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

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**FORM 10-Q**

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

For the quarterly period ended September 30, 2008

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)

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

**1801 California Street, Denver, Colorado**  
(Address of principal executive offices)

**84-0273800**  
(I.R.S. Employer  
Identification No.)

**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.

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 a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐      Accelerated filer ☐      Non-accelerated filer ☒      Smaller reporting company ☐

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

On October 29, 2008, one share of Qwest Corporation common stock was outstanding.

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## **GLOSSARY OF TERMS**

Our industry uses many terms and acronyms that may not be familiar to you. To assist you in reading this document and other documents we file with the Securities and Exchange Commission, we have provided below definitions of some of these terms.

- *Access Lines* . Telephone lines reaching from the customer's premises to a connection with the public switched telephone network. Our access lines include lines used to provide services to our external customers, as well as lines used by us and our affiliates.
- *Asynchronous Transfer Mode (ATM)*. A broadband, network transport service utilizing data switches that provides a fast, efficient way to move large quantities of information.
- *Broadband Services*. Services used to connect to the Internet through existing telephone lines that operate at higher speeds than dial-up access.
- *Competitive Local Exchange Carriers (CLECs)* . Telecommunications providers that compete with us in providing local voice and other services in our local service area.
- *Data Integration* . Telecommunications equipment located on customers' premises and related professional services. These services include network management, installation and maintenance of data equipment and building of proprietary fiber-optic broadband networks for our governmental and business customers.
- *Dedicated Internet Access (DIA)* . Internet access ranging from 128 kilobits per second to 10 gigabits per second.
- *Frame Relay* . A high speed data switching technology used primarily to interconnect multiple local networks.
- *Hosting Services* . The providing of space, power, bandwidth and managed services in data centers.
- *Incumbent Local Exchange Carrier (ILEC)*. A traditional telecommunications provider that, prior to the Telecommunications Act of 1996, had the exclusive right and responsibility for providing local telecommunications services in its local service area. Qwest Corporation is an ILEC.
- *Integrated Services Digital Network (ISDN)* . A telecommunications standard that uses digital transmission technology to support voice, video and data communications applications over regular telephone lines.
- *Internet Dial Access*. Provides ISPs and business customers with a comprehensive, reliable and cost-effective dial-up network infrastructure.
- *Internet Protocol (IP)*. Those protocols that facilitate transferring information in packets of data and that enable each packet in a transmission to "tell" the data switches it encounters where it is headed and enables the computers on each end to confirm that message has been accurately transmitted and received.
- *Internet Service Providers (ISPs)*. Businesses that provide Internet access to retail customers.
- *Managed Services*. Customized, turnkey solutions for integrated voice, data and Internet services offered to our business markets customers. These services include a diverse combination of emerging technology products and services, such as VoIP, Ethernet, MPLS, hosting services and advanced voice services, such as Web conferencing and call center solutions. Most of these services can be performed from outside our customers' internal networks, with an emphasis on integrating and certifying Internet security for applications and content.

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- *Multi-Protocol Label Switching (MPLS)*. A standards-approved data networking technology, compatible with existing ATM and frame relay networks that can deliver the quality of service required to support real-time voice and video, as well as service level agreements that guarantee bandwidth. MPLS is deployed by many telecommunications providers and large enterprises for use in their own national networks.
- *Private Line*. Direct circuit or channel specifically dedicated to a customer for the purpose of directly connecting two or more sites. Private line offers a high-speed, secure solution for frequent transmission of large amounts of data between sites.
- *Public Switched Telephone Network (PSTN)*. The worldwide voice telephone network that is accessible to every person with a telephone equipped with dial tone.
- *Unbundled Network Elements (UNEs)*. Discrete elements of our network that are sold or leased to competitive telecommunications providers and that may be combined to provide their retail telecommunications services.
- *Universal Service Funds (USF)*. Federal and state funds established generally to promote the availability of telecommunications services to all consumers at reasonable and affordable rates, among other things. As a telecommunications provider, we are often required to contribute to these funds.
- *Virtual Private Network (VPN)*. A private network that operates securely within a public network (such as the Internet) by means of encrypting transmissions.
- *Voice over Internet Protocol (VoIP)*. An application that provides real-time, two-way voice communication similar to our traditional voice services that originates in the Internet protocol over a broadband connection and often terminates on the PSTN.
- *Wide Area Network (WAN)*. A communications network that covers a wide geographic area, such as a state or country. A WAN typically extends a local area network outside the building, over telephone common carrier lines to link to other local area networks in remote locations, such as branch offices or at-home workers and telecommuters.

**PART I. FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**QWEST CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(UNAUDITED)**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(Dollars in millions)			
Operating revenue:				
Operating revenue	\$ 2,134	\$ 2,183	\$ 6,462	\$ 6,596
Operating revenue—affiliates	422	485	1,325	1,453
Total operating revenue	<u>2,556</u>	<u>2,668</u>	<u>7,787</u>	<u>8,049</u>
Operating expenses (Note 1):				
Cost of sales (exclusive of depreciation and amortization)	461	417	1,299	1,229
Selling	468	448	1,371	1,325
General, administrative and other operating	424	449	1,271	1,380
Operating expenses—affiliates	60	42	150	120
Depreciation and amortization	523	556	1,551	1,664
Total operating expenses	<u>1,936</u>	<u>1,912</u>	<u>5,642</u>	<u>5,718</u>
Other expense (income)—net:				
Interest expense on long-term borrowings and capital leases—net	145	154	444	454
Other—net	(7)	(4)	(7)	15
Total other expense (income)—net	<u>138</u>	<u>150</u>	<u>437</u>	<u>469</u>
Income before income taxes	482	606	1,708	1,862
Income tax expense	183	228	649	707
Net income	<u>\$ 299</u>	<u>\$ 378</u>	<u>\$ 1,059</u>	<u>\$ 1,155</u>

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

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### QWEST CORPORATION CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	September 30,	December 31,
	2008	2007
	(Dollars in millions)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 289	\$ 292
Accounts receivable—net of allowance of \$55 and \$55, respectively	909	1,006
Accounts receivable—affiliates	101	59
Deferred income taxes	207	481
Prepaid expenses and other	205	244
Total current assets	1,711	2,082
Property, plant and equipment—net	11,691	12,155
Capitalized software—net	832	820
Prepaid pension—affiliates	1,041	1,020
Other	472	445
Total assets	\$ 15,747	\$ 16,522
LIABILITIES AND STOCKHOLDER’S EQUITY		
Current liabilities:		
Current portion of long-term borrowings	\$ 342	\$ 343
Accounts payable	493	503
Accounts payable—affiliates	291	341
Dividends payable—Qwest Services Corporation	600	200
Accrued expenses and other	884	952
Current portion of post-retirement and other post-employment benefits and other—affiliates	198	210
Deferred revenue and advance billings	420	437
Total current liabilities	3,228	2,986
Long-term borrowings—net of unamortized debt discount of \$114 and \$117, respectively	7,545	7,568
Post-retirement and other post-employment benefits and other—affiliates	2,611	2,612
Deferred income taxes	1,356	1,406
Other	605	580
Total liabilities	15,345	15,152
Commitments and contingencies (Note 7)		
Stockholder’s equity:		
Common stock—one share without par value, owned by Qwest Services Corporation	11,310	11,132
Accumulated deficit	(10,908)	(9,762)
Total stockholder’s equity	402	1,370
Total liabilities and stockholder’s equity	\$ 15,747	\$ 16,522

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

**QWEST CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(UNAUDITED)**

	Nine Months Ended September 30,	
	2008	2007
	(Dollars in millions)	
Operating activities:		
Net income	\$ 1,059	\$ 1,155
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,551	1,664
Deferred income taxes	281	(138)
Provision for bad debt—net	65	58
Other non-cash charges—net	22	27
Changes in operating assets and liabilities:		
Accounts receivable	29	(44)
Accounts receivable—affiliates	(42)	169
Prepaid expenses and other current assets	29	50
Accounts payable and accrued expenses and other current liabilities	(87)	(168)
Accounts payable and other current liabilities—affiliates	(50)	7
Deferred revenue and advance billings	(21)	(25)
Other non-current assets and liabilities including affiliates	(109)	(82)
Cash provided by operating activities	<u>2,727</u>	<u>2,673</u>
Investing activities:		
Expenditures for property, plant and equipment and capitalized software	(1,115)	(885)
Changes in interest in investments managed by Qwest Services Corporation	(31)	—
Other	13	12
Cash used for investing activities	<u>(1,133)</u>	<u>(873)</u>
Financing activities:		
Proceeds from long-term borrowings	—	500
Repayments of long-term borrowings, including current maturities	(22)	(337)
Proceeds from current borrowings—affiliate	—	184
Repayments of current borrowings—affiliate	(22)	(138)
Dividends paid to Qwest Services Corporation	(1,800)	(1,870)
Equity infusions from Qwest Services Corporation	231	25
Other	16	(5)
Cash used for financing activities	<u>(1,597)</u>	<u>(1,641)</u>
Cash and cash equivalents:		
(Decrease) increase in cash and cash equivalents	(3)	159
Beginning balance	292	276
Ending balance	<u>\$ 289</u>	<u>\$ 435</u>

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

**QWEST CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**For the Three and Nine Months Ended September 30, 2008**  
**(Unaudited)**

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

**Note 1: Basis of Presentation**

The condensed consolidated balance sheet as of December 31, 2007, which was derived from audited financial statements, and the unaudited interim condensed consolidated financial statements as of and for the three and nine months ended September 30, 2008 have been prepared 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 accounting principles generally accepted in the United States of America (“GAAP”) have been condensed or omitted. We believe that the disclosures made are adequate to make the information not misleading.

In the opinion of management, these statements include all normal recurring adjustments necessary to fairly present our condensed consolidated results of operations, financial position and cash flows as of September 30, 2008 and for all periods presented. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2007, as updated by our Current Report on Form 8-K dated April 4, 2008 (our “April 4, 2008 Form 8-K”).

The condensed consolidated results of operations for the three and nine months ended September 30, 2008 and the condensed consolidated statement of cash flows for the nine months ended September 30, 2008 are not necessarily indicative of the results or cash flows expected for the full year or of the results we would have incurred had we operated as a stand-alone entity during the periods presented.

**Business Combinations**

In light of regulatory changes in 2007 and consistent with QCII’s continuing strategy to simplify its and our corporate structure and gain operational efficiencies, in the first quarter of 2008 QCII moved to us most of the administrative and other functions of QSC and merged into us two of QSC’s other wholly owned subsidiaries that previously charged the majority of their costs to us:

- a procurement company that managed real estate and other supplier selection and negotiations; and
- a computer system support services company that handled development, application, maintenance, integration and testing of software.



**QWEST CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**For the Three and Nine Months Ended September 30, 2008**  
**(Unaudited)**

These reorganization activities combined businesses that were already controlled by QCII, therefore we accounted for these activities in a manner similar to a pooling of interests. These activities had the following effect on our condensed consolidated financial statements for the three and nine months ended September 30, 2007 and as of December 31, 2007:

	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2007
	(Dollars in millions)	
Increases in:		
Total operating revenue	\$ 215	\$ 637
Income before income taxes	13	46
Net income	7	26

  

	December 31, 2007 (Dollars in millions)
Increases in:	
Total assets	\$ 1,125
Total liabilities	732

In addition, to aid the understanding of these and future financial statements, we recast prior year financial information in our April 4, 2008 Form 8-K.

QCII continues to evaluate other ways to better organize the legal structure and operations of its subsidiaries and may make additional changes to the legal structure and operations of its subsidiaries, including us, in the future. In connection with these past or future reorganization activities, we do not believe we have consummated, and we do not expect to consummate in the future, any business combinations or other transactions that will adversely affect our consolidated financial condition or results of operations.

***Reclassifications***

During the first quarter of 2008, we changed the definitions we use to classify expenses as cost of sales, selling expenses or general, administrative and other operating expenses. Operating expenses are now reported as follows:

- Cost of sales are costs incurred in providing products and services to our customers. These include: employee-related costs directly attributable to operating and maintaining our network (such as salaries, wages and certain benefits); and other cost of sales directly related to our network operations (such as professional fees, materials and supplies, equipment sales costs and outsourced services).
- Selling expenses are costs incurred in selling products and services to our customers. These include: employee-related costs directly attributable to selling products or services (such as salaries, wages, internal commissions and certain benefits); marketing, advertising and external commissions and other selling costs (such as bad debt expense, professional fees and outsourced services).
- General, administrative and other operating expenses are corporate overhead and other operating costs. These include: employee-related costs for administrative functions (such as salaries, wages and certain

**QWEST CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**For the Three and Nine Months Ended September 30, 2008**  
**(Unaudited)**

benefits); taxes and fees (such as property and other taxes and Universal Service Fund, or USF, charges); real estate and occupancy costs (such as rents, utilities and fleet costs); and other general, administrative and other operating costs (such as professional fees, outsourced services, litigation related charges and general computer systems support services). These expenses also include our pension and post-retirement benefits costs for all employees and retirees.

