

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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

**For the quarterly period ended March 31, 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 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.

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**QWEST CORPORATION**  
**FORM 10-Q**

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**PART I—FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**QWEST CORPORATION**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(DOLLARS IN MILLIONS)**  
**(UNAUDITED)**

	Three Months Ended March 31,	
	2003	2002
		(As restated, see Note 2)
Operating revenues	\$ 2,742	\$ 2,972
Operating revenues—affiliates	134	96
Total operating revenues	2,876	3,068

Operating expenses:		
Cost of sales (exclusive of depreciation and amortization detailed below)	596	606
Cost of sales—affiliates	92	114
Selling, general and administrative	504	571
Selling, general and administrative—affiliates	302	290
Depreciation	613	695
Intangible assets amortization	85	64
Restructuring, Merger-related and other charges (credits)	12	(30)
	<hr/>	<hr/>
Total operating expenses	2,204	2,310
	<hr/>	<hr/>
Operating income	672	758
	<hr/>	<hr/>
Other expense (income):		
Interest expense—net	137	120
Interest expense—net—affiliates	36	45
Other expense (income)—net	8	(8)
	<hr/>	<hr/>
Total other expense—net	181	157
	<hr/>	<hr/>
Income before income taxes and cumulative effect of change in accounting principle	491	601
Income tax expense	(187)	(231)
	<hr/>	<hr/>
Income before cumulative effect of change in accounting principle	304	370
	<hr/>	<hr/>
Cumulative effect of change in accounting principle, net of taxes of \$139 and \$0, respectively	219	—
	<hr/>	<hr/>
Net income	\$ 523	\$ 370
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The accompanying notes are an integral part of these condensed consolidated financial statements.

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**QWEST CORPORATION**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**(DOLLARS IN MILLIONS)**

	March 31, 2003	December 31, 2002
	<hr/>	<hr/>
	(unaudited)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 1,299	\$ 232
Restricted cash	10	26
Accounts receivable—net	1,301	1,494
Accounts receivable—affiliates	200	120
Deferred income taxes	120	133
Prepaid and other assets	297	323
Prepaid income taxes—QSC	—	255
	<hr/>	<hr/>
Total current assets	3,227	2,583
	<hr/>	<hr/>
Property, plant and equipment—net	17,379	17,311
Intangible assets—net	1,236	1,275

Other assets	1,356	1,356
Total assets	\$ 23,198	\$ 22,525
<b>LIABILITIES AND STOCKHOLDER'S EQUITY</b>		
Current liabilities:		
Current borrowings	\$ 1,104	\$ 1,255
Current borrowings—affiliates	1,953	1,888
Accounts payable	533	587
Accounts payable—affiliates	446	331
Dividends payable—QSC	1,297	774
Accrued expenses and other current liabilities	1,059	952
Deferred revenue and customer deposits	570	595
Total current liabilities	6,962	6,382
Long-term borrowings (net of unamortized debt discount of \$141 million and \$142 million, respectively—see Note 3)	6,014	6,016
Post-retirement and other post-employment benefit obligations	2,607	2,612
Deferred income taxes	2,390	2,181
Deferred credits and other	767	837
Total liabilities	18,740	18,028
Commitments and contingencies (Note 7)		
Stockholder's equity:		
Common stock—one share without par, owned by QSC	8,361	8,400
Note receivable—affiliate	(286)	(286)
Accumulated deficit	(3,617)	(3,617)
Total stockholder's equity	4,458	4,497
Total liabilities and stockholder's equity	\$ 23,198	\$ 22,525

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)**

	Three Months Ended March 31,	
	2003	2002
		(As restated, see Note 2)
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 523	\$ 370
Adjustments to net income:		
Depreciation and amortization	698	759

Provision for bad debts	62	82
Cumulative effect of change in accounting principle—net	(219)	—
Deferred income taxes	83	141
Income tax benefit distributed to QSC	(39)	—
Other non-cash items	4	2
Changes in operating assets and liabilities:		
Accounts receivable	131	97
Accounts receivable—affiliate	(80)	(43)
Prepaid and other current assets	(5)	63
Prepaid income taxes—QSC	255	(42)
Accounts payable, accrued expenses and other current liabilities	77	(148)
Accounts payable—affiliate	115	23
Deferred revenue and customer deposits	(29)	121
Other long-term assets and liabilities	(57)	(23)
	<hr/>	<hr/>
Cash provided by operating activities	1,519	1,402
	<hr/>	<hr/>
<b>INVESTING ACTIVITIES</b>		
Expenditures for property, plant and equipment	(364)	(628)
Other	12	2
	<hr/>	<hr/>
Cash used for investing activities	(352)	(626)
	<hr/>	<hr/>
<b>FINANCING ACTIVITIES</b>		
Net repayments of current borrowings	—	(978)
Net proceeds from current borrowings—affiliates	65	104
Proceeds from long-term borrowings	—	1,476
Repayments of current portion of long-term borrowings	(165)	(48)
Dividends paid to QSC	—	(627)
Debt issuance costs	—	(35)
	<hr/>	<hr/>
Cash used for financing activities	(100)	(108)
	<hr/>	<hr/>
<b>CASH AND CASH EQUIVALENTS</b>		
Increase in cash	1,067	668
Beginning balance	232	150
	<hr/>	<hr/>
Ending balance	\$ 1,299	\$ 818
	<hr/>	<hr/>

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

## QWEST CORPORATION

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

THREE MONTHS ENDED MARCH 31, 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.

