do not improve, if revenue and operating cash flow declines are worse than expected, if economic conditions do not improve or if we or QCII become subject to significant judgments and/or settlements in connection with the resolution of one or more matters described in Note 7—Commitments and Contingencies to our condensed consolidated financial statements in Item 1 of this report. Also, we may be impacted by factors relating to or affecting QCII's liquidity and capital resources due to perception in the market, impacts on credit ratings or provisions in our and QCII's financing agreements that may restrict our flexibility under certain conditions.

Additionally, the degree to which we, together with QCII are leveraged may have important limiting consequences on us, including the following:

- our ability to obtain additional financing in the future for working capital, capital expenditures or general corporate purposes may be impaired;
- we may be placed at a competitive disadvantage as compared with our less leveraged competitors, including some who have significantly reduced their debt through a bankruptcy proceeding;
- we may be more vulnerable to the current or future downturns in general economic conditions or in any of our businesses;
- our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate may be limited; and
- QCII's high debt levels could adversely impact our credit ratings.

***We may be unable to significantly reduce the substantial capital requirements or operating expenses necessary to continue to operate our business, which may in turn affect our operating results.***

We anticipate that our capital requirements relating to maintaining and routinely upgrading our network will continue to be significant in the coming years. We also may be unable to significantly reduce the operating expenses associated with our future contractual cash obligations, including future purchase commitments, which may in turn affect our operating results. While we believe that our

current level of capital expenditures will meet both our maintenance and our core growth, if circumstances underlying our expectations change, we may be unable to further significantly reduce such capital requirements or operating expenses, even if revenue is decreasing. Such nondiscretionary capital outlays may lessen our ability to compete with other providers who face less significant spending requirements.

***The cash needs of our affiliated companies consume a significant amount of the cash we generate.***

Our current practice is to distribute to QSC cash dividends in an amount equal to our net income from wireline entities, generally during the same period in which the net income is earned. We expect to continue this practice for the foreseeable future.

***The debt agreements of QCII and Qwest will allow each to incur significantly more debt, which could exacerbate the other risks described herein.***

The terms of QCII's and our debt instruments permit both QCII and us to incur additional indebtedness. Such debt may be necessary to comply with regulatory obligations to maintain QCII's or our assets, to satisfy regulatory service obligations, to adequately respond to competition or for financial reasons alone. Incremental borrowings or borrowings at maturities that impose additional financial risks to our various efforts to improve our financial condition and results of operations could exacerbate the other risks described herein.

#### **Other Risks Affecting Qwest**

***If conditions or assumptions differ from the judgments, assumptions or estimates used in our critical accounting policies, the accuracy of our financial statements and related disclosures could be affected.***

The preparation of financial statements and related disclosures in conformity with GAAP requires management to make judgments, assumptions and estimates that affect the amounts reported in our consolidated financial statements and accompanying notes. Our critical accounting policies, which are described in our 2002 Form 10-K, describe the significant accounting policies and methods used in the preparation of our condensed consolidated financial statements. These accounting policies are considered "critical" because they require judgments, assumptions and estimates that materially impact our consolidated financial statements and related disclosures. As a result, if future events differ significantly from the judgments, assumptions and estimates in our critical accounting policies or different assumptions are used in the future, such events or assumptions could have a material impact on our consolidated financial statements and related disclosures.

***If we fail to extend or renegotiate our collective bargaining contracts with our labor unions as they expire from time to time, or if our unionized employees were to engage in a strike or other work stoppage, our business and operating results could be materially harmed.***

We are a party to collective bargaining contracts with our labor unions, which represent a significant number of our employees. Although we believe that our relations with our employees are satisfactory, no assurance can be given that we will be able to successfully extend or renegotiate our collective bargaining agreements as they expire from time to time. If we fail to extend or renegotiate our collective bargaining agreements, if disputes with our unions arise, or if our unionized workers engage in a strike or other work stoppage, we could incur higher ongoing labor costs or experience a significant disruption of operations, which could have a material adverse effect on our business. We recently reached agreements with the Communications Workers of America and the International Brotherhood of Electrical Workers on new two-year labor contracts. Each of these agreements was ratified by union members, went into effect on August 17, 2003 and expires on August 13, 2005.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information under the caption of "Risk Management" in "Management's Discussion and Analysis of Financial Condition and Results of Operations" is incorporated herein by reference.

### ITEM 4. CONTROLS AND PROCEDURES

The effectiveness of our or any system of disclosure controls and procedures is subject to certain limitations, including the exercise of judgment in designing, implementing and evaluating the controls and procedures, the assumptions used in identifying the likelihood of future events and the inability to eliminate misconduct completely. As a result, there can be no assurance that our disclosure controls and procedures will detect all errors or fraud.

As reported more fully in our 2002 Form 10-K/A, we learned during 2002 of certain deficiencies in our internal controls related to each of the following:

- the structure and design of certain financial information and reporting processes;
- the design of policies and execution of processes related to accounting for operating activities;
- inadequate or ineffective policies for complex transactions and certain other matters; and
- our internal control environment (which had been corrected by December 31, 2002).

As reported in our 2002 Form 10-K/A, we have taken, during the second half of 2002 and the first half of 2003, many measures to improve the effectiveness of our internal controls. Though it may take some time to realize all of the benefits from the measures we have taken, we believe that our internal controls are improving and that there is no reason to believe that the financial statements included in this report are not fairly stated in all material respects.

We completed on October 16, 2003, an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2003. Based on that evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that these procedures and controls were effective at September 30, 2003. There were no changes in the Company's internal control over financial reporting that occurred in the third quarter of 2003 that materially affected, or were reasonably likely to materially affect, its internal control over financial reporting.

