

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

FORM 10-K

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

For the fiscal year ended December 31, 2010

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

QWEST CORPORATION

(Exact name of registrant as specified in its charter)

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)

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

Title of Each Class
6.5% Notes Due 2017

Name of Each Exchange on Which Registered
New York Stock Exchange

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

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

☒

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 has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐

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

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.

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

(Do not check if a 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 February 15, 2011, one share of Qwest Corporation common stock was outstanding. None of Qwest Corporation's common stock is held by non-affiliates.

DOCUMENTS INCORPORATED BY REFERENCE: None.

Table of Contents

TABLE OF CONTENTS

	Glossary of Terms	ii
	PART I	
Item 1.	Business	1
Item 1A.	Risk Factors	10
Item 1B.	Unresolved Staff Comments	17
Item 2.	Properties	18
Item 3.	Legal Proceedings	18
Item 4.	Reserved	20
	PART II	
Item 5.	Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	21
Item 6.	Selected Financial Data	21
Item 7.	Management’s Discussion and Analysis of Financial Condition and Results of Operations	22
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	47
Item 8.	Consolidated Financial Statements and Supplementary Data	48
	Consolidated Statements of Operations	49
	Consolidated Balance Sheets	50
	Consolidated Statements of Cash Flows	51
	Consolidated Statements of Stockholder’s (Deficit) Equity and Comprehensive Income	52
	Notes to Consolidated Financial Statements	53
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	88
Item 9A.	Controls and Procedures	88
Item 9B.	Other Information	88
	PART III	
Item 10.	Directors, Executive Officers and Corporate Governance	89
Item 11.	Executive Compensation	89
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	89
Item 13.	Certain Relationships and Related Transactions, and Director Independence	89
Item 14.	Principal Accountant Fees and Services	89
	PART IV	
Item 15.	Exhibits and Financial Statement Schedules	91
	Signatures	93

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 reported in this document include only those lines used to provide services to external customers and exclude lines used solely by us and our affiliates. We also exclude residential lines that are used solely to provide broadband services.
- *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 (also known as high-speed Internet services)*. Services used to connect to the Internet through existing telephone lines and fiber-optic cables 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, predominantly using our network.
- *Customer Premises Equipment (CPE)*. Telecommunications equipment sold to a customer, usually in connection with our providing telecommunications services to that customer.
- *Data Integration*. Telecommunications equipment that is 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 government and business customers.
- *Dedicated Internet Access (DIA)*. Internet access ranging from 128 kilobits per second to 10 gigabits per second.
- *Facilities expenses*. Third-party telecommunications expenses we incur for using other carriers' networks to provide services to our customers.
- *Fiber to the Cell Site (FTTCS)*. A type of telecommunications network consisting of fiber-optic cables that run from a telecommunication provider's broadband interconnection points to cellular sites. Fiber to the cell site services, commonly referred to as wireless backhaul, allow for the delivery of higher bandwidth services supporting mobile technologies than would otherwise generally be available through a more traditional telecommunications network.
- *Fiber to the Node (FTTN)*. A type of telecommunications network that combines fiber-optic cables (which run from a telecommunication provider's central office to a single location within a particular neighborhood or geographic area) and traditional copper wires (which run from this location to individual residences and businesses within the neighborhood or geographic area). Fiber to the node allows for the delivery of higher speed broadband services than would otherwise generally be available through a more traditional telecommunications network made up of only copper wires.
- *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.

Table of Contents

- *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.
- *Managed Services*. Customized, turnkey solutions for integrated data, Internet and voice services offered to 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.
- *Multi-Protocol Label Switching (MPLS)*. A standards-approved data networking technology that is a substitute for existing frame relay and ATM networks and that can deliver the quality of service required to support real-time voice and video, as well as service level agreements that guarantee bandwidth.
- *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 a 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 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.

Table of Contents

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 in this report to “QCII” refer to our ultimate parent company, Qwest Communications International Inc., and its consolidated subsidiaries.

PART I

ITEM 1. BUSINESS

We offer data, Internet, video and voice services within 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.

We are wholly owned by QSC, which is wholly owned by QCII. Our operations are included in the consolidated operations of 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:

- Data integration;
- Dedicated Internet access;
- Hosting services;
- Long-distance services that allow calls that cross telecommunications geographical areas;
- Managed services;
- Multi-protocol label switching; and
- Voice over Internet Protocol, or VoIP.

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 data and voice 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 and our traditional wide area network, or WAN, services, which consist of asynchronous transfer mode, or ATM, and frame relay.