During 2003 and 2002 we performed an internal analysis ("internal analysis") of our previously issued condensed consolidated financial statements for the three months ended March 31, 2002. Our analysis also included our previously issued consolidated financial statements for 2001 and 2000, which are not included in this report. The condensed consolidated financial statements for the three months ended March 31, 2002 have been restated. For further details on the nature of the errors and the related effects on our previously issued condensed consolidated financial statements, see Note 2—Restatement of Results. Where appropriate, we have identified all balances that have been restated with the notation "as restated". Throughout these notes, the term "previously reported" will be used to refer to balances from our previously issued March 31, 2002 condensed consolidated financial statements.

We have revised this presentation to conform to our current annual consolidated financial statement presentation. These statements include all the adjustments necessary to fairly present our condensed consolidated results of operations, financial position and cash flows as of March 31, 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 month period ended March 31, 2003 and the condensed consolidated statement of cash flows for the three month period ended March 31, 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.

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#### *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 those 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 three months ended March 31, 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 three months ended March 31, 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 are more fully described 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

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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:

	<b>Three Months Ended March 31,</b>	
	<b>2003</b>	<b>2002</b>
	<b>(As restated, see Note 2)</b>	
	<b>(Dollars in millions)</b>	
Net income:		
As reported	\$ 523	\$ 370
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 effects	(11)	(13)
Pro forma	\$ 512	\$ 357

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: Restatement of Results**

We have determined that, in certain cases, we misinterpreted or misapplied GAAP in our 2001 and 2000 consolidated financial statements and our condensed consolidated financial statements for the three months ended March 31, 2002. Accordingly, we restated our consolidated financial statements for each of the years in the two year period ended December 31, 2001 and related interim periods, and the condensed consolidated financial statements for the three month period ended March 31, 2002.

As discussed more fully below, the restatements involve, among other matters, revenue recognition issues related to installation fees, Public Utility Commission ("PUC") fine reclassification and transactions with affiliates. In making these restatements, we have performed an internal analysis of our accounting policies, practices, procedures and disclosures for the affected periods.

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### *Summary of restatement items*

The following table sets forth the effects of the restatement adjustments discussed below on revenue; pre-tax income (i.e., income before income taxes and cumulative effect of change in accounting principle); and net income as presented in our condensed consolidated statement of operations for the three month period ended March 31, 2002. The restatement adjustments are discussed in the paragraphs following the table.

	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

### *Installation fees*

In 2001 and 2000, we recognized revenue for certain up-front fees charged to customers in connection with special plant construction or relocation. These fees were recognized as revenue in full at the time the construction or relocation was completed. Under Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" these fees should have been initially deferred and recognized over the estimated life of the customer relationship. In our restated condensed consolidated financial statements, we have increased our previously reported revenue and increased our pre-tax income by \$19 million each for the three months ended March 31, 2002.

### *PUC fine reclassification*

We properly accrued for anticipated amounts due under two state PUC orders for restitution in our previously reported financial statements. When the actual orders were received in February 2003, they included direct credits to customers as well as payments to the state PUCs. As part of the restatement, we reduced both revenue and operating expenses by the amount of these customer credits. As a result, in our restated condensed consolidated financial statements, we have decreased our previously reported revenue by \$12 million for the three months ended March 31, 2002. There is no impact on our previously disclosed net income. This adjustment represents an adjustment for a subsequent event rather than a correction of an error.

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### *Transactions with affiliates*

In 2002, we inaccurately recorded revenue and expenses related to transactions with affiliated companies within the QCII group of companies. These transactions included billings for data processing services, allocations of corporate overhead costs and payments made on behalf of affiliated companies, among other items. In our restated condensed consolidated financial statements, we have increased our previously reported revenue by \$9 million and increased our pre-tax income by \$29 million for the three months ended March 31, 2002.

### *Out-of-period expenses*

We recorded certain charges in 2000 as expenses for contractual sponsorships. We have since determined that we recorded these charges



in the wrong period. As a result, in our restated condensed consolidated financial statements, we have decreased our previously reported pre-tax income by \$54 million for the three months ended March 31, 2002.