## PART II—OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

The information set forth above under Note 7—Commitments and Contingencies contained in the "Notes to Condensed Consolidated Financial Statements" included in this Quarterly Report on Form 10-Q/A is hereby incorporated by reference.

### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

- (a) Exhibits filed for Qwest through the filing of this Form 10-Q/A:

Exhibits identified in parentheses below are on file with the SEC and are incorporated herein by reference. All other exhibits are provided as part of this electronic submission.

Exhibit Number	Description
(3.1)	Restated Articles of Incorporation of Qwest (incorporated by reference to Qwest's Annual Report on Form 10-K for the year ended December 31, 1997, File No. 1-3040).
(3.2)	Articles of Amendment to the Articles of Incorporation of Qwest (incorporated by reference to Qwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 2000).
(3.3)	Amended and Restated Bylaws of Qwest (incorporated by reference to Qwest's Annual Report on Form 10-K for the year ended December 31, 2002, File No. 1-3040).
(4.1)	No instrument which defines the rights of holders of Qwest's long and intermediate term debt is filed herewith pursuant to Regulation S-K, Item 601(b)(4)(iii)(A). Pursuant to this regulation, Qwest hereby agrees to furnish a copy of any such instrument to the SEC upon request.
(4.2)	Indenture, dated as of April 15, 1990, by and between Mountain States Telephone and Telegraph Company and The First National Bank of Chicago (incorporated by reference to Qwest's Annual Report on Form 10-K for the year ended December 31, 2002, File No. 1-3040).
(4.3)	First Supplemental Indenture, dated as of April 16, 1991, by and between US WEST Communications, Inc. and The First National Bank of Chicago (incorporated by reference to Qwest's Annual Report on Form 10-K for the year ended December 31, 2002, File No. 1-3040).
(4.4)	Indenture, dated as of October 15, 1999, by and between U S WEST Communications, Inc. and Bank One Trust Company, NA, as Trustee (incorporated by reference to Qwest's Annual Report on Form 10-K for the year ended December 31, 1999, File No. 1-3040).
(10.1)	Purchase Agreement, dated as of June 5, 2000, among U S WEST Communications, Inc. and Lehman Brothers Inc., Merrill Lynch & Co., Merrill Lynch, Pierce, Fenner & Smith Incorporated, Banc of America Securities LLC, and J.P. Morgan Securities Inc., as Representatives of the Initial Purchasers listed therein (incorporated by reference to Qwest's Form S-4 filed on October 11, 2000).

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- (10.2) Term Loan Agreement, dated as of June 9, 2003, by and among Qwest, the Lenders listed therein, and Merrill Lynch & Co., Merrill Lynch, Pierce, Fenner & Smith Incorporated, as sole book-runner, joint lead arranger and syndication agent, and Credit Suisse First Boston, acting through its Cayman Islands branch as joint lead arranger and administrative agent, and Deutsche Bank Trust Company Americas, as documentation agent and Deutsche Bank Securities, Inc. as arranger. (incorporated by reference to Qwest's Current Report on Form 8-K, dated June 10, 2003, File No. 1-15577).

- (10.3) Private Label PCS Services Agreement between Sprint Spectrum L.P. and Qwest Wireless LLC dated August 3, 2003 (incorporated by reference to Qwest Communications International Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2004).†
- 31.1 Chief Executive Officer Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Chief Financial Officer Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
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( ) Previously filed.

† Application has been made to the Securities and Exchange Commission to seek confidential treatment of certain provisions. Omitted material for which confidential treatment has been requested has been filed separately with the Commission.

(b) Reports on Form 8-K:

We did not file any reports on Form 8-K during the third quarter of 2003.

## SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Qwest Corporation

By: /s/ OREN G. SHAFFER

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Oren G. Shaffer  
*Vice Chairman and Chief Financial Officer*  
*(Duly Authorized Officer and Principal Financial Officer)*

November 12, 2004



**CERTIFICATION OF CHIEF EXECUTIVE OFFICER**

I, Richard C. Notebaert, certify that:

1. I have reviewed this quarterly report on Form 10-Q/A of Qwest Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 12, 2004

/s/ RICHARD C. NOTEBAERT

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Richard C. Notebaert  
Chairman, Chief Executive Officer and President

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Exhibit 31.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

**CERTIFICATION OF CHIEF FINANCIAL OFFICER**

I, Oren G. Shaffer, certify that:

1. I have reviewed this quarterly report on Form 10-Q/A of Qwest Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 12, 2004

/s/ OREN G. SHAFFER

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Oren G. Shaffer  
Vice Chairman and Chief Financial Officer

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Exhibit 31.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER

Each of the undersigned hereby certifies, for the purposes of section 1350 of chapter 63 of title 18 of the United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, in his capacity as an officer of Qwest Corporation ("Qwest"), that, to his knowledge, the Quarterly Report of Qwest on Form 10-Q/A for the quarter ended September 30, 2003, fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and that the information contained in such report fairly presents, in all material respects, the financial condition and results of operation of Qwest. This written statement is being furnished to the Securities and Exchange Commission as an exhibit to such Form 10-Q/A. A signed original of this statement has been provided to Qwest and will be retained by Qwest and furnished to the Securities and Exchange Commission or its staff upon request.

By: /s/ RICHARD C. NOTEBAERT

Dated: November 12, 2004

By: /s/ OREN G. SHAFFER

Oren G. Shaffer  
Vice Chairman and Chief Financial Officer

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Exhibit 32

CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER CERTIFICATION