We believe these changes allow users of our financial statements to better understand our cost structure and the way we manage our business. These expense classifications may not be comparable to those of other companies. These changes had no impact on total operating expenses or net income for any period. To reflect the impact these changes would have had if they had been implemented in prior periods, we have reclassified certain financial information for the three and nine months ended September 30, 2007 that is presented in these condensed consolidated financial statements. In addition, to aid the understanding of these and future financial statements, we reclassified certain prior year financial information in our April 4, 2008 Form 8-K.

We have also reclassified certain other prior period amounts to conform to the current period presentations.

***Derivative Financial Instruments***

We sometimes use derivative financial instruments, specifically interest rate swap contracts, to manage interest rate risks. We execute these instruments with creditworthy banks and monitor our counterparty exposure. An interest rate hedge is generally designated as either a cash flow hedge or a fair value hedge. In a cash flow hedge, a borrower of variable interest debt agrees with another party to make fixed payments equivalent to paying fixed rate interest on debt in exchange for receiving payments from the other party equivalent to receiving variable rate interest on debt, the effect of which is to eliminate some portion of the variability in the borrower's overall cash flows. In a fair value hedge, a borrower of fixed rate debt agrees with another party to make variable payments equivalent to paying variable rate interest on the debt in exchange for receiving fixed payments from the other party equivalent to receiving fixed rate interest on debt, the effect of which is to eliminate some portion of the variability in the fair value of the borrower's overall debt portfolio.

We recognize all derivatives on our condensed consolidated balance sheets at fair value. We generally designate the derivative as either a cash flow hedge or a fair value hedge on the date on which we enter into the derivative instrument.

For a derivative that is designated as and meets all of the required criteria for a cash flow hedge, we record in accumulated other comprehensive income, which is included in accumulated deficit on our condensed consolidated balance sheets, any changes in the fair value of the derivative. We then reclassify these amounts into earnings as the underlying hedged item affects earnings. In addition, if there are any changes in the fair value of the derivative arising from ineffectiveness of the cash flow hedging relationship, we record those amounts immediately in other expense (income)—net in our condensed consolidated statements of operations. For a derivative that is designated as and meets all of the required criteria for a fair value hedge, we record in other expense (income)—net in our condensed consolidated statements of operations the changes in fair value of the derivative and the underlying hedged item.

We assess quarterly whether each derivative is highly effective in offsetting changes in fair values or cash flows of the hedged item. If we determine that a derivative is not highly effective as a hedge, or if a derivative

**QWEST CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**For the Three and Nine Months Ended September 30, 2008**  
**(Unaudited)**

ceases to be a highly effective hedge, we discontinue hedge accounting with respect to that derivative prospectively. We record immediately in earnings changes in the fair value of derivatives that are not designated as hedges.

***Use of Estimates***

Our condensed consolidated financial statements are prepared in accordance with GAAP. These accounting principles require us to make certain estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions made when accounting for items and matters such as, but not limited to, investments, long-term contracts, customer retention patterns, allowance for doubtful accounts, depreciation, amortization, asset valuations, internal labor capitalization rates, affiliate transactions, recoverability of assets (including deferred tax assets), impairment assessments, employee benefits, taxes, reserves and other provisions and contingencies are reasonable, based on information available at the time they are made. These estimates, judgments and assumptions can affect the reported amounts of assets, liabilities and components of equity as of the dates of the condensed consolidated balance sheets, as well as the reported amounts of revenue, expenses and components of cash flows during the periods presented in our condensed consolidated statements of operations and our condensed consolidated statements of cash flows. We also make estimates in our assessments of potential losses in relation to threatened or pending tax and legal matters. See Note 5—Tax Matters and Note 7—Commitments and Contingencies for additional information.

- For matters not related to income taxes, if a loss is considered probable and the amount can be reasonably estimated, we recognize an expense for the estimated loss. If we have the potential to recover a portion of the estimated loss from a third party, we make a separate assessment of recoverability and reduce the estimated loss if recovery is also deemed probable.
- For matters related to income taxes and in accordance with Financial Accounting Standards Board (“FASB”) Interpretation No. 48, “Accounting for Uncertainty in Income Taxes” (“FIN 48”), the impact of an uncertain tax position that is more likely than not of being sustained upon audit by the relevant taxing authority must be recognized at the largest amount that is more likely than not to be sustained. No benefit from an uncertain tax position will be recognized if the position has less than a 50% likelihood of being sustained. Also, interest expense is recognized on the full amount of uncertain tax positions recorded under FIN 48.

For all of these and other matters, actual results could differ from our estimates.

***USF, Gross Receipts Taxes and Other Surcharges***

Our revenue and general, administrative and other operating expenses include taxes and surcharges that we recognize on a gross basis of \$51 million and \$151 million for the three and nine months ended September 30, 2008, respectively, and \$53 million and \$157 million for the three and nine months ended September 30, 2007, respectively.

***Depreciation and Amortization***

Property, plant and equipment is shown net of accumulated depreciation on our condensed consolidated balance sheets. Accumulated depreciation was \$32.726 billion and \$31.976 billion as of September 30, 2008 and December 31, 2007, respectively.

**QWEST CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**For the Three and Nine Months Ended September 30, 2008**  
**(Unaudited)**

Capitalized software is shown net of accumulated amortization on our condensed consolidated balance sheets. Accumulated amortization was \$1.403 billion and \$1.311 billion as of September 30, 2008 and December 31, 2007, respectively.

***Recently Adopted Accounting Pronouncements***

Effective January 1, 2008, we adopted Statement of Financial Accounting Standards (“SFAS”) No. 157, “Fair Value Measurements” (“SFAS No. 157”), for all financial instruments and non-financial instruments accounted for at fair value on a recurring basis. SFAS No. 157 provides a definition of fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements for future transactions. We carry on our condensed consolidated balance sheets financial instruments whose value cannot be determined by reference to an observable market—including those described in more detail in Note 2—Investments. We continue to estimate the value of these instruments using judgmentally determined inputs, some of which are observable and some of which are not observable. We have not changed the methods used to value these financial instruments as a result of our adoption of this standard. Our condensed consolidated balance sheets also indirectly reflect the value of financial instruments held by certain QCII employee benefit plans in which our employees and retirees participate. However, we only adjust our balance sheet annually at December 31 to reflect market changes in the value of QCII employee benefit plan assets. QCII continues to assess whether the methods previously used to determine the fair value of employee benefit plan assets are appropriate within the SFAS No. 157 framework for measuring fair value, but we do not anticipate that any changes in valuation methods will have a material impact on our financial position or results of operations.

Effective January 1, 2008, we also adopted SFAS No. 159, “Fair Value Option for Financial Assets and Financial Liabilities” (“SFAS No. 159”). Under SFAS No. 159, entities may choose to measure at fair value many financial instruments and certain other items that are not currently required to be measured at fair value. SFAS No. 159 also establishes recognition, presentation, and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 does not affect any existing accounting literature that requires certain assets and liabilities to be carried at fair value. Although we have adopted this standard, we have not yet elected the fair value option for any assets or liabilities that currently are not required to be recorded at fair value. Therefore, the adoption of this standard has not had any impact on our financial position or results of operations.

**Note 2: Investments**

QSC manages all cash and investments for us and our affiliates. Our proportionate ownership of any investments, including illiquid investments, can change because we record our portion of the entire portfolio of cash and investments managed by QSC. These changes are reflected on a net basis in cash flows from investing activities on our consolidated statements of cash flows.

As of September 30, 2008 and December 31, 2007, our investments included auction rate securities of \$56 million and \$31 million, respectively, which are classified as non-current, available-for-sale investments and are included in other non-current assets at estimated fair value on our condensed consolidated balance sheets. Auction rate securities are generally long-term debt instruments that provide liquidity through a Dutch auction process that resets the applicable interest rate at pre-determined calendar intervals, generally every 28 days. This mechanism generally allows existing investors to rollover their holdings and continue to own their respective securities or liquidate their holdings by selling their securities at par value. Prior to August 2007, QSC invested in these securities for short periods of time as part of its cash management program. However, the uncertainties

**QWEST CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**For the Three and Nine Months Ended September 30, 2008**  
**(Unaudited)**

in the credit markets have prevented QSC and other investors from liquidating their holdings of these securities in auctions since the third quarter of 2007. These securities are insured against loss of principal and interest by bond insurers with AA and BB credit ratings at September 30, 2008 and AAA credit ratings at December 31, 2007 and they are collateralized by the issuer. These securities were valued using a discounted cash flow model that takes into consideration the following factors among others:

- the interest rate of the securities;
- the probability that QSC will be able to sell the securities in an auction or that the securities will be redeemed early;
- the probability that a default will occur and its severity; and
- a discount rate.

We recorded unrealized losses, net of deferred income taxes, on these auction rate securities of \$3 million and \$6 million, respectively, for the three and nine months ended September 30, 2008. The cumulative unrealized losses related to these securities as of September 30, 2008 were \$6 million, net of deferred income taxes. These unrealized losses were recorded in accumulated other comprehensive income, which is included in accumulated deficit in our condensed consolidated balance sheets. We consider the decline in fair value to be a temporary impairment because the securities are rated investment grade and the issuer continues to make interest payments in accordance with the terms of the offering document and because we have the ability and intent to hold the securities until they recover or mature. However, if the credit ratings of the securities or the bond insurers deteriorate or the value of the collateral deteriorates, we may further adjust the carrying value of these investments. We may also determine that the decline in fair value is other than temporary if our intent or ability to hold these securities until they recover changes or the creditworthiness of the issuer deteriorates, we would then recognize the decline in fair value in other expense (income)—net in our condensed consolidated statements of operations. An increase of one percentage point in the discount rate used in our valuation model would result in an immaterial decrease in the estimated fair value of these investments. Because we are uncertain as to when the liquidity issues relating to these investments will improve, we continue to classify these securities as non-current as of September 30, 2008.

During the fourth quarter of 2007, an investment fund we historically treated as a cash equivalent began liquidating its holdings and restricting distributions. As a result, we reclassified our holdings in the fund from cash and cash equivalents to investments, which are included in other current assets on our condensed consolidated balance sheets. We valued this investment considering the asset values of the securities underlying the fund. As of December 31, 2007, \$21 million of our remaining investment in the fund was included in other current assets and \$3 million was included in other non-current assets on our condensed consolidated balance sheet because we did not expect to be able to liquidate this portion of our investment in 2008. As of September 30, 2008, \$12 million of our remaining investment in the fund was included in other current assets and \$6 million was included in other non-current assets on our condensed consolidated balance sheet because we continued to expect that we would not be able to liquidate this portion of our investment in the subsequent twelve months. During the three and nine months ended September 30, 2008, we recorded immaterial realized and unrealized losses for the change in the fair value of the fund, which were recorded in other expense (income)—net in our condensed consolidated statements of operations.

**QWEST CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**For the Three and Nine Months Ended September 30, 2008**  
**(Unaudited)**

**Note 3: Borrowings**

We were in compliance with all provisions and covenants of our borrowings as of September 30, 2008. The fair value of our long-term borrowings was approximately \$7.0 billion and \$8.0 billion at September 30, 2008 and December 31, 2007, respectively. The book value of our long-term borrowings was approximately \$7.9 billion at September 30, 2008 and December 31, 2007.

During the first quarter of 2008, we entered into the interest rate hedges described below as part of our long- and short-term debt strategies. One objective of our short-term debt strategy is to take advantage of favorable interest rates by swapping floating rate debt to fixed rate debt using cash flow hedges. One objective of our long-term debt strategy is to achieve a more balanced ratio of fixed rate to floating rate debt by swapping a portion of our fixed interest rate debt to floating rate debt through fair value hedges. This decreases our exposure to changes in the fair value of our fixed interest rate debt due to changes in interest rates.

We evaluate counterparty credit risk before entering into any hedge transaction. During the third quarter of 2008, one of our counterparties was in the process of merging into a large bank. While the merger was not completed by September 30, 2008, we evaluated the new counterparty risk and found it to be acceptable. We will continue to closely monitor the financial market and the risk that our counterparties will default on their obligations to us. We have the ability and are prepared to unwind these hedge transactions if our counterparties' credit risk becomes unacceptable to us.

In March 2008, we entered into interest rate hedges on \$500 million of the outstanding \$750 million aggregate principal amount of our Floating Rate Notes due 2013. The notes bear interest at a rate per year equal to the London Interbank Offered Rate ("LIBOR") plus 3.25%. These hedges had the economic effect of converting our floating interest rate to fixed interest rates of approximately 6.0% for a term of approximately two years. We designated these swaps as cash flow hedges. The value of our cash flow hedges of approximately \$3 million is recorded in other non-current assets on our condensed consolidated balance sheet as of September 30, 2008, with a related increase, net of deferred taxes, in accumulated other comprehensive income, which is included in accumulated deficit. We did not recognize any gain or loss in earnings for hedge ineffectiveness during the three and nine months ended September 30, 2008.