#### *Network labor costs*

In 2000, we began capitalizing certain labor costs that were associated with designing, deploying and testing facilities. During our internal analysis, we determined that certain of these costs should have been expensed as incurred. As a result, in our restated condensed consolidated financial statements, we have recorded adjustments to increase operating expenses and decrease property, plant and equipment by \$22 million for the three months ended March 31, 2002.

#### *Settlement charges*

In 2001 and 2000, we made payments to one of our vendors in connection with the termination of certain service contracts. During the same time, we were negotiating new contracts with the vendor's parent company. These payments were recorded as current assets with the understanding that the costs would be recovered under the new contracts with the parent company. When the negotiations with the parent company were terminated in the first quarter of 2002, the \$22 million in payments previously recorded as current assets were charged to expense. During our internal analysis, we determined that we could not conclusively determine that the settlement charges were linked to the new contracts. As a result, in our restated condensed consolidated financial statements we recognized expense as the payments were made in 2001 and 2000, and reversed the previous \$22 million charge to expense during the three months ended March 31, 2002.

#### *Property tax accrual*

Property taxes were under accrued in our previously reported condensed consolidated financial statements for the three months ended March 31, 2002. This error was corrected in the three months ended June 30, 2002. During restatement, we adjusted the expense to the correct period. As a result, we have decreased our previously reported pre-tax income by \$16 million for the three months ended March 31, 2002.

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#### *Balance sheet reconciliations*

During our internal analysis, we were unable to support the balances of certain asset and liability accounts through the reconciliation process that we performed. As a result, in our restated condensed consolidated financial statements, we have recorded adjustments to decrease operating expenses and increase net property, plant and equipment by \$15 million for the three months ended March 31, 2002.

#### *Other*

We increased our previously reported revenue by \$3 million and decreased our pre-tax income by \$29 million for the three months ended March 31, 2002 for other adjustments discovered as a result of our internal analysis. These adjustments have been aggregated in our presentation. The individual adjustments to revenue range from \$2 million to \$7 million individually, and adjustments to pre-tax income range from \$300,000 to \$11 million individually and have an average impact of \$5 million on revenue and \$4 million on pre-tax income.

### **Note 3: Borrowings**

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

	March 31, 2003	December 31, 2002
	(Dollars in millions)	
Current borrowings:		
Current borrowings—affiliates	\$ 1,953	\$ 1,888
Current portion of long-term borrowings	1,038	1,179
Current portion of capital lease obligations and other	66	76
Total current borrowings	\$ 3,057	\$ 3,143
Long-term borrowings:		
Long-term notes	\$ 5,997	\$ 5,995

Long-term capital lease obligations and other

17

21

Total long-term borrowings

\$ 6,014

\$ 6,016

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.

#### *Subsequent Event—Debt-Related Matters*

On June 9, 2003, we completed a senior term loan in two tranches for a total of \$1.75 billion principal amount of debt. 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

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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 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 on 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 three months ended March 31, 2003, we, as part of QCII's restructuring plan, 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 \$10 million to cover the cost of severance benefits pursuant to established severance policies associated with a reduction in the employees. We identified approximately 300 employees from various functional areas to be terminated as part of this reduction. During the three months ended March 31, 2003, none of the planned reductions had been completed and no payments were made related to this restructuring.

Other charges classified as restructuring, primarily severance-related payments not associated with the specific plans, were \$2 million for the three months ended March 31, 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.

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An analysis of activity associated with our 2002 restructuring plan for the three months ended March 31, 2003 is as follows:

January 1,  
2003  
Balance

2003  
Utilization

March 31,  
2003  
Balance

(Dollars in millions)

Severance and employee-related charges	\$ 37	\$ 24	\$ 13
Contractual settlements, legal contingencies and lease losses	23	1	22
	<hr/>	<hr/>	<hr/>
Total	\$ 60	\$ 25	\$ 35
	<hr/>	<hr/>	<hr/>

During 2002, QCII identified approximately 2,400 of our employees from various functional areas to be terminated as part of this reduction. At March 31, 2003, approximately 2,200 of the planned reductions had been accomplished and for the three months ended March 31, 2003, \$24 million of the restructuring reserve had been used for severance payments and enhanced pension benefits. We expect the remaining employee reductions to be essentially completed by December 31, 2003.

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 three months ended March 31, 2003, we utilized \$1 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 three months ended March 31, 2003 is as follows:

	January 1, 2003 Balance	2003 Utilization	March 31, 2003 Balance
	<hr/>	<hr/>	<hr/>
	(Dollars in millions)		
Severance and employee-related charges	\$ 10	\$ —	\$ 10
Contractual settlements, legal contingencies and lease losses	11	7	4
	<hr/>	<hr/>	<hr/>
Total	\$ 21	\$ 7	\$ 14
	<hr/>	<hr/>	<hr/>

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 March 31, 2003, approximately 3,700 employees had been terminated. 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

three months ended, March 31, 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 consolidated 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 (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 revenues and expenses that are eliminated in consolidation by QCII.