In March 2008, we also entered into interest rate hedges on the outstanding \$500 million aggregate principal amount of our 6.5% Notes due 2017. These hedges had the economic effect of converting our fixed interest rate to a floating interest rate until these notes mature in 2017. We designated these swaps as fair value hedges. The fair value of these hedges is approximately \$11 million and is recorded in other non-current liabilities on our condensed consolidated balance sheet as of September 30, 2008, with a related reduction in the carrying value of long-term debt of \$14 million. A net immaterial gain for hedge ineffectiveness is recorded in other expense (income)—net in our condensed consolidated statements of operations.

The cash flow and fair value hedges are valued using projected future cash flows, discounted at mid-market implied forward LIBOR rates. The debt underlying the fair value hedges is valued using projected future cash flows, discounted at mid-market implied forward LIBOR rates, plus a constant spread above LIBOR determined at the inception of the hedging relationship. These valuations are determined excluding accrued interest.

**Note 4: Severance**

For the three months ended September 30, 2008 and 2007, we accrued severance costs of \$62 million and \$6 million, respectively, reversed severance costs of \$1 million and \$0 million, respectively, and paid severance

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costs of \$9 million and \$12 million, respectively. For the nine months ended September 30, 2008 and 2007, we accrued severance costs of \$121 million and \$15 million, respectively, reversed severance costs of \$11 million and \$7 million, respectively, and paid severance costs of \$60 million and \$38 million, respectively. A portion of our severance charges is included in each of cost of sales, selling expenses and general, administrative and other operating expenses in our condensed consolidated statements of operations. As of September 30, 2008 and December 31, 2007, our severance liability was \$73 million and \$23 million, respectively.

**Note 5: Tax Matters**

During the third quarter of 2008, we collected a state property tax refund of \$40 million, which was recognized in the second quarter of 2008, as the result of a property tax settlement on assessments we challenged for tax years 2002-2007.

We are included in consolidated federal income tax returns of QCII. QCII treats our consolidated results as if we were a separate taxpayer. QCII's policy requires us to pay our tax liabilities in cash based upon separate return taxable income. As a result, QCII's federal tax audits may affect us.

During the third quarter of 2008, QCII executed a settlement with the IRS relating to its audit of the 1998-2001 tax years. We have not yet funded our share of the settlement determined in accordance with our tax allocation policies. We expect to pay \$71 million in the fourth quarter of 2008 as our share of the settlement. We recognized an immaterial interest benefit as a result of the settlement. Our unrecognized tax benefits have decreased by \$34 million since December 31, 2007 primarily due to the 1998-2001 settlement.

On April 15, 2008, QCII received from the Internal Revenue Service ("IRS") the Revenue Agent's Report for tax years 2004 and 2005. The report contains proposed adjustments on several issues, including issues that may affect us. Based on QCII's and our evaluation of the IRS's positions reflected in the proposed adjustments, we have not recorded a material adjustment to our unrecognized tax benefits or our uncertain tax position liability. However, there can be no assurance that QCII and the IRS will reach settlements on any of these issues or that, if QCII does reach settlements, the terms will be favorable to us.

**Note 6: Product Revenue**

We generate the majority of our revenue by providing services using our telecommunications network. We also generate revenue from services we provide to our affiliates. These services are further described below.

- *Voice services* . Voice services include local voice services, wireless and access services. Local voice services include basic local exchange, switching and enhanced voice services. Local voice services also includes unbundled network elements ("UNEs") provided to our wholesale customers. Access services include fees we charge to other telecommunications providers to connect their customers and their networks to our network.
- *Data, Internet and video services* . Data, Internet and video services include: broadband services and satellite video services that we offer to consumers; private line services that we offer to other telecommunications providers and enterprise customers; and other data services such as integrated services digital network, ATM and frame relay that we offer primarily to enterprise customers.
- *Affiliate services*. We provide to our affiliates voice services, data services and billing and collection services that we also provide to external customers. In addition, we provide to our affiliates: marketing,



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sales and advertising; computer system development and support services; network support and technical services; and other support services, such as legal, regulatory, general finance and accounting, tax, human resources and executive support.

We also generate other revenue from USF surcharges and the subleasing of space in our office buildings, warehouses and other properties.

Revenue from our products and services for the three and nine months ended September 30, 2008 and 2007 is summarized in the following table:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(Dollars in millions)			
Operating revenue by products and services:				
Voice services	\$1,280	\$1,402	\$3,930	\$4,299
Data, Internet and video services	810	734	2,398	2,156
Affiliate services	422	485	1,325	1,453
Other revenue (primarily USF surcharges)	44	47	134	141
Total operating revenue	<u>\$2,556</u>	<u>\$2,668</u>	<u>\$7,787</u>	<u>\$8,049</u>

In April 2008, we signed a five-year agreement with a nationwide wireless service provider to market its wireless products and services under its brand name beginning in 2008. Revenue from services provided under this new arrangement will be recorded on a net basis in our consolidated financial statements as voice services. One of our affiliates currently offers wireless services under a service arrangement with a different nationwide wireless service provider. Under this arrangement, which will end in 2009, our affiliate sells wireless products and services under the Qwest brand name and reports revenues on a gross basis.

In the fourth quarter of 2007, we changed the way we determine sales and marketing and advertising support services billed to our affiliates. For the three and nine months ended September 30, 2008, our revenue from affiliate services would have been higher by \$33 million and \$97 million, respectively, had we billed our affiliates for these services based upon the policy in effect in 2007.

**Note 7: Commitments and Contingencies**

QCII is involved in several legal proceedings to which we are not a party that, if resolved against QCII, could have a material adverse effect on our business and financial condition. We have included below a discussion of these matters, together with a discussion of those matters to which we are a party. Only those matters to which we are a party (primarily the third matter described under the heading “Other Matters” relating to litigation brought by several owners of payphones) represent contingencies for which we have recorded, or could reasonably anticipate recording, an accrual if appropriate to do so.

Throughout this note, when we refer to a class action as “putative” it is because a class has been alleged, but not certified in that matter. Until and unless a class has been certified by the court, it has not been established that the named plaintiffs represent the class of plaintiffs they purport to represent. Settlement classes have been certified in connection with the settlements of certain of the putative class actions described below where the courts held that the named plaintiffs represented the settlement class they purported to represent.



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The terms and conditions of applicable bylaws, certificates or articles of incorporation, agreements or applicable law may obligate QCII to indemnify its former directors, officers and employees with respect to certain of the matters described below, and QCII has been advancing legal fees and costs to many former directors, officers and employees in connection with certain matters described below.

***Settlement of Consolidated Securities Action***

Twelve putative class actions purportedly brought on behalf of purchasers of QCII's publicly traded securities between May 24, 1999 and February 14, 2002 were consolidated into a consolidated securities action pending in federal district court in Colorado against QCII and various other defendants. The first of these actions was filed on July 27, 2001. Plaintiffs alleged, among other things, that defendants issued false and misleading financial results and made false statements about QCII's business and investments, including materially false statements in certain of QCII's registration statements. The most recent complaint in this matter sought unspecified compensatory damages and other relief. However, counsel for plaintiffs indicated that the putative class would seek damages in the tens of billions of dollars.

In November 2005, QCII, certain other defendants, and the putative class representatives entered into, and filed with the federal district court in Colorado, a Stipulation of Partial Settlement that, if implemented, will settle the consolidated securities action against QCII and certain other defendants (the "QCII settlement"). No parties admit any wrongdoing as part of the QCII settlement. Pursuant to the QCII settlement, QCII deposited approximately \$400 million in cash into a settlement fund. In connection with the QCII settlement, QCII received \$10 million from Arthur Andersen LLP. As part of the QCII settlement, the class representatives and the settlement class they represent are also releasing Arthur Andersen. If the QCII settlement is not implemented, QCII will be repaid the \$400 million plus interest, less certain expenses, and QCII will repay the \$10 million to Arthur Andersen.

If implemented, the QCII settlement will resolve and release the individual claims of the class representatives and the claims of the settlement class they represent against QCII and all defendants except Joseph Nacchio, our former chief executive officer, and Robert Woodruff, our former chief financial officer. In September 2006, the federal district court in Colorado issued an order approving the proposed QCII settlement on behalf of purchasers of QCII's publicly traded securities between May 24, 1999 and July 28, 2002, over the objections of Messrs. Nacchio and Woodruff. Messrs. Nacchio and Woodruff then appealed that order to the United States Court of Appeals for the Tenth Circuit. In addressing that appeal, the Tenth Circuit held that the federal district court order overruling Nacchio and Woodruff's objections to the QCII settlement was not sufficiently specific, and it remanded the case to the district court with instructions to consider certain issues and to provide a more detailed explanation for its earlier decision overruling those objections. Subsequent to the remand, a proposed settlement was reached involving the claims of the putative class against Messrs. Nacchio and Woodruff as described below that, if implemented, will also result in the implementation of the QCII settlement.

On August 4, 2008, QCII, Messrs. Nacchio and Woodruff, and the putative class representatives entered into a Stipulation of Settlement (the "Nacchio/Woodruff settlement") that, if implemented, will, among other things, (i) settle the individual claims of the putative class representatives and the class they purport to represent against Messrs. Nacchio and Woodruff, and (ii) result in the withdrawal by Messrs. Nacchio and Woodruff of their objections to the QCII settlement and the resolution of their indemnification dispute with QCII arising from the QCII settlement. Under the proposed Nacchio/Woodruff settlement, QCII would contribute \$40 million, and

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Messrs. Nacchio and Woodruff would contribute a total of \$5 million of insurance proceeds. The Nacchio/Woodruff settlement is subject to a number of conditions and future contingencies, including that it (i) requires both preliminary and final court approval, and (ii) provides QCII with the right to terminate the settlement if class members representing more than a specified amount of alleged securities losses elect to opt out of the settlement. No parties admit any wrongdoing as a part of the Nacchio/Woodruff settlement.

***KPNQwest Litigation/Investigation***

On June 25, 2004, the trustees in the Dutch bankruptcy proceeding for KPNQwest, N.V. (of which QCII was a major shareholder) filed a lawsuit in the federal district court for the District of New Jersey alleging violations of the Racketeer Influenced and Corrupt Organizations Act, and breach of fiduciary duty and mismanagement under Dutch law. QCII is a defendant in this lawsuit along with Joseph Nacchio, Robert S. Woodruff and John McMaster, the former president and chief executive officer of KPNQwest. Plaintiffs allege, among other things, that defendants' actions were a cause of the bankruptcy of KPNQwest and they seek damages for the bankruptcy deficit of KPNQwest of approximately \$2.4 billion. Plaintiffs also seek treble damages as well as an award of plaintiffs' attorneys' fees and costs. On October 17, 2006, the court issued an order granting defendants' motion to dismiss the lawsuit, concluding that the dispute should be adjudicated in the Netherlands rather than New Jersey. Plaintiffs appealed this decision to the United States Court of Appeals for the Third Circuit, which affirmed the dismissal. Plaintiffs have petitioned the United States Supreme Court to review the Third Circuit's decision.

On September 13, 2006, Cargill Financial Markets, Plc and Citibank, N.A. filed a lawsuit in the District Court of Amsterdam, located in the Netherlands, against QCII, KPN Telecom B.V., Koninklijke KPN N.V. ("KPN"), Joseph Nacchio, John McMaster, and other former employees or supervisory board members of QCII, KPNQwest, or KPN. The lawsuit alleges that defendants misrepresented KPNQwest's financial and business condition in connection with the origination of a credit facility and wrongfully allowed KPNQwest to borrow funds under that facility. Plaintiffs allege damages of approximately €219 million (or approximately \$316 million based on the exchange rate on September 30, 2008).

On October 31, 2002, Richard and Marcia Grand, co-trustees of the R.M. Grand Revocable Living Trust, dated January 25, 1991, filed a lawsuit in Arizona Superior Court. As amended and following the appeal of a partial summary judgment against plaintiffs which was affirmed in part and reversed in part, plaintiffs allege, among other things, that defendants violated state securities laws in connection with plaintiffs' investments in KPNQwest securities. QCII is a defendant in this lawsuit along with Qwest B.V. (one of QCII's subsidiaries), Joseph Nacchio and John McMaster. Plaintiffs claim to have lost approximately \$10 million in their investments in KPNQwest, and are also seeking interest and attorneys' fees.

On August 23, 2005, the Dutch Shareholders Association (Vereniging van Effectenbezitters, or VEB) filed a petition for inquiry with the Enterprise Chamber of the Amsterdam Court of Appeals, located in the Netherlands, with regard to KPNQwest. VEB sought an inquiry into the policies and course of business at KPNQwest that are alleged to have caused the bankruptcy of KPNQwest in May 2002, and an investigation into alleged mismanagement of KPNQwest by its executive management, supervisory board members, joint venture entities (QCII and KPN), and KPNQwest's outside auditors and accountants. On December 28, 2006, the Enterprise Chamber ordered an inquiry into the management and conduct of affairs of KPNQwest for the period January 1 through May 23, 2002. QCII and others have appealed that order to the Netherlands Supreme Court.