Revenue and expenses are based on the types of products and services described below. Network infrastructure is designed to be scalable and flexible to handle multiple products and services. As a result, QCII does not allocate network infrastructure costs to individual products. 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 personal communications services ("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 Corporation ("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. See Note 8—Subsequent Events.

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.

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

	Three Months Ended March 31,	
	2003	2002
	(As restated)	
	(Dollars in millions)	
Operating revenue:		
Wireline services	\$ 2,586	\$ 2,778
Wireless services	151	188
Other services	5	6
	<u>2,742</u>	<u>2,972</u>
Total contribution to QCII segment revenue	\$ 2,742	\$ 2,972
Operating expenses:		
Wireline services	\$ 742	\$ 783

Wireless services	98	159
Other Services	260	235
	<hr/>	<hr/>
Total contribution to QCII segment expenses	\$ 1,100	\$ 1,177
	<hr/>	<hr/>
Contribution to QCII segment income (loss):		
Wireline services	\$ 1,844	\$ 1,995
Wireless services	53	29
Other services	(255)	(229)
	<hr/>	<hr/>
Total contribution to QCII segment income	\$ 1,642	\$ 1,795
	<hr/>	<hr/>
Capital expenditures:		
Wireline	\$ 311	\$ 438
Wireless	11	31
Other	44	176
	<hr/>	<hr/>
Total contribution to QCII capital expenditures	366	645
Non-cash investing activities	(2)	(17)
	<hr/>	<hr/>
Total contribution to QCII cash capital expenditures	\$ 364	\$ 628
	<hr/>	<hr/>

The following table reconciles the segment information to net income for the three months ended March 31, 2003 and 2002:

	Three Months Ended March 31,	
	2003	2002
	<hr/>	<hr/>
	(Dollars in millions)	
Total contribution to QCII segment income	\$ 1,642	\$ 1,795
Add:		
Affiliate revenue	134	96
Cumulative effect of change in accounting principle, net of taxes	219	—
Deduct:		
Affiliate expenses	394	404
Depreciation	613	695
Intangible assets amortization	85	64
Restructuring, Merger-related and other charges (credits)	12	(30)
Total other expense—net	181	157
Income tax provision	187	231
	<hr/>	<hr/>
Net income	\$ 523	\$ 370
	<hr/>	<hr/>

#### 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 on hours worked or charges 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 our affiliates using 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 of our services, include the development of marketing and advertising plans, sales unit forecasts, market research, sales training and compensation plans.

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#### *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 communication services.

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

#### **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

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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 setting forth the penalties described above on May 21, 2003. On June 19, 2003, we appealed the Minnesota Commission's orders to the United States District Court for the District of Minnesota. 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

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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.

On July 23, 2001, we filed a demand for arbitration against Citizens Communications Company ("Citizens") alleging that it breached Agreements for Purchase and Sale of Telephone Exchanges data as of June 16, 1999, between Citizens and U S WEST Communications, Inc. with respect to the purchase and sale of exchanges in Arizona, Colorado, Idaho, Iowa, Minnesota, Montana, Nebraska and Wyoming. The demand for arbitration was filed after Citizens failed to close the exchange sales in violation of the terms of the related purchase agreements. Citizens, in turn, filed a demand for arbitration alleging counter claims against the Company in connection with the sale of those same exchanges, as well as exchanges located in North Dakota that the Company did sell to Citizens. We settled our dispute with Citizens in March 2003 for a net payment to us of \$65,000.

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. At the date of this filing, no action has 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, although QCII cannot predict the outcome of this referral.

#### *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

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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 ("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, revenue, 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 trader 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

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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 revenue 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, revenue 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 revenue and decrease its

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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 disgorgement.

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 cases. 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.

#### *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

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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**

##### **Asset Impairment**

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 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 will be 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.

## **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.

### **Restatement of Results**

This report on Form 10-Q contains our restated condensed consolidated financial statements for the three months ended March 31, 2002. We performed an analysis of our previously issued condensed consolidated financial statements for the three months ended March 31, 2002 and identified a number of errors. Our analysis also included the consolidated financial statements for the years ended December 31, 2001 and 2000 and related interim periods, which periods are not included in this report.

The nature of the errors and the restatement adjustments that we have made to our condensed consolidated financial statements for the three months ended March 31, 2002 are set forth in Note 2—Restatement of Results to our condensed consolidated financial statements in Item 1 of this report.

The net impact of the restatement adjustments includes the following:

	Three Months Ended March 31, 2002
	(Dollars in millions)
Revenue	\$ 19
Income before income taxes and cumulative effect of change in accounting principle	\$ (36)
Net income	\$ (21)

The restatements involve, among other matters, revenue recognition issues related to installation fees, Public Utility Commission, or PUC, fine reclassification and transactions with affiliates. In making these restatements, we have performed an internal analysis of our accounting policies, practices, procedures and disclosures for the affected periods.