QCII will continue to defend against the pending KPNQwest litigation matters vigorously.

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***Other Matters***

Several putative class actions relating to the installation of fiber optic cable in certain rights-of-way were filed against QCII on behalf of landowners on various dates and in various courts in California, Colorado, Georgia, Illinois, Indiana, Kansas, Massachusetts, Mississippi, Missouri, Oregon, South Carolina, Tennessee and Texas. For the most part, the complaints challenge QCII's right to install its fiber optic cable in railroad rights-of-way. Complaints in Colorado, Illinois and Texas, also challenge QCII's right to install fiber optic cable in utility and pipeline rights-of-way. The complaints allege that the railroads, utilities and pipeline companies own the right-of-way as an easement that did not include the right to permit QCII to install its fiber optic cable in the right-of-way without the plaintiffs' consent. Most actions (California, Colorado, Georgia, Kansas, Mississippi, Missouri, Oregon, South Carolina, Tennessee and Texas) purport to be brought on behalf of state-wide classes in the named plaintiffs' respective states. The Massachusetts action purports to be on behalf of state-wide classes in all states in which QCII has fiber optic cable in railroad rights-of-way (other than Louisiana and Tennessee), and also on behalf of two classes of landowners whose properties adjoin railroad rights-of-way originally derived from federal land grants. Several actions purport to be brought on behalf of multi-state classes. The Illinois state court action purports to be on behalf of landowners in Illinois, Iowa, Kentucky, Michigan, Minnesota, Nebraska, Ohio and Wisconsin. The Illinois federal court action purports to be on behalf of landowners in Arkansas, California, Florida, Illinois, Indiana, Missouri, Nevada, New Mexico, Montana and Oregon. 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 complaints seek damages on theories of trespass and unjust enrichment, as well as punitive damages. On July 18, 2008, the Massachusetts court entered an order preliminarily approving a settlement of all of the actions described above, except the action pending in Tennessee. The court also set a hearing for November 17, 2008 to consider final approval of the proposed settlement.

Qwest Communications Corporation ("QCC"), one of QCII's other subsidiaries, is a defendant in litigation filed by several billing agents for the owners of payphones seeking compensation for coinless calls made from payphones. The matter is pending in the United States District Court for the District of Columbia. Generally, the payphone owners claim that QCC underpaid the amount of compensation due to them under Federal Communications Commission ("FCC") regulations for coinless calls placed from their phones onto QCC's network. The claim seeks compensation for calls, as well as interest and attorneys' fees. QCC will vigorously defend against this action.

We have been a defendant in litigation brought by several owners of payphones relating to the rates we charged them for the lines to their payphones between 1997 and 2003. Generally, the payphone owners have claimed that we charged more for payphone access lines than we were permitted to charge under the applicable FCC rules. The largest of these lawsuits, filed in the United States District Court for the Western District of Washington, has been amicably settled for an immaterial amount and dismissed. One lawsuit is still pending in the United States District Court for the District of Utah, which is currently stayed pending resolution of related proceedings before the FCC. Another proceeding against us is also pending before the Oregon Public Utility Commission. Several related proceedings are underway at the FCC involving us, other telecommunications companies, and payphone owners. In all of these proceedings, the payphone owners seek damages for amounts paid allegedly exceeding the amounts that were permitted under the applicable FCC rules. We will vigorously defend against these actions.

A putative class action filed on behalf of certain of QCII's retirees was brought against QCII, the Qwest Life Insurance Plan and other related entities in federal district court in Colorado in connection with QCII's decision

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to reduce the life insurance benefit for these retirees to a \$10,000 benefit. The action was filed on March 30, 2007. The plaintiffs allege, among other things, that QCII and other defendants were obligated to continue their life insurance benefit at the levels in place before QCII decided to reduce them. Plaintiffs seek restoration of the life insurance benefit to previous levels and certain equitable relief. The district court ruled in QCII's favor on the central issue of whether QCII properly reserved its right to reduce the life insurance benefit under applicable law and plan documents. The retirees have amended their complaint to assert additional claims. QCII believes the remaining claims are without merit, and QCII will continue to vigorously defend against this matter.

***Flood Damage***

During June 2008, floods in the Midwest, particularly Iowa, caused damage to our network and other assets. Based on our current assessment, we estimate that cumulative expenditures required for the restoration of our network and physical plant will be approximately \$30 million, including repairs and equipment replacement. For the three and nine months ended September 30, 2008, we incurred repair expenditures of \$6 million and \$8 million, respectively, which are included in the \$30 million estimate. Although we carry commercial property insurance that covers certain property damage and business interruption, we do not expect that a substantial portion of the \$30 million estimate will be covered because we are subject to a \$5 million deductible for buildings and contents and a \$25 million deductible for buried outside plant. We are working with our insurance carriers to determine the extent to which insurance proceeds will offset these expenditures.

**Note 8: Labor Union Contracts**

In August 2008, we reached tentative agreements with our labor unions, the Communications Workers of America ("CWA") and the International Brotherhood of Electrical Workers ("IBEW"), on new three-year collective bargaining agreements. Each of these agreements needed to be ratified by union members, and in September 2008 CWA members failed to ratify the CWA agreement. In October 2008, we again reached tentative agreements with the CWA and IBEW, this time on new four-year collective bargaining agreements. Each of these agreements must be ratified by union members, and if ratified, will expire on October 6, 2012. As of September 30, 2008, employees covered by these agreements totaled 18,135, or 57% of all our employees.

**Note 9: Dividends**

We declared dividends to QSC of \$600 million and \$2.2 billion and paid dividends of \$800 million and \$1.8 billion during the three and nine months ended September 30, 2008, respectively.

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

*Unless the context requires otherwise, references in this report to "QC" refer to Qwest Corporation, references to "Qwest," "we," "us," the "Company" and "our" refer to Qwest Corporation and its consolidated subsidiaries, references to "QSC" refer to our direct parent company, Qwest Services 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. See "Special Note Regarding Forward-Looking Statements" at the end of this Item 2 for additional factors relating to such statements, and see "Risk Factors" in Item 1A of Part II of this report for a discussion of certain risk factors applicable to our business, financial condition and results of operations.

**Business Overview and Presentation**

We provide voice, data, Internet and satellite video services. We generate revenue from services provided in the 14-state region of Arizona, Colorado, Idaho, Iowa, Minnesota, Montana, Nebraska, New Mexico, North Dakota, Oregon, South Dakota, Utah, Washington and Wyoming. We refer to this region as our local service area.

Our operations are included in the consolidated operations of our ultimate parent, QCII, and generally account for the majority of QCII's consolidated revenue. In addition to our operations, QCII maintains a national telecommunications network. Through its fiber optic network, QCII provides the following products and services that we do not provide:

- Long-distance services that allow calls that cross telecommunications geographical areas;
- Dedicated Internet access;
- Virtual private network;
- Hosting services;
- Data integration;
- Voice over Internet protocol, or VoIP;
- Multi-protocol label switching; and
- Cable-based video.

For certain products and services we provide, and for a variety of internal communications functions, we use parts of QCII's telecommunications network to transport voice and data traffic. Through its network, QCII also provides nationally and globally some data and Internet access services that are similar to services we provide within our local service area. These services include private line, ATM and frame relay.

Our analysis presented below is organized to provide the information we believe will be useful for understanding the relevant trends going forward. However, this discussion should be read in conjunction with our condensed consolidated financial statements and the notes thereto in Item 1 of Part I of this report.

In light of regulatory changes in 2007 and consistent with QCII's continuing strategy to simplify its and our corporate structure and gain operational efficiencies, in the first quarter of 2008 QCII moved to us most of the administrative and other functions of QSC and merged into us two of QSC's other wholly owned subsidiaries that previously charged the majority of their costs to us:

- a procurement company that managed real estate and other supplier selection and negotiations; and

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- a computer system support services company that handled development, application, maintenance, integration and testing of software.

These reorganization activities combined businesses that were already controlled by QCII, therefore we accounted for these activities in a manner similar to a pooling of interests. These activities had the following effect on our condensed consolidated financial statements for the three and nine months ended September 30, 2007 and as of December 31, 2007:

	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2007
	(Dollars in millions)	
Increases in:		
Total operating revenue	\$ 215	\$ 637
Income before income taxes	13	46
Net income	7	26
	December 31, 2007	
	(Dollars in millions)	
Increases in:		
Total assets	\$ 1,125	
Total liabilities	732	

In addition, to aid the understanding of these and future financial statements, we recast prior year financial information in our Current Report on Form 8-K dated April 4, 2008 (our “April 4, 2008 Form 8-K”).

QCII continues to evaluate other ways to better organize the legal structure and operations of its subsidiaries and may make additional changes to the legal structure and operations of its subsidiaries, including us, in the future. In connection with these past or future reorganization activities, we do not believe we have consummated, and we do not expect to consummate in the future, any business combinations or other transactions that will adversely affect our consolidated financial condition or results of operations.

During the first quarter of 2008, we also changed the definitions we use to classify expenses as cost of sales, selling expenses or general, administrative and other operating expenses. Operating expenses are now reported as follows:

- Cost of sales are costs incurred in providing products and services to our customers. These include: employee-related costs directly attributable to operating and maintaining our network (such as salaries, wages and certain benefits); and other cost of sales directly related to our network operations (such as professional fees, materials and supplies, equipment sales costs and outsourced services).
- Selling expenses are costs incurred in selling products and services to our customers. These include: employee-related costs directly attributable to selling products or services (such as salaries, wages, internal commissions and certain benefits); marketing, advertising and external commissions; and other selling costs (such as bad debt expense, professional fees and outsourced services).
- General, administrative and other operating expenses are corporate overhead and other operating costs. These include: employee-related costs for administrative functions (such as salaries, wages and certain benefits); taxes and fees (such as property and other taxes and Universal Service Fund, or USF, charges); real estate and occupancy costs (such as rents, utilities and fleet costs); and other general, administrative and other operating costs (such as professional fees, outsourced services, litigation related charges and general computer systems support services). These expenses also include our pension and post-retirement benefits costs for all employees and retirees.

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We believe these reclassification changes allow users of our financial statements to better understand our cost structure and the way we manage our business. These expense classifications may not be comparable to those of other companies. These changes had no impact on total operating expenses or net income for any period.

To reflect the impact that the reorganization activities and expense reclassifications described above would have had if they had been implemented in prior periods, we have recast and reclassified certain financial information for the three and nine months ended September 30, 2007 that is presented in this Item 2 and in our condensed consolidated financial statements in Item 1 of Part I of this report. In addition, to aid the understanding of this filing and future filings, we recast and reclassified certain prior year financial information in our April 4, 2008 Form 8-K.

We have also reclassified certain other prior year revenue, expenses and access line amounts to conform to the current year presentation.

## Business Trends

Our financial results continue to be impacted by several significant trends, which are described below:

- *Data, Internet and video growth.* Revenue from data, Internet and video services represented 31% and 27% of our total revenue for the nine months ended September 30, 2008 and 2007, respectively, and continues to grow. We also continue to see shifts in the makeup of this revenue as customers move from traditional data, Internet and video products to more-advanced technologies. As a result, we continue to focus on these more-advanced, high-growth products, which include: broadband services; private line; and satellite video services. The revenue increases from these more-advanced, high-growth products have outpaced revenue declines from traditional data, Internet and video services (such as asynchronous transfer mode, or ATM; frame relay; dedicated Internet access, or DIA; virtual private network, or VPN; and Internet dial-up access).

We also continue to focus on improving penetration of broadband services, and broadband subscribers continue to grow as customers migrate to higher speed Internet connections. We reached 2.7 million broadband subscribers as of September 30, 2008 compared to 2.4 million as of the same date in 2007. We believe the ability to continually increase connection speeds is competitively important. As a result, we continue to invest in increasing our available connection speeds to meet customer demand. We expect broadband subscriber growth to continue, but at a lesser rate than in prior periods, as we continue to compete in a maturing market where a significant portion of consumers already have a broadband connection.

- *Access line losses.* Our revenue has been, and we expect it will continue to be, adversely affected by access line losses. Increased competition, including product substitution, continues to drive our access line losses. For example, many consumers are substituting cable, wireless and VoIP for traditional voice telecommunications services. This has increased the number and type of competitors within our industry and has decreased our market share. Additionally, we believe declining economic conditions have contributed to an acceleration in our access line losses in 2008, and may continue to do so for the remainder of the year. The declining economic conditions will likely continue to impact our business into 2009. Product bundling, as described below, continues to be one of our responses to access line losses.
- *Product promotions.* We offer many of our customers the ability to bundle several products and services. For example, through joint marketing and advertising efforts with our affiliates, these customers can bundle local voice services with other services such as broadband, video, long-distance and wireless. We believe customers value the convenience of, and price discounts associated with, receiving multiple services through a single company. In addition to our bundle discounts, we also offer limited time promotions and a fixed price on our broadband service for qualifying customers who have our broadband product in their bundle. This “Price for Life” guarantee allows qualifying



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customers to lock-in their monthly broadband charges for as long as they qualify. While bundle price discounts have resulted in lower average revenue for our individual products, we believe product bundles continue to positively impact our customer retention.

- *Margin contraction* . We continue to see customers moving from traditional products and services to more-advanced technology products and services. The costs associated with providing these more-advanced products and services have generally not yet achieved benefits of scale and are often higher than the costs to provide traditional products and services. As scale improves on the more-advanced products and services, we expect our cost structure will improve. We are responding to this trend with improved operational efficiencies and operating initiatives to stem the loss of revenue from traditional products and services.
- *Operational efficiencies* . We continue to evaluate our operating structure and focus. In some cases, this involves adjusting our workforce in response to productivity improvements and changes in the telecommunications industry and governmental regulations. Through planned reductions and normal employee attrition, we have reduced our workforce and employee-related costs while achieving operational efficiencies and improving processes through automation.
- *Wireless services*. In April 2008, we signed a five-year agreement with a nationwide wireless service provider to market its wireless products and services under its brand name beginning in the third quarter of 2008. Revenue from reselling these products and services is recorded on a net basis in our consolidated financial statements as a voice service. One of our affiliates currently offers wireless services under a service arrangement with a different nationwide wireless service provider. Under this arrangement, which will end in 2009, our affiliate provides wireless services under the Qwest brand name.

While these trends are important to understanding and evaluating our financial results, the other transactions, events and trends discussed in “Risk Factors” in Item 1A of Part II of this report may also materially impact our business operations and financial results.

## Results of Operations

### Overview

We generate the majority of our revenue by providing services using our telecommunications network. We also generate revenue from services we provide to our affiliates. Depending on the products or services purchased, a customer may pay a service activation fee, a monthly service fee, a usage charge or a combination of these. Our services are further described below.

- *Voice services* . Voice services include local voice services and access services. Local voice services include basic local exchange, switching and enhanced voice services. Local voice services also includes unbundled network elements, or UNEs, provided to our wholesale customers. Access services include fees we charge to other telecommunications providers to connect their customers and their networks to our network. As discussed above, we will begin to generate revenue from reselling wireless services in 2008.
- *Data, Internet and video services* . Data, Internet and video services include: broadband services and satellite video services that we offer to consumers; private line services that we offer to other telecommunications providers and enterprise customers; and other data services such as integrated services digital network, ATM and frame relay that we offer primarily to enterprise customers.
- *Affiliate services*. We provide to our affiliates voice services, data services and billing and collections services that we also provide to external customers. In addition, we provide to our affiliates: marketing,



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sales and advertising; computer system development and support services; network support and technical services; and other support services, such as legal, regulatory, general finance and accounting, tax, human resources and executive support.

We also generate other revenue from USF surcharges and the subleasing of space in our office buildings, warehouses and other properties.

The following table summarizes our results of operations for the three and nine months ended September 30, 2008 and 2007 and the number of employees as of September 30, 2008 and 2007:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2008	2007	Increase/ (Decrease)	% Change	2008	2007	Increase/ (Decrease)	% Change
	(Dollars in millions)							
Operating revenue	\$2,556	\$2,668	\$ (112)	(4)%	\$ 7,787	\$ 8,049	\$ (262)	(3)%
Operating expenses	1,936	1,912	24	1%	5,642	5,718	(76)	(1)%
Other expense—net	138	150	(12)	(8)%	437	469	(32)	(7)%
Income before income taxes	482	606	(124)	(20)%	1,708	1,862	(154)	(8)%
Income tax expense	183	228	(45)	(20)%	649	707	(58)	(8)%
Net income	<u>\$ 299</u>	<u>\$ 378</u>	<u>\$ (79)</u>	(21)%	<u>\$ 1,059</u>	<u>\$ 1,155</u>	<u>\$ (96)</u>	(8)%
Employees (as of September 30)					31,765	34,490	(2,725)	(8)%

### Operating Revenue

The following table compares our total operating revenue by products and services for the three and nine months ended September 30, 2008 and 2007:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2008	2007	Increase/ (Decrease)	% Change	2008	2007	Increase/ (Decrease)	% Change
	(Dollars in millions)							
Operating revenue:								
Voice services	\$1,280	\$1,402	\$ (122)	(9)%	\$3,930	\$4,299	\$ (369)	(9)%
Data, Internet and video services	810	734	76	10%	2,398	2,156	242	11%
Affiliate services	422	485	(63)	(13)%	1,325	1,453	(128)	(9)%
Other revenue (primarily USF surcharges)	44	47	(3)	(6)%	134	141	(7)	(5)%
Total operating revenue	<u>\$2,556</u>	<u>\$2,668</u>	<u>\$ (112)</u>	(4)%	<u>\$7,787</u>	<u>\$8,049</u>	<u>\$ (262)</u>	(3)%

In addition to the specific items discussed below, we believe declining economic conditions negatively impacted our revenue for the three and nine months ended September 30, 2008.

### Voice Services Revenue

Voice services revenue decreased primarily due to lower local voice services revenue as a result of access line losses of 9% as of September 30, 2008 compared to September 30, 2007. We had 11.869 million and 13.032 million access lines as of September 30, 2008 and 2007, respectively. We continue to experience access line losses as a result of competitive pressures and declining economic conditions, as described in “Business Trends.”

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### Data, Internet and Video Services Revenue

Data, Internet and video services revenue increased primarily due to an 11% increase in broadband subscribers and, to a lesser extent, a 30% increase in satellite video subscribers as of September 30, 2008 compared to September 30, 2007. The growth in broadband services revenue resulted from continuing increases in penetration and, to a lesser extent, increased rates as customers upgraded to higher speed services. Private line services revenue also increased as a result of higher volumes. These revenue increases were partially offset by a decline in frame relay and ATM services revenue due to lower volumes.

### Affiliate Services Revenue

Affiliate services revenue decreased primarily due to a change in the way we determine sales and marketing and advertising support services billed to our affiliates. We implemented this change in the fourth quarter of 2007. These revenue decreases were partially offset by an increase in services we provided to support an affiliate's data and Internet product offerings.

We estimate that the profit from these affiliate services was approximately \$90 million and \$100 million, before income taxes, for the three months ended September 30, 2008 and 2007, respectively, and \$290 million, before income taxes, for each of the nine month periods ended September 30, 2008 and 2007.

### Operating Expenses

The following table provides further detail regarding our total operating expenses for the three and nine months ended September 30, 2008 and 2007:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2008	2007	Increase/ (Decrease)	% Change	2008	2007	Increase/ (Decrease)	% Change
	(Dollars in millions)							
Cost of sales (exclusive of depreciation and amortization):								
Employee-related costs	\$ 328	\$ 311	\$ 17	5%	\$ 930	\$ 932	\$ (2)	— %
Other	133	106	27	25%	369	297	72	24%
Total cost of sales	461	417	44	11%	1,299	1,229	70	6%
Selling:								
Employee-related costs	268	261	7	3%	802	788	14	2%
Marketing, advertising and external commissions	119	123	(4)	(3)%	344	350	(6)	(2)%
Other	81	64	17	27%	225	187	38	20%
Total selling	468	448	20	4%	1,371	1,325	46	3%
General, administrative and other operating:								
Employee-related costs	115	118	(3)	(3)%	352	385	(33)	(9)%
Taxes and fees	101	107	(6)	(6)%	277	344	(67)	(19)%
Real estate and occupancy costs	78	78	—	— %	230	231	(1)	— %
Other	130	146	(16)	(11)%	412	420	(8)	(2)%
Total general, administrative and other operating	424	449	(25)	(6)%	1,271	1,380	(109)	(8)%
Affiliates	60	42	18	43%	150	120	30	25%
Depreciation and amortization	523	556	(33)	(6)%	1,551	1,664	(113)	(7)%
Total operating expenses	<u>\$1,936</u>	<u>\$1,912</u>	<u>\$ 24</u>	1%	<u>\$5,642</u>	<u>\$5,718</u>	<u>\$ (76)</u>	(1)%

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### **Cost of Sales (exclusive of depreciation and amortization)**

Cost of sales are costs incurred in providing products and services to our customers. These include: employee-related costs directly attributable to operating and maintaining our network (such as salaries, wages and certain benefits); and other cost of sales directly related to our network operations (such as professional fees, materials and supplies, equipment sales costs and outsourced services).

Employee-related costs increased for the three months ended September 30, 2008 primarily due to a severance charge of approximately \$40 million related to network operations, partially offset by lower costs associated with the first quarter of 2008 employee reductions in our network operations. Employee-related costs remained essentially flat for the nine months ended September 30, 2008 primarily due to severance charges of approximately \$40 million in each of the first and third quarters of 2008 related to employee reductions in our network operations, which were partially offset by lower costs as a result of the first quarter of 2008 employee reductions. As a result of these employee reductions, we expect total employee-related costs to decrease by approximately 4% to 5% in future periods.

Other cost of sales increased primarily due to higher equipment sales costs and higher professional fees and other costs for operating and maintaining our network.

As discussed in Note 7—Commitments and Contingencies to our condensed consolidated financial statements in Item 1 of Part I of this report, during June 2008 floods in the Midwest, particularly Iowa, caused damage to our network. Based on our current assessment, we estimate that cumulative expenditures required for the restoration of our network and physical plant will be approximately \$30 million, including repairs and equipment replacement. For the three and nine months ended September 30, 2008, we incurred repair expenditures of \$6 million and \$7 million, respectively, which are included in the \$30 million estimate.

### **Selling Expenses**

Selling expenses are costs incurred in selling products and services to our customers. These include: employee-related costs directly attributable to selling products or services (such as salaries, wages, internal commissions and certain benefits); marketing, advertising and external commissions; and other selling costs (such as bad debt expense, professional fees and outsourced services).

Employee-related costs increased primarily due to a severance charge of \$8 million in the third quarter of 2008 and higher costs associated with our sales force. These increases were partially offset by a decline in the amortization of customer acquisition costs associated with the activation of access lines. Certain customer acquisition costs are deferred and amortized over the expected life of the customer relationship and have been declining in amount as a result of access line losses and promotional waivers of activation fees.

Marketing, advertising and external commissions decreased primarily due to lower costs for media advertising in 2008.

Other selling costs increased due to higher professional fees related to systems and process improvements to support selling and billing functions and higher costs for postage and shipping, bad debt expense and other costs, including expenses associated with sponsoring the Democratic and Republican National Conventions, which took place in our 14-state region in the third quarter of 2008.

### **General, Administrative and Other Operating Expenses**

General, administrative and other operating expenses are corporate overhead and other operating costs. These include: employee-related costs for administrative functions (such as salaries, wages and certain benefits);

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taxes and fees (such as property and other taxes and USF charges); real estate and occupancy costs (such as rents, utilities and fleet costs); and other general, administrative and other operating costs (such as professional fees, outsourced services, litigation related charges and general computer systems support services). These expenses also include our pension and post-retirement benefits costs for all employees and retirees.

Employee-related costs decreased for the three months ended September 30, 2008 primarily due to lower pension and post-retirement benefit costs, partially offset by increases in certain health care costs and a severance charge of \$15 million. Employee-related costs decreased for the nine months ended September 30, 2008 primarily due to lower pension costs, payroll taxes and certain health care costs, partially offset by severance charges of \$24 million and an increase in post-retirement benefit costs.

Taxes and fees for the nine months ended September 30, 2008 decreased primarily due to a \$40 million favorable property tax settlement recognized in the second quarter of 2008 and other favorable adjustments in 2008.

Other expenses for the three months ended September 30, 2008 decreased primarily due to a \$13 million legal reserve accrual recorded in the third quarter of 2007 related to patent infringement claims. For the nine months ended September 30, 2008, other expenses decreased due to the legal reserve recorded in the third quarter of 2007 and lower marketing research expense partially offset by increased professional fees.

### Affiliate Expenses

Affiliate expenses include charges for our use of long-distance services, wholesale Internet access, insurance, occupancy charges and certain retiree benefits.

Affiliate expenses increased primarily due to Internet access and voicemail services, occupancy charges and a general liability insurance credit adjustment in 2007.