## 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.

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.

## 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 revenue 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 revenue 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 revenue 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.

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## **Revenue**

In general, we expect to see a continued decrease in voice-related revenue as a result of a decrease in demand for 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 expand due to access fees charged to our affiliates selling interexchange services in our region. We also expect a corresponding reduction in IntraLATA long-distance revenue from the loss of customers transitioning to these affiliates.

## **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 and 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.

## ***Presentation***

The results for the three months ended March 31, 2002 presented below are "As Restated." Please refer to Note 2—Restatement of Results to our condensed consolidated financial statements in Item 1 of this report. 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, or the QCII 2002 Form 10-K. Our business

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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—Contribution to QCII Segments to our condensed consolidated financial statements in Item 1 of this report.

## Results of Operations

Three Months Ended March 31,				
	2003	2002	Increase/ (Decrease)	%
	(As restated)			
	(Dollars in millions)			
Operating revenue	\$ 2,876	\$ 3,068	\$ (192)	(6)%
Operating expenses:				
Cost of sales (exclusive of depreciation and amortization detailed below)	688	720	(32)	(4)%
Selling, general and administrative	806	861	(55)	(6)%
Depreciation	613	695	(82)	(12)%
Intangible assets amortization	85	64	21	33%
Restructuring, Merger-related and other charges (credits)	12	(30)	42	nm
Operating income	672	758	(86)	(11)%
Other expense (income):				
Interest expense—net	173	165	8	5%
Other expense (income)—net	8	(8)	16	nm
Total other expense—net	181	157	24	15%
Income before income taxes and cumulative effect of change in accounting principle	491	601	(110)	(18)%
Income tax expense	(187)	(231)	44	19%
Income before cumulative effect of change in accounting principle	304	370	(66)	(18)%
Cumulative effect of change in accounting principle, net of taxes	219	—	219	nm
Net income	\$ 523	\$ 370	\$ 153	41%

nm—not meaningful

## Operating Revenue

Three Months Ended March 31,			
2003	2002	Increase/ (Decrease)	%
(As restated)			
(Dollars in millions)			



Voice services	\$ 2,047	\$ 2,221	\$ (174)	(8)%
Data and Internet services	539	557	(18)	(3)%
Wireless	151	188	(37)	(20)%
Other services	5	6	(1)	(17)%
Affiliate services	134	96	38	40%
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total operating revenue	\$ 2,876	\$ 3,068	\$ (192)	(6)%
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

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

#### *Voice Services*

Voice services revenue decreased \$174 million, or 8%, for the three months ended March 31, 2003 as compared to the three months ended March 31, 2002. The voice services revenue decrease was the result of lower local voice services revenue and access services revenue.

For the three months ended March 31, 2003 as compared to the three months ended March 31, 2002, local voice revenue declined \$113 million associated with the loss of approximately 719,000 access lines along with pricing declines driven by competitive pressures. The access line losses were driven by 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 is growth in UNE-P revenue.

We also experienced a revenue decline of \$32 million in access services revenue for the three months ended March 31, 2003 as compared to the same period in 2002. The access services revenue declines were due primarily to the same economic effects described above. Volumes also fell due to general declines in long-distance usage and competitive losses.

In addition to the revenue decreases above, voice services declined \$29 million for the three months ended March 31, 2003 as compared to the same period in 2002 primarily due to declines in IntraLATA long-distance due to intense competition.

#### *Data and Internet Services*

Data and Internet services revenue decreased \$18 million, or 3%, the three months ended March 31, 2003 as compared to the three months ended March 31, 2002. Data services revenue declines are mainly the result of the bankruptcy of large customers, primarily in 2002, such as Touch America, Inc. and MCI and Genuity.

#### *Wireless*

Wireless services revenue decreased \$37 million, or 20%, for the three months ended March 31, 2003 as compared to the three months ended March 31, 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 reduction in the number of customers of 126,000, or 11%, between March 31, 2003 and March 31, 2002.

#### *Affiliate Services*

Affiliate services revenue consists of telecommunications services provided to affiliate enterprises. Affiliate services revenue increased \$38 million, or 40%, for the three months ended March 31, 2003 as compared to the same period in 2002 due to moving 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 March 31,			
2003	2002	Increase/ (Decrease)	%
<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

(As restated)

(Dollars in millions)

Operating expenses:

Cost of sales	\$ 688	\$ 720	\$ (32)	(4)%
Selling, general and administrative ("SG&A")	806	861	(55)	(6)%
Depreciation	613	695	(82)	(12)%
Intangible assets amortization	85	64	21	33%
Restructuring, Merger-related and other charges (credits)	12	(30)	42	nm
Total operating expenses	\$ 2,204	\$ 2,310	\$ (106)	(5)%

nm—not meaningful

**Cost of Sales**

The following table shows a breakdown of cost of sales by major component for the three months ending March 31, 2003 and 2002:

	Three Months Ended March 31,			
	2003	2002	Increase/ (Decrease)	%
	(As restated)			
	(Dollars in millions)			
Employee and service-related costs	\$ 424	\$ 429	\$ (5)	(1)%
Network costs	72	89	(17)	(19)%
Non-employee related costs	100	88	12	14%
Affiliate costs	92	114	(22)	(19)%
Total cost of sales	\$ 688	\$ 720	\$ (32)	(4)%

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.