### Depreciation and Amortization

The following table provides detail regarding depreciation and amortization expense:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	<u>2008</u>	<u>2007</u>	<u>Increase/ (Decrease)</u>	<u>% Change</u>	<u>2008</u>	<u>2007</u>	<u>Increase/ (Decrease)</u>	<u>% Change</u>
	(Dollars in millions)							
Depreciation and amortization:								
Depreciation	\$465	\$507	\$ (42)	(8)%	\$1,392	\$1,512	\$ (120)	(8)%
Amortization	<u>58</u>	<u>49</u>	<u>9</u>	18%	<u>159</u>	<u>152</u>	<u>7</u>	5%
Total depreciation and amortization	<u>\$523</u>	<u>\$556</u>	<u>\$ (33)</u>	(6)%	<u>\$1,551</u>	<u>\$1,664</u>	<u>\$ (113)</u>	(7)%

Depreciation expense decreased due to lower capital expenditures and the changing mix of our investment in property, plant and equipment since 2002. If our capital investment program remains approximately the same and we do not significantly shorten our estimates of the useful lives of our assets, we expect that our depreciation expense will continue to decrease.

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### Other Consolidated Results

The following table provides detail regarding other expense (income)—net and income tax expense:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2008	2007	Increase/ (Decrease)	% Change (Dollars in millions)	2008	2007	Increase/ (Decrease)	% Change
Other expense (income)—net:								
Interest expense on long-term borrowings and capital leases—net	\$145	\$154	\$ (9)	(6)%	\$444	\$454	\$ (10)	(2)%
Other—net	(7)	(4)	(3)	(75)%	(7)	15	(22)	nm
Total other expense (income)—net	<u>\$138</u>	<u>\$150</u>	<u>\$ (12)</u>	(8)%	<u>\$437</u>	<u>\$469</u>	<u>\$ (32)</u>	(7)%
Income tax expense	\$183	\$228	\$ (45)	(20)%	\$649	\$707	\$ (58)	(8)%

nm— Percentages greater than 200% and comparisons between positive and negative values or to/from zero values are considered not meaningful.

Interest expense on long-term borrowings and capital leases—net decreased due to lower interest rates on floating rate debt and interest rate swaps.

Other—net includes, among other things, interest income, other interest expense, such as interest on income taxes, and gains or losses related to fair value interest rate hedges. The change in other—net for the three months ended September 30, 2008 compared to the same period in 2007 was primarily due to an interest benefit related to QCII's income tax settlement in the third quarter of 2008, partially offset by lower interest income resulting from lower interest rates in 2008.

For the nine months ended September 30, 2008, other—net includes an interest benefit related to QCII's income tax settlement and interest income, partially offset by tax interest expense. For the nine months ended September 30, 2007, other—net includes an \$18 million loss on early retirement of debt in the second quarter of 2007 and tax interest expense, partially offset by interest income.

The effective income tax rate is the provision for income taxes as a percentage of income before income taxes. Our effective income tax rate was 38.0% and 37.6% for the three months ended September 30, 2008 and 2007, respectively, and 38.0% for each of the nine month periods ended September 30, 2008 and 2007.

### 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 impacts on our credit ratings, our access to capital markets and changes in the market's perception of us. QCII and its consolidated subsidiaries had total borrowings of \$14.1 billion at September 30, 2008 and \$14.3 billion at December 31, 2007.

QCII has cash management arrangements between certain of its subsidiaries that include lines of credit, affiliate 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 inter-company obligations vary from time to time and are classified as short-term borrowings.

### Near-Term View

We had \$289 million in cash and cash equivalents available at September 30, 2008. For the nine months ended September 30, 2008, our cash was generated by operating activities. For the next 12 months, we expect to use our available excess cash primarily to pay dividends and income taxes to QSC and to make additional

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investments in our network. We expect our 2008 capital expenditures to be higher than our 2007 level and our 2009 capital expenditures to approximate our 2008 level. For the nine months ended September 30, 2008, we declared dividends of \$2.2 billion to QSC and paid dividends of \$1.8 billion to QSC.

Our working capital deficit, or the amount by which our current liabilities exceed our current assets, was \$1.517 billion as of September 30, 2008 and \$904 million as of December 31, 2007. Our working capital deficit increased by \$613 million primarily due to dividends declared to QSC and capital expenditures, partially offset by earnings before depreciation, amortization and income taxes.

Our working capital deficit is primarily caused by dividends that we pay to QSC. The timing of cash payments for declared dividends to QSC is at our discretion in consultation with QSC. We continue to produce significant cash from operating activities, and we believe that our cash on hand and our cash flows from operations should be sufficient to meet our cash needs through the next 12 months. We have approximately \$320 million of debt maturing in the next 12 months, and we may elect to refinance some or all of that debt. However, due to recent turmoil in the credit markets and the continued decline in the economy, we may not be able to refinance maturing debt at terms that are as favorable as those from which we previously benefited or at terms that are acceptable to us.

To the extent that QCII's earnings before interest, taxes, depreciation and amortization, or EBITDA (as defined in QCII's debt covenants), is reduced by cash judgments, settlements and/or tax payments, its debt to consolidated EBITDA ratios under certain debt agreements will be adversely affected. This could reduce QCII's liquidity and flexibility due to potential restrictions on drawing on its revolving credit facility (referred to as the Credit Facility) and potential restrictions on incurring additional debt under certain provisions of its debt agreements. As a wholly owned subsidiary of QCII, our business operations and financial condition could be similarly affected, potentially impacting our credit ratings and access to capital markets.

On March 27, 2008, in connection with the addition of a new lender to its Credit Facility, QCII increased the amount available to it under the Credit Facility from \$850 million to \$910 million. On September 14, 2008, a potential lender with a \$60 million lending commitment under the Credit Facility filed for bankruptcy, and QCII does not believe that this \$60 million will be available to it. The Credit Facility is currently undrawn and expires in October 2010. The Credit Facility contains various limitations, including a restriction on using any proceeds from the facility to pay settlements or judgments relating to securities-related actions discussed in Note 7—Commitments and Contingencies to our condensed consolidated financial statements in Item 1 of Part I of this report. Any amounts drawn on the Credit Facility are guaranteed by QSC and are secured by a senior lien on our stock.

On October 16, 2008, QCII's Board of Directors declared a quarterly dividend of \$0.08 per share totaling approximately \$136 million, payable on December 5, 2008 to shareholders of record as of November 14, 2008. It is the expectation of QCII's Board of Directors to pay a quarterly dividend going forward.

On October 4, 2006, QCII's Board of Directors approved a stock repurchase program for up to \$2 billion of QCII's common stock. For the three and nine months ended September 30, 2008, QCII repurchased 46 million and 95 million shares, respectively, of its common stock under this program at a weighted average price per share of \$3.72 and \$4.49, respectively. As of September 30, 2008, QCII had repurchased a total of \$1.807 billion of common stock under this program; thus \$193 million remained available for stock repurchases. In light of current credit market conditions, QCII's Board of Directors has extended the timeframe to complete these repurchases, which were originally scheduled to be completed in 2008.

### *Long-Term View*

We have historically operated with a working capital deficit due to our practice of declaring and paying regular cash dividends to QSC, and it is likely that we will operate with a working capital deficit in the future. As

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discussed below, we continue to generate substantial cash from operations. We believe that cash provided by operations, combined with our current cash position and continued access to capital markets to refinance our debt as it matures, should allow us to meet our cash requirements for the foreseeable future. Due to recent turmoil in the credit markets, we may not be able to refinance maturing debt at terms that are as favorable as those from which we previously benefited or at terms that are acceptable to us.

We may periodically need to obtain financing in order to meet our debt obligations as they come due. We may also need to obtain additional financing or investigate other methods to generate cash (such as further cost reductions or the sale of assets) if revenue and cash provided by operations decline, if economic conditions continue to weaken, if competitive pressures increase, if holders of the 3.50% Convertible Senior Notes elect to convert their notes because market-based conversion provisions are met or every five years on November 15, beginning in 2010, if we or QCII are required to contribute a material amount of cash to QCII's pension plan or if we or QCII become subject to significant judgments or settlements in one or more of the matters discussed in Note 7—Commitments and Contingencies to our condensed consolidated financial statements in Item 1 of Part I of this report. In the event of an adverse outcome in one or more of these matters, we or QCII could be required to make significant payments that may cause us to draw down significantly on our cash balances. The magnitude of any settlements or judgments resulting from these matters could materially and adversely affect QCII's financial condition and ability to meet its debt obligations, potentially impacting its credit ratings, its ability to access capital markets and its compliance with debt covenants. As a wholly owned subsidiary of QCII, our business operations and financial condition could be similarly affected, potentially impacting our credit ratings and access to capital markets.

The Credit Facility makes available to QCII \$910 million of additional credit subject to certain restrictions as described below and is currently undrawn. However, as noted above, QCII does not believe that a \$60 million portion of the Credit Facility will be available to it. This facility has a cross payment default provision, and this facility and certain other debt issues of QCII and its other subsidiaries also have cross acceleration provisions. When present, such provisions could have a wider impact on liquidity than might otherwise arise from a default or acceleration of a single debt instrument. These provisions generally provide that a cross default under these debt instruments could occur if:

- QCII fails to pay any indebtedness when due in an aggregate principal amount greater than \$100 million;
- any indebtedness is accelerated in an aggregate principal amount greater than \$100 million; or
- judicial proceedings are commenced to foreclose on any of QCII's assets that secure indebtedness in an aggregate principal amount greater than \$100 million.

Upon such a cross default, the creditors of a material amount of QCII's debt may elect to declare that a default has occurred under their debt instruments and to accelerate the principal amounts due such creditors. Cross acceleration provisions are similar to cross default provisions, but permit a default in a second debt instrument to be declared only if in addition to a default occurring under the first debt instrument, the indebtedness due under the first debt instrument is actually accelerated. As a wholly owned subsidiary of QCII, in the event of such a cross-default or cross-acceleration, our business operations and financial condition could be affected, potentially impacting our credit ratings and access to the capital markets. In addition, the Credit Facility contains various limitations, including a restriction on using any proceeds from the facility to pay settlements or judgments relating to the securities-related actions discussed in Note 7—Commitments and Contingencies to our condensed consolidated financial statements in Item 1 of Part I of this report.

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### Historical View

The following table summarizes cash flow activities for the nine months ended September 30, 2008 and 2007:

	Nine Months Ended September 30,		Increase/ (Decrease)	% Change
	2008	2007		
	(Dollars in millions)			
Cash flows:				
Provided by operating activities	\$2,727	\$2,673	\$ 54	2%
Used for investing activities	1,133	873	260	30%
Used for financing activities	1,597	1,641	(44)	(3)%

### Operating Activities

Cash provided by operating activities increased due to lower cash outflows for affiliate transactions. This included a decrease in tax payments to QSC year over year of \$371 million as a result of utilization of acquired net operating losses.

### Investing Activities

Cash used for investing activities increased primarily due to higher capital expenditures to support anticipated growth in our data and Internet services.

### Financing Activities

Cash used for financing activities decreased primarily due to an equity infusion from QSC of \$231 million in connection with the transfer to us of most of QSC's administrative and other functions and related assets and liabilities.

We paid cash dividends of \$1.800 billion and \$1.870 billion for the nine months ended September 30, 2008 and 2007, respectively. We may declare and pay dividends to QSC in excess of our earnings to the extent permitted by applicable law. Our debt covenants do not limit the amount of dividends we can pay to QSC.

For the nine months ended September 30, 2008, we repaid \$22 million of long-term borrowings. For the nine months ended September 30, 2007, we repaid \$337 million of long-term borrowings and received \$500 million of proceeds from long-term borrowings.

We were in compliance with all provisions and covenants of our borrowings as of September 30, 2008.

### Letters of Credit

As of September 30, 2008, we had outstanding letters of credit of approximately \$56 million.

### 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 currently use derivative financial instruments to manage our interest rate risk exposure and we may continue to employ them in the future.



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### Near-Term Maturities

As of September 30, 2008, we had \$320 million of long-term debt obligations maturing in the subsequent 12 months. We would be exposed to changes in interest rates at any time that we choose to refinance any of this debt. A hypothetical increase of 100 basis points in the interest rate on a refinancing of the entire current portion of long-term debt would decrease annual pre-tax earnings by approximately \$3 million.

### Floating-Rate Debt

One objective of our short-term debt strategy is to take advantage of favorable interest rates by effectively converting floating rate debt to fixed rate debt using interest rate swaps. As of September 30, 2008, we had \$750 million of floating-rate debt outstanding, of which \$250 million was exposed to changes in interest rates. This exposure is linked to the London Interbank Offered Rate, or LIBOR. We entered into interest rate swaps related to the other \$500 million that have the economic effect of converting the floating interest rates to fixed interest rates until March 2010. A hypothetical increase of 100 basis points in LIBOR relative to the \$250 million of floating-rate debt that is exposed to changes in interest rates would decrease annual pre-tax earnings by approximately \$2.5 million.

### Fixed-Rate Debt

One objective of our long-term debt strategy is to achieve a more balanced ratio of fixed rate to floating rate debt by effectively converting a portion of our fixed interest rate debt to floating rate debt using interest rate swaps. These transactions increase our exposure to changes in interest rates. As of September 30, 2008, we had approximately \$500 million of fixed rate debt covered by interest rate swaps that have the economic effect of converting the fixed interest rates to floating interest rates until 2017. A hypothetical increase of 100 basis points in LIBOR relative to this debt would decrease annual pre-tax earnings by approximately \$5 million.

### Investments

As of September 30, 2008, our cash and investments managed by QSC included \$287 million of highly liquid cash equivalent instruments, \$56 million invested in auction rate securities and \$18 million in an investment fund. As interest rates change, so will the interest income derived from these instruments. Assuming that these investment balances were to remain constant, a hypothetical decrease of 100 basis points in interest rates would decrease annual pre-tax earnings by approximately \$4 million.

### Off-Balance Sheet Arrangements

There were no substantial changes to our off-balance sheet arrangements or contractual commitments in the nine months ended September 30, 2008, when compared to the disclosures provided in our Annual Report on Form 10-K for the year ended December 31, 2007.

### Special Note Regarding Forward-Looking Statements

This Form 10-Q contains or incorporates by reference forward-looking statements 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 have filed or will file with the Securities and Exchange Commission, or SEC. You can find many

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of these statements by looking for words such as “may,” “would,” “could,” “should,” “plan,” “believes,” “expects,” “anticipates,” “estimates,” or similar expressions used in this document or in documents incorporated by reference in this document.

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 in Item 1A of Part II of this report.

These risk factors should be considered in connection with any written or oral forward-looking statements that we or persons acting on our behalf may issue. Given these uncertainties, we caution investors not to unduly rely on our forward-looking statements. 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 document or to reflect the occurrence of unanticipated events. Further, the information about our intentions contained in this document is a statement of our intentions as of the date of this document 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.

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

The information under the heading “Risk Management” in Item 2 of Part I of this report is incorporated herein by reference.

**ITEM 4. CONTROLS AND PROCEDURES**

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

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, or the “Exchange Act”) as of September 30, 2008. On the basis of this review, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures are designed, and are effective, to give reasonable assurance that the information required to be disclosed by us in reports that we file under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and to ensure that information required to be disclosed in the reports filed or submitted under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, in a manner that allows timely decisions regarding required disclosure.

There were no changes in our internal control over financial reporting that occurred in the third quarter of 2008 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II—OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

The information contained in Note 7—Commitments and Contingencies to our condensed consolidated financial statements in Item 1 of Part I of this report is incorporated herein by reference.

**ITEM 1A. RISK FACTORS**

**Risks Affecting Our Business**

***Increasing competition, including product substitution, continues to cause access line losses, 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 continue to intensify. We are facing greater competition in providing wireline services from cable companies, wireless providers (including us and one of our affiliates), facilities-based providers using their own networks as well as those leasing parts of our network, and resellers. In addition, regulatory developments over the past several years have generally increased competitive pressures on our business. Due to some of these and other factors, we continue to lose access lines.

We are continually evaluating our responses to these competitive pressures. Some of our more recent responses are product bundling and packaging and QCII's and our continuing focus on customer service. However, we may not be successful in these efforts. We may not be able to distinguish our service levels from those of our competitors, and we may not be successful in integrating our product offerings, especially products for which we act as a reseller, such as wireless services and satellite video services. If these initiatives are unsuccessful or insufficient and our revenue declines significantly without corresponding cost reductions, this will cause a significant deterioration to our results of operations and financial condition and adversely affect our ability to service debt and pay other obligations.

***Consolidation among participants in the telecommunications industry may allow our competitors to compete more effectively against us, which could adversely affect our operating results and financial performance.***

The telecommunications industry has experienced some consolidation, and several of our competitors have consolidated with other telecommunications providers. This consolidation results in competitors that are larger and better financed and affords our competitors increased resources and greater geographical reach, thereby enabling those competitors to compete more effectively against us. We have begun to experience and expect further increased pressures as a result of this consolidation and in turn have been and may continue to be forced to respond with lower profit margin product offerings and pricing plans in an effort to retain and attract customers. These pressures could adversely affect our operating results and financial performance.

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

The telecommunications industry is experiencing significant technological changes, and our ability to execute our business plans and compete depends upon our and our affiliates' ability to develop and deploy new products and services, such as broadband data, wireless, video and VoIP services. The development and deployment of new products and services could also require substantial expenditure of financial and other resources in excess of contemplated levels. If we and our affiliates are not able to develop new products and services to keep pace with technological advances, or if those products and services are not widely accepted by

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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 debt securities.

### Risks Relating to Legal and Regulatory Matters

***Any adverse outcome of the securities-related matters pending against QCII, including the KPNQwest litigation, could have a material adverse impact on our financial condition and operating results, on the trading price of our debt securities and on our ability to access the capital markets.***

As described in Note 7—Commitments and Contingencies to our condensed consolidated financial statements in Item 1 of Part I of this report, the securities-related matters, including the KPNQwest matters, present material and significant risks to QCII and us. In the aggregate, the plaintiffs in the KPNQwest matters seek billions of dollars in damages. In addition, the outcome of one or more of these matters could have a negative impact on the outcomes of the other matters. QCII continues to defend against these matters vigorously and is currently unable to provide any estimate as to the timing of their resolution. In addition, the ultimate outcome of the appeal by Messrs. Nacchio and Woodruff of the decision approving the QCII settlement of the consolidated securities action is uncertain and could result in the payment of additional monies by QCII in connection with indemnification claims by Messrs. Nacchio and Woodruff if the proposed settlement of the claims of the putative class against Messrs. Nacchio and Woodruff is not implemented.

We can give no assurance as to the impacts on QCII's and our financial results or financial condition that may ultimately result from these matters. The ultimate outcomes of these matters are still uncertain, and substantial settlements or judgments in these matters could have a significant impact on QCII and us. The magnitude of such settlements or judgments resulting from these matters could materially and adversely affect QCII's financial condition and ability to meet its debt obligations, potentially impacting its credit ratings, its ability to access capital markets and its compliance with debt covenants. In addition, the magnitude of any such settlements or judgments may cause QCII to draw down significantly on its cash balances, which might force it to obtain additional financing or explore other methods to generate cash. Such methods could include issuing additional securities or selling assets. As a wholly owned subsidiary of QCII, our business operations and financial condition could be similarly affected.

Further, there are other material proceedings pending against QCII and us as described in Note 7—Commitments and Contingencies to our condensed consolidated financial statements in Item 1 of Part I of this report that, depending on their outcome, may have a material adverse effect on QCII's and our financial position. Thus, we can give no assurances as to the impacts on QCII's and our financial results or financial condition as a result of these matters.

***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.***

We are subject to significant state and federal regulation. Interstate communications (including international communications that originate or terminate in the U.S.) are regulated by the Federal Communications Commission, or FCC, pursuant to the Communications Act of 1934, as amended by the Telecommunications Act of 1996, and other laws. Intrastate communications are regulated by state utilities commissions pursuant to state utility laws. Generally, we must obtain and maintain certificates of authority from the FCC and regulatory bodies in most states where we offer regulated services and must obtain prior regulatory approval of rates, terms and conditions for regulated services, where required. We are subject to numerous, and often quite detailed, requirements under federal, state and local laws, rules and regulations. Accordingly, we cannot ensure that we are always in compliance with all these requirements at any single point in time. The agencies responsible for the enforcement of these laws, rules and regulations may initiate inquiries or actions based on customer complaints or on their own initiative.

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Regulation of the telecommunications industry is changing rapidly, and the regulatory environment varies substantially from state to state. A number of state legislatures and state utility commissions have adopted reduced or modified forms of regulation for retail services. These changes also generally allow more flexibility for rate changes and for new product introduction, and they enhance our ability to respond to competition. At the same time, some of the changes at both the state and federal level may have the potential effect of reducing some regulatory protections, including having FCC-approved tariffs that include rates, terms and conditions. Despite these regulatory changes, a substantial portion of our local voice services revenue remains subject to FCC and state utility commission pricing regulation, which could expose us to unanticipated price declines. The FCC is considering changing the rates that carriers can charge each other for originating, carrying and terminating traffic. To meet a court-imposed deadline, the FCC may issue an order in November 2008 changing terminating switched access and reciprocal compensation rates. The FCC is also considering imposing additional obligations for broadband deployment to receive USF funds and reimposing price regulation on some facilities that we lease to other carriers. There can be no assurance that future regulatory, judicial or legislative activities will not have a material adverse effect on our operations, or that regulators or third parties will not raise material issues with regard to our compliance or noncompliance with applicable regulations.

All of our operations are also subject to a variety of environmental, safety, health and other governmental 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 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, continues to carry significant debt. As of September 30, 2008, our consolidated debt was approximately \$7.9 billion, which was included in QCII's consolidated debt of \$14.1 billion. Approximately \$5.5 billion of QCII's debt, which includes approximately \$1.6 billion of our debt obligations, comes due over the next three years. The \$5.5 billion amount also includes \$1.265 billion of QCII's 3.50% Convertible Senior Notes due 2025 (the "3.50% Convertible Senior Notes"), which QCII may elect to redeem, and holders have the option to convert, every five years on November 15, beginning in 2010. In addition, holders of these 3.50% Convertible Senior Notes may also elect to convert the principal of their notes into cash during periods when specified, market-based conversion requirements are met. While we currently believe QCII and we will have the financial resources to meet our obligations when they come due, we cannot fully anticipate our future condition or that of QCII, the credit markets or the economy generally. We may have unexpected costs and liabilities and we may have limited access to financing. In addition, QCII has \$193 million of potential stock repurchases remaining under its previously disclosed stock repurchase program, and it is the expectation of QCII's Board of Directors to continue to pay a quarterly dividend. Cash used by QCII to purchase its common stock or to pay dividends will not be available for other purposes, including the repayment of debt.

We may periodically need to obtain financing in order to meet our debt obligations as they come due. Due to recent turmoil in the credit markets and the continued decline in the economy, we may not be able to refinance maturing debt at terms that are as favorable as those from which we previously benefited, at terms that are acceptable to us or at all. We may also need to obtain additional financing or investigate other methods to generate cash (such as further cost reductions or the sale of assets) if revenue and cash provided by operations decline, if economic conditions continue to weaken, if competitive pressures increase, if holders of the 3.50% Convertible Senior Notes elect to convert their notes because market-based conversion provisions are met or on November 15, 2010, if we or QCII is required to contribute a material amount of cash to QCII's pension plan or if QCII or we become subject to significant judgments or settlements in one or more of the matters discussed in

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Note 7—Commitments and Contingencies to our condensed consolidated financial statements in Item 1 of Part I of this report. We can give no assurance that this additional financing will be available on terms that are acceptable to us or at all. Also, we may be impacted by factors relating to or affecting our liquidity and capital resources due to perception in the market, impacts on our credit ratings or provisions in our financing agreements that may restrict our flexibility under certain conditions.

QCII's \$910 million revolving credit facility (referred to as the Credit Facility), which is currently undrawn, has a cross payment default provision, and the Credit Facility and certain other debt issues of QCII and its other subsidiaries have cross acceleration provisions. When present, these provisions could have a wider impact on liquidity than might otherwise arise from a default or acceleration of a single debt instrument. As a subsidiary of QCII, any such event could adversely affect our ability to conduct business or access the capital markets and could adversely impact our credit ratings. In addition, the Credit Facility contains various limitations, including a restriction on using any proceeds from the facility to pay settlements or judgments relating to the securities-related actions discussed in Note 7—Commitments and Contingencies to our condensed consolidated financial statements in Item 1 of Part I of this report. See "Liquidity and Capital Resources—Near-Term View" in Item 2 of this report for more information about the Credit Facility and our belief that a \$60 million portion of the Credit Facility will not be available to us.

The degree to which we, together with QCII, are leveraged may have other important limiting consequences, including the following:

- placing us at a competitive disadvantage as compared with our less leveraged competitors;
- making us more vulnerable to downturns in general economic conditions or in any of our businesses;
- limiting our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate; and
- impairing our ability to obtain additional financing in the future for working capital, capital expenditures or general corporate purposes.

***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.***

The industry in which we operate is capital intensive, and we anticipate that our capital requirements will continue to be significant in the coming years. Although we have reduced our operating expenses over the past few years, we may be unable to further significantly reduce these costs, even if revenue in some areas of our business is decreasing. While we believe that our planned level of capital expenditures will meet both our maintenance and our core growth requirements going forward, this may not be the case if circumstances underlying our expectations change.

***Adverse changes in the value of assets or obligations associated with QCII's employee benefit plans could negatively impact QCII's stockholders' equity balance and liquidity, which may in turn affect our business and liquidity.***

Our employees participate in employee benefit plans sponsored by QCII.