Total cost of sales decreased \$32 million, or 4%, for the three months ended March 31, 2003 as compared to the same period in 2002. Cost of sales, as a percent of revenue, was 24% for the three months ended March 31, 2003 as compared to 23% for the three months ended March 31, 2002. Cost of sales decreased primarily due to lower network and affiliate costs.

Our network costs decreased \$17 million, or 19%, for the three months ended March 31, 2003 as compared to the same period in 2002. We reduced our reliance on third-party contractors to provide network maintenance services, by shifting this work to our employees. We also experienced lower costs associated with wireless handset sales as a result of lower unit prices and decreases in the number of new wireless subscribers.

Non-employee related costs, such as real estate and regulatory fees increased \$12 million, or 14%, for the three months ended March 31, 2003 as compared to the same period in 2002. The increase is primarily attributable to increases in regulatory fees and real estate expenses.

Affiliate costs, such as services for corporate administration, information technology, advertising and technical support, decreased \$22 million, or 19%, for the three months ended March 31, 2003 as compared with the same period in 2002. The decrease is primarily attributable to lower information technology support costs.

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

The following table shows a breakdown of SG&A by major component for the three months ending March 31, 2003 and 2002:

	Three Months Ended March 31,			
	2003	2002	Increase/ (Decrease)	%
		(As restated)		
	(Dollars in millions)			
Employee and service-related costs	\$ 208	\$ 259	\$ (51)	(20)%
Bad debt	62	82	(20)	(24)%
Property and other taxes	105	126	(21)	(17)%
Non-employee related costs	129	104	25	24%
Affiliate costs	302	290	12	4%
Total SG&A	\$ 806	\$ 861	\$ (55)	(6)%

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 \$55 million, or 6%, for the three months ended March 31, 2003 as compared to the same period in 2002. SG&A, as a percent of revenue, was flat at 28% for both the three month period ended March 31, 2003 and the same period in 2002. Third party costs, bad debt expense and property taxes all decreased.

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 \$51 million, or 20%, for the three months ended March 31, 2003 as compared to the same period in 2002. The decline is primarily due to reduced professional fees due to the decreased use of third-party vendors for customer service and telemarketing. Partially offsetting the decrease were increases in incentive compensation costs and a decreased net pension credit and higher healthcare costs.

Bad debt expense decreased \$20 million, or 24%, for the three months ended March 31, 2003 as compared to the same period in 2002. Bad debt decreased as a percentage of revenue to 2% for the three months ended March 31, 2003 from 3% for the three months ended March 31, 2002. Bad debt declined across the business units as a result of fewer customer bankruptcy filings, improved collections practices and tighter credit policies.

Property and other taxes decreased \$21 million, or 17%, for the three months ended March 31, 2003 as compared to the same period in 2002. Reduced property and other taxes resulted from changes in estimates of property tax liabilities for the three months ended March 31, 2002.

Non-employee related costs, such as real estate and reciprocal compensation payments increased \$25 million, or 24%, for the three months ended March 31, 2003 as compared to the same period in 2002. The increase is primarily driven by a decrease in information technology costs that are eligible for capitalization partially offset by lower marketing and advertising and real estate costs due to first quarter cost reduction efforts.

### ***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 first quarter of 2003 and a pension credit, net of post-retirement benefit expenses of \$8 million, in the first quarter of 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 months ended March 31, 2003 from a net pension credit in the three months ended March 31, 2002 is primarily due to decreased returns on investments and increased medical costs for plan participants.

## Depreciation

Depreciation expense for the three months ended March 31, 2003 decreased \$82 million, or 12%, compared to the three months ended March 31, 2002. The decrease was the result of the impairment we recorded on June 30, 2002 (as discussed in Note 6—Property, Plant and Equipment in our annual report on Form 10-K for the year ended December 31, 2002, or 2002 Form 10-K) which reduced annual depreciation expense by \$125 million effective July 1, 2002; certain assets becoming fully depreciated in 2002; and the completion of certain capitalized lease agreements occurring in the three months ended March 31, 2002.

## Intangible Assets Amortization

Amortization expense increased \$21 million, or 33%, for the three months ended March 31, 2003 compared to the same period in 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

### *Recent Developments—asset impairments*

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 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 prices for similar 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 a total of \$230 million.

## 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 months ended March 31, 2003 and 2002 is as follows:

	Three Months Ended March 31,	
	2003	2002
		(As restated)
	(Dollars in millions)	
2003 restructuring	\$ 10	\$ —
Merger reserve reversals	—	(30)
Other restructuring related charges	2	—
Total restructuring and Merger-related charges (credits)	\$ 12	\$ (30)

### *2003 Activities*

During the three months ended March 31, 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 \$10 million to cover the costs associated with these actions. The charge of \$10 million relates to severance benefits and other charges pursuant to established severance policies associated with a reduction in employees. We identified approximately 300 employees from various functional areas to be terminated as part of

this reduction. During the three months ended March 31, 2003, no payments were made relating to this restructuring.

As a result of these restructuring activities, we expect to realize cost savings of approximately \$15 million in 2004.

#### *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 million to \$55 million.

#### *Merger-Related Charges*

We considered those costs that were incremental and directly related to the June 30, 2000 acquisition of U S WEST, Inc. by QCII, or the Merger, to be "Merger-related." During the three months ended March 31, 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 ended March 31 are as follows:

	Three Months Ended March 31,			
	2003	2002	Change	%
	(As restated)			
	(Dollars in millions)			
Interest expense—net	\$ 137	\$ 120	\$ 17	14%
Interest expense—net—affiliates	36	45	(9)	(20)%
Other expense (income)—net	8	(8)	16	nm
Total other expense—net	\$ 181	\$ 157	\$ 24	15%

*Interest expense—net.* Interest expense—net, was \$173 million and \$165 million for the three months ended March 31, 2003 and 2002, respectively. The increase was primarily due to a decrease in the amount of interest that was capitalized for the three months ended March 31, 2003. This decrease in capitalized interest was primarily due to a decrease in network buildout for the three months ended March 31, 2003 as compared to the same period ended 2002.

*Other expense (income)—net.* Other expense (income)—net was \$8 million for the three months ended March 31, 2003 compared to \$(8) million for the same period ended March 31, 2002. The \$16 million of additional net other expense was primarily the result of an increase in abandoned projects and a decrease in interest income in the first quarter of 2003 over the same period in 2002.

#### **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 the three months ended March 31, 2003 and 2002.

#### **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 include 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, \$3.7 billion and \$3.8 billion as of September 30, 2003, March 31, 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 in January 2005. We expect that the maturities of the borrowings will be extended by our affiliates as necessary.

There was only a slight improvement in our working capital deficit of approximately \$100 million for the three months ended March 31, 2003. While our working capital deficit was improved by an increase in cash and cash equivalents of approximately \$1.0 billion during the three months ended March 31, 2003, this was substantially offset by changes in other working capital components including increases in dividends payable of \$523 million. We were able to continue to improve our working capital deficit by \$2.0 billion for the nine months ended September 30, 2003, due to a combination of an increase in cash and cash equivalents and our refinancing of current borrowings with long term debt. The increase in cash was due to our decision to reduce capital expenditures and 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 into long term. For more information about this loan, see Recent Developments Impacting Liquidity and Capital Resources below.

As of September 30, 2003, March 31, 2003 and December 31, 2002, our consolidated debt was approximately \$9.8 billion, \$9.1 billion and \$9.2 billion, respectively including borrowings from affiliates. In addition, our unrestricted cash balances were approximately \$1.4 billion, \$1.3 billion and \$232 million, as of the same dates. We expect to use our cash primarily to invest in telecommunications assets, to 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 highly 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 \$1.519 billion and \$1.402 billion, for the three months ended March 31, 2003 and March 31, 2002, respectively. Cash flows from operations increased \$117 million for the three months ended March 31, 2003 compared to the same period in 2002. This increase was primarily the result of cash management improvements of approximately \$350 million offset by reduced cash flows related to a \$192 million decrease in revenue. The cash management improvements during these periods were primarily a result of reductions in cash outlays for operating expenses, and the reduction of prepaid income 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 \$274 million to \$352 million for the three months ended March 31, 2003 from \$626 million, for the three months ended March 31, 2002. This decrease was primarily due to a decrease in capital expenditures of \$264 million. The 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.

Capital expenditures for the three months ended March 31, 2003 and 2002 were \$364 million and \$628 million, respectively.

*Financing activities.* Cash used for financing activities was \$100 million through March 31, 2003 and \$108 million for the same period in 2002. At March 31, 2003, we were in compliance with all provisions or 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.

Affiliate borrowings of our wholly owned subsidiary, Qwest Wireless, in the form of short-term unsecured lines of credit, were \$1.953 billion and \$1.888 billion at March 31, 2003 and December 31, 2002, respectively. These affiliate borrowings fluctuate based on operating needs of Qwest Wireless and mature on January 15, 2005.

### **Subsequent Event—Financing Activities**

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 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%.

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

For the nine months ended September 30, 2003, we have declared regular dividends in the amount of \$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.

### **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. We do not hold any derivatives for other than hedging purposes.