QCII maintains a qualified pension plan, a nonqualified pension plan and post-retirement benefit plans. QCII's condensed consolidated balance sheets indirectly reflect the value of all plan assets and benefit obligations under these plans. The accounting for employee benefit plans is complex, as is the process of calculating the benefit obligations under the plans. Adverse changes in interest rates or market conditions, among other assumptions and factors, could cause a significant increase in QCII's benefit obligations or a significant decrease of the asset values without necessarily impacting QCII's net income in the short term. In addition, QCII's benefit obligations could increase significantly if it needs to unfavorably revise the assumptions it used to calculate the obligations. Because the combined value of plan assets and the combined benefit obligations are

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each approximately 20 times larger than QCII's stockholders' equity as of December 31, 2007, these adverse changes could have a significant negative impact on its stockholders' equity. Stockholders' equity is one of several measures used by certain customers and vendors, among others, to evaluate a company's financial condition. As such, a significant negative impact on QCII's stockholders' equity could adversely impact QCII's and our competitiveness in obtaining favorable purchase arrangements and make it more challenging for QCII and us to compete for certain sales contracts, among other things.

In addition, with respect to QCII's qualified pension plan, adverse changes could require QCII to contribute a material amount of cash to the plan or could accelerate the timing of any required payments. Based on current actuarial analyses and forecasts, QCII does not expect to be required to make any contributions before 2010. However, given the significant decline in the capital markets in recent months, QCII can give no assurances that it will not be required to make any such contributions in or after 2010. Future material cash contributions, if any, could have a negative impact on QCII's liquidity by reducing cash flows, which in turn could affect our liquidity.

Because we are a wholly owned subsidiary of QCII, these events could adversely affect our ability to conduct business or to access the capital markets.

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

We regularly declare and pay dividends to our direct parent, QSC. We may declare and pay dividends in excess of our earnings to the extent permitted by applicable law, which may consume a significant amount of the cash we generate. Our debt covenants do not limit the amount of dividends we can pay to our parent.

### ***Our debt agreements and the debt agreements of QCII allow us and QCII to incur significantly more debt, which could exacerbate the other risks described in this report.***

The terms of QCII's and our debt instruments permit both QCII and us to incur additional indebtedness. Additional debt may be necessary for many reasons, including to adequately respond to competition, to comply with regulatory requirements related to our service obligations or for financial reasons alone. Incremental borrowings or borrowings at maturity on terms that impose additional financial risks to our various efforts to improve our financial condition and results of operations could exacerbate the other risks described in this report.

## **Other Risks Relating to 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 accounting principles generally accepted in the United States 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 Annual Report on Form 10-K for the year ended December 31, 2007, describe those significant accounting policies and methods used in the preparation of our consolidated financial statements that 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 or assumptions differ significantly from the judgments, assumptions and estimates in our critical accounting policies, these events or assumptions could have a material impact on our consolidated financial statements and related disclosures.

### ***Taxing authorities may determine we owe additional taxes relating to various matters, which could adversely affect our financial results.***

We are included in the consolidated federal income tax return of QCII. As such, we could be severally liable for tax examinations and adjustments attributed to other members of the QCII affiliated group. As a significant



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taxpayer, QCII is subject to frequent and regular audits by the Internal Revenue Service, or IRS, as well as state and local tax authorities. These audits could subject us to tax liabilities if adverse positions are taken by these tax authorities. In June 2006, QCII received notices of proposed adjustments on several significant issues for the 2002 through 2003 audit cycle, including a proposed adjustment disallowing a loss recognized by QCII relating to the sale of its DEX directory publishing business. QCII has reached a tentative settlement with the IRS on several of these issues, including the DEX sale. These settlements are subject to formal review and approval by the IRS, and there is no assurance that these settlements will ultimately be effected in accordance with QCII's expectations.

In April 2008, QCII received from the IRS proposed adjustments on several issues for the 2004 and 2005 audit cycle. Based on QCII's and our evaluation of the IRS's positions reflected in the proposed adjustments, we have not recorded a material adjustment of our unrecognized tax benefits. However there can be no assurance that QCII and the IRS will reach settlements on any of these issues or that, if QCII does reach settlements, the terms will be favorable to us.

Because prior to 1999 we were a member of affiliated groups filing consolidated U.S. federal income tax returns, we could be severally liable for tax examinations and adjustments not directly applicable to us or to current members of the QCII affiliated group. Tax sharing agreements have been executed between QCII and previous affiliates, and QCII believes the liabilities, if any, arising from adjustments to previously filed returns would be borne by the affiliated group member determined to have a deficiency under the terms and conditions of such agreements and applicable tax law. We have not generally provided for liabilities attributable to current or former affiliated companies or for claims they have asserted or may assert against us.

We believe that we have adequately provided for tax contingencies. However, our tax audits and examinations may result in tax liabilities that differ materially from those that we have recorded in our condensed consolidated financial statements. Because the ultimate outcomes of all of these matters are uncertain, we can give no assurance as to whether an adverse result from one or more of them will have a material effect on our financial results.

***If we fail to extend or renegotiate our collective bargaining agreements 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.***

In August 2008, we reached tentative agreements with our labor unions, the Communications Workers of America, or CWA, and the International Brotherhood of Electrical Workers, or IBEW, on new three-year collective bargaining agreements. Each of these agreements needed to be ratified by union members, and in September 2008 CWA members failed to ratify the CWA agreement. In October 2008, we again reached tentative agreements with the CWA and IBEW, this time on new four-year collective bargaining agreements. Each of these agreements must be ratified by union members, and if ratified, will expire on October 6, 2012. Although we believe that our relations with our employees are satisfactory, no assurance can be given that union members will ratify these tentative agreements or that we will otherwise be able to successfully extend or renegotiate our collective bargaining agreements as they expire from time to time. The impact of future negotiations, including changes in wages and benefit levels, could have a material impact on our financial results. Also, 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.

***As a result of recent regulatory developments or other business needs, QCII is reorganizing the legal structure of its subsidiaries, which could adversely affect the trading price of our debt securities and our credit ratings.***

In February 2007, the FCC issued an order that freed us from some regulatory obligations under the Telecommunications Act. Among other things, the order gives us more flexibility to integrate our local

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operations with the long-distance operations of QCII and gives QCII more flexibility to integrate the operations of its subsidiaries that provide shared services to us and QCII's other subsidiaries. In light of this order and consistent with QCII's continuing strategy to simplify its and our corporate structure and gain operational efficiencies, QCII has made changes to the legal organization of some of its subsidiaries and has moved some of its operations among its subsidiaries. QCII continues to evaluate other ways to better organize its legal organization and operations of its subsidiaries and may make additional changes in the future. In connection with these activities, we do not expect that QCII will consummate any business combinations or other transactions that will adversely affect our consolidated financial condition or results of operations. However, if we continue to be involved in any of these activities and are unable to successfully integrate the affected operations, the trading price of our debt securities and credit ratings could be adversely affected. Additionally, these reorganization activities will impact the entities that are consolidated into our financial statements and, as a result, our future financial statements will be different from the financial statements we have historically presented. Therefore, our historical financial performance might not be indicative of future financial performance.

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### ITEM 6. EXHIBITS

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.

<u>Exhibit Number</u>	<u>Description</u>
(3.1)	Restated Articles of Incorporation of Qwest Corporation (incorporated by reference to Qwest Corporation's Annual Report on Form 10-K for the year ended December 31, 1997, File No. 001-03040).
(3.2)	Articles of Amendment to the Articles of Incorporation of Qwest Corporation (incorporated by reference to Qwest Corporation's Quarterly Report on Form 10-Q for the quarter ended June 30, 2000, File No. 001-03040).
(3.3)	Amended and Restated Bylaws of Qwest Corporation (incorporated by reference to Qwest Corporation's Annual Report on Form 10-K for the year ended December 31, 2002, File No. 001-03040).
(4.1)	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 Corporation's Annual Report on Form 10-K for the year ended December 31, 2002, File No. 001-03040).
(4.2)	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 Corporation's Annual Report on Form 10-K for the year ended December 31, 2002, File No. 001-03040).
(4.3)	Indenture, dated as of October 15, 1999, by and between U S West Communications, Inc. and Bank One Trust Company, N.A. (incorporated by reference to Qwest Corporation's Annual Report on Form 10-K for the year ended December 31, 1999, File No. 001-03040).
(4.4)	Officer's Certificate of Qwest Corporation, dated as of March 12, 2002 (including forms of 8 <sup>7</sup> / 8 % notes due March 15, 2012) (incorporated by reference to Qwest Corporation's Form S-4, File No. 333-115119).
(4.5)	First Supplemental Indenture, dated as of August 19, 2004, by and between Qwest Corporation and U.S. Bank National Association (incorporated by reference to Qwest Communications International Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2004, File No. 001-15577).
(4.6)	Second Supplemental Indenture, dated as of November 23, 2004, by and between Qwest Corporation and U.S. Bank National Association (incorporated by reference to Qwest Corporation's Current Report on Form 8-K filed November 23, 2004, File No. 001-03040).
(4.7)	Third Supplemental Indenture, dated as of June 17, 2005, by and between Qwest Corporation and U.S. Bank National Association (incorporated by reference to Qwest Corporation's Current Report on Form 8-K filed June 23, 2005, File No. 001-03040).
(4.8)	Fourth Supplemental Indenture, dated August 8, 2006, by and between Qwest Corporation and U.S. Bank National Association (incorporated by reference to Qwest Corporation's Current Report on Form 8-K filed August 8, 2006, File No. 001-03040).
(4.9)	Fifth Supplemental Indenture, dated May 16, 2007, by and between Qwest Corporation and U.S. Bank National Association (incorporated by reference to Qwest Corporation's Current Report on Form 8-K filed May 18, 2007, File No. 001-03040).

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<u>Exhibit Number</u>	<u>Description</u>
(10.1)	Registration Rights Agreement, dated May 16, 2007, among Qwest Corporation and the initial purchasers listed therein (incorporated by reference to Qwest Corporation's Current Report on Form 8-K filed May 18, 2007, File No. 001-03040).
(10.2)	Aircraft Time Sharing Agreement, dated December 13, 2007, by and between Qwest Corporation and Edward A. Mueller (incorporated by reference to Qwest Communications International Inc.'s Annual Report on Form 10-K for the year ended December 31, 2007, File No. 001-15577).
12	Calculation of Ratio of Earnings to Fixed Charges.
31.1	Chief Executive Officer Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Chief Financial Officer Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

( ) Previously filed.

In accordance with Item 601(b) (4) (iii) (A) of Regulation S-K, copies of certain instruments defining the rights of holders of certain of our long-term debt are not filed herewith. Pursuant to this regulation, we hereby agree to furnish a copy of any such instrument to the SEC upon request.

**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.

**Q WEST C CORPORATION**

By:                     /s/ R. William Johnston                      
**R. William Johnston**  
**Senior Vice President, Controller and**  
**Chief Accounting Officer**  
*(chief accounting officer and duly authorized officer)*

October 29, 2008

**QWEST CORPORATION**  
**CALCULATION OF RATIO OF EARNINGS TO FIXED CHARGES**  
**(UNAUDITED)**

	Nine Months Ended September 30,	Years Ended December 31,		
	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
		(Dollars in millions)		
Income from continuing operations before income taxes, discontinued operations and cumulative effect of changes in accounting principles	\$ 1,708	\$2,440	\$1,882	\$1,628
Add: estimated fixed charges	506	682	700	700
Add: estimated amortization of capitalized interest	9	10	10	12
Less: interest capitalized	(11)	(12)	(12)	(10)
Total earnings available for fixed charges	<u>\$ 2,212</u>	<u>\$3,120</u>	<u>\$2,580</u>	<u>\$2,330</u>
Estimate of interest factor on rentals	\$ 51	\$ 62	\$ 72	\$ 82
Interest expense, including amortization of premiums, discounts and debt issuance costs <sup>(1)</sup>	444	608	616	608
Interest capitalized	11	12	12	10
Total fixed charges	<u>\$ 506</u>	<u>\$ 682</u>	<u>\$ 700</u>	<u>\$ 700</u>
Ratio of earnings to fixed charges	4.4	4.6	3.7	3.3

<sup>(1)</sup> Interest expense includes only interest related to long-term borrowings and capital lease obligations.

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER**

I, Edward A. Mueller, 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 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(s) 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) 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
  - d) 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(s) 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: October 29, 2008

/s/ Edward A. Mueller

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Edward A. Mueller  
Chief Executive Officer

**CERTIFICATION OF CHIEF FINANCIAL OFFICER**

I, Joseph J. Euteneuer, 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 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(s) 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) 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
  - d) 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(s) 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: October 29, 2008

/s/ Joseph J. Euteneuer

**Joseph J. Euteneuer**

**Executive Vice President and 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 September 30, 2008, 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 operations 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: October 29, 2008

By: /s/ Edward A. Mueller  
**Edward A. Mueller**  
**Chief Executive Officer**

Dated: October 29, 2008

By: /s/ Joseph J. Euteneuer  
**Joseph J. Euteneuer**  
**Executive Vice President and Chief Financial Officer**