As of March 31, 2003 and at December 31, 2002, QC did not have floating rate debt exposed to changes in interest rates. As of March 31, 2003 and December 31, 2002, we had approximately \$1.1 billion and \$1.2 billion, respectively, of long-term fixed rate debt obligations maturing in the following 12 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 approximately \$6.1 billion of long-term fixed rate debt at both March 31, 2003 and at December 31, 2002. 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 March 31, 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 March 31, 2003 and December 31, 2002, respectively.

As of March 31, 2003, we had \$1.299 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.

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## **SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This Form 10-Q 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 revenue, 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.

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## **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.



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***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.

#### **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. At the date of this filing, no action has 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, although QCII cannot predict the outcome of this referral.

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.

***The breadth of QCII's internal analysis of its accounting policies, practices and procedures, the passage of time and the turnover in accounting personnel or further review by the SEC could result in additional adjustments.***

QCII continues to discuss its periodic filings with the staff of the SEC's Division of Corporation Finance. They have reviewed QCII's 2001 Form 10-K and its Form 10-Q for the three months ended March 31, 2002. As appropriate, QCII has attempted to address the Staff's comments in its current filings and has provided responses to those other comments that it could address. Following their review of QCII's 2002 Form 10-K and Form 10-Qs for the three, six and nine months ended March 31, 2003, June 30, 2003 and September 30, 2003, QCII may receive additional comments from the staff of the Division of Corporation Finance and may be required to make further adjustments or additional disclosures. It is possible that these comments may lead to further investigations from the SEC's Division of Enforcement.

While QCII has attempted to address all the matters identified in its internal analysis of its accounting policies, practices and procedures, due to the breadth of this analysis, the passage of time and the turnover in accounting personnel employed by QCII, QCII may have overlooked some matters in its internal analysis.

***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 cases. 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 at this time 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. In addition, we cannot assure you that we will not have to further restate earnings for prior periods as a result of any formal actions, the SEC's review of QCII's filings or because of our own periodic internal investigations. Any such restatement could further impact our ability to access the capital markets and the trading price of our securities.

***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 PUCs 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.

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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.

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***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. As we will need to maintain the quality of our products and services in the future, we may be unable to further significantly reduce such capital requirements or operating expenses, even if revenue are 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

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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 "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 prevent all errors or fraud or ensure that all material information will be made known to appropriate management in a timely fashion.

As reported more fully in our 2002 Form 10-K, we learned of certain deficiencies in our internal controls that existed in 2002 and prior years. These deficiencies 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.

As reported in our 2002 Form 10-K, we have taken 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. Nonetheless, we can give no assurance that all internal control deficiencies have been entirely corrected. The inherent limitations of any system of controls preclude the possibility of preventing all errors and all fraud. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. In addition, controls can be circumvented by the individual acts of some persons or by collusion of two or more people. Owing to these limitations, error or fraud may occur and not be detected.

We recently evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that these procedures and controls were effective, given the inherent limitations stated above, to provide reasonable assurances that the controls and procedures met their objectives. Except for certain of the measures to improve internal controls described in our 2002 Form 10-K, there have been no significant changes during the quarterly period covered by this report in our internal controls or in other factors that could significantly affect internal controls.

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## **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 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:

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.

<b>Exhibit Number</b>	<b>Description</b>
(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 U S 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).
- (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).
- 31.1 Chief Executive Officer Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

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- 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.

(b) Reports on Form 8-K:

We filed the following report on Form 8-K during the first quarter of 2003:

On February 13, 2003, we filed a report on Form 8-K announcing additional results of QCII's internal review of the 2001 and 2000 financial statements and the estimated impact of the total financial restatement for those years.

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### 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

*Vice Chairman and Chief Financial Officer  
(Duly Authorized Officer and Principal Financial and Chief Accounting Officer)*

January 12, 2004

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**CERTIFICATION OF CHIEF EXECUTIVE OFFICER**

I, Richard C. Notebaert, certify that:

1. I have reviewed this quarterly report on Form 10-Q 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 condensed consolidated 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: January 12, 2004

/s/ RICHARD C. NOTEBAERT

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Richard C. Notebaert  
Chairman, Chief Executive Officer and President

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[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 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 condensed consolidated 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: January 12, 2004

/s/ OREN G. SHAFFER

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Oren G. Shaffer  
Vice Chairman and Chief Financial Officer

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[CERTIFICATION OF CHIEF FINANCIAL OFFICER](#)



**CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER CERTIFICATION**

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 for the quarter ended March 31 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 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.

Dated: January 12, 2004

By: /s/ RICHARD C. NOTEBAERT

Richard C. Notebaert  
Chairman, Chief Executive Officer and President

Dated: January 12, 2004

By: /s/ OREN G. SHAFFER

Oren G. Shaffer  
Vice Chairman and Chief Financial Officer

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[CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER CERTIFICATION](#)