We were incorporated under the laws of the State of Colorado in 1911. Our principal executive offices are located at 1801 California Street, Denver, Colorado 80202, and our telephone number is (303) 992-1400.

On April 21, 2010, QCII entered into a merger agreement whereby CenturyLink, Inc., or CenturyLink, will acquire QCII in a tax-free, stock-for-stock transaction. Under the terms of the agreement, QCII’s stockholders will receive 0.1664 shares of CenturyLink common stock for each share of QCII’s common stock they own at closing. Based on QCII’s and CenturyLink’s number of outstanding shares as of the date of the merger agreement, at closing CenturyLink shareholders are expected to own approximately 50.5% and QCII’s stockholders are expected to own approximately 49.5% of the combined company. On July 15, 2010, QCII and CenturyLink received notification from the Department of Justice and the Federal Trade Commission that they received early termination of the waiting period under the Hart-Scott-Rodino Act, and as such have clearance from a federal antitrust perspective to proceed with the merger. On August 24, 2010, stockholders of each company approved all proposals relating to the merger. Completion of this transaction remains subject to a number of regulatory approvals as well as other customary closing conditions. QCII and CenturyLink have received most of the necessary approvals from state public service or public utility commissions, but they still need approvals from the Federal Communications Commission, or FCC, and several other state public service or

Table of Contents

public utility commissions. While the timing of the receipt of these approvals cannot be predicted with certainty, QCII currently expects to receive all required approvals in the first quarter and is planning toward an April 1st closing date. If the merger agreement is terminated under certain circumstances, QCII may be obligated to pay CenturyLink a termination fee of \$350 million.

For a discussion of certain risks applicable to our business, financial condition and results of operations, see “Risk Factors” in Item 1A of this report. The financial information in this section should be read in conjunction with, and is qualified by reference to, our consolidated financial statements and notes thereto in Item 8 and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in Item 7 of this report.

Financial and Operational Highlights

The table below provides a summary of some of our financial highlights.

	Years Ended December 31,		
	2010	2009	2008
	(Dollars in millions)		
Operating results:			
Operating revenue	\$9,271	\$9,731	\$10,388
Operating expenses	6,788	7,169	7,525
Income before income taxes	1,873	1,921	2,267
Net income	1,082	1,197	1,438
Cash flow data:			
Cash provided by operating activities	\$3,235	\$3,167	\$ 3,479
Expenditures for property, plant and equipment and capitalized software	1,240	1,106	1,404
Dividends paid to QSC	2,260	2,000	2,000

	December 31,	
	2010	2009
	(Dollars in millions)	
Balance sheet data:		
Cash and cash equivalents	\$ 192	\$1,014
Total borrowings—net ⁽¹⁾	8,012	8,386
Working capital deficit ⁽²⁾	(1,716)	(474)
Total stockholder’s (deficit) equity	(831)	312

(1) Total borrowings—net is the sum of current portion of long-term borrowings and long-term borrowings—net on our consolidated balance sheets. For total obligations, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Future Contractual Obligations” in Item 7 of this report.

(2) Working capital deficit is the amount by which our current liabilities exceed our current assets.

The table below presents some of our operational metrics.

	December 31,		
	2010	2009	2008
	(in thousands)		
Operational metrics: ⁽¹⁾			
Total broadband subscribers	2,906	2,803	2,574
Total video subscribers	1,003	932	772
Total access lines	8,855	9,925	11,127

(1) We have updated our methodology for counting our subscribers and access lines. For additional information see “Business Overview and Presentation” in Item 7 in this report.

Table of Contents

Operations

Our operations are integrated into and are part of the segments of QCII. Our business contributes to all three of QCII's segments: business markets, mass markets and wholesale markets. We group our products and services among three major categories, including:

- strategic services, which include primarily private line, broadband, DIRECTV video services and Verizon Wireless services;
- legacy services, which include primarily local, access, integrated services digital network, or ISDN, and traditional WAN services; and
- affiliates and other services, consisting primarily of services we provide to our affiliates and universal service fund, or USF, surcharges.

Additional information about our contribution to QCII's segments is provided in Note 15—Contribution to QCII Segments to our consolidated financial statements in Item 8 of this report. For more information about QCII's reporting segments, see QCII's Annual Report on Form 10-K for the year ended December 31, 2010.

Substantially all of our revenue comes from customers located in the United States, and substantially all of our long-lived assets are located in the United States.

Products, Services and Customers

Our products and services include a variety of data, Internet and voice services. Through our strategic partnerships with DIRECTV and Verizon Wireless, we also offer satellite digital television and wireless services to customers in our local service area. As noted above, our business contributes to all three of QCII's segments: business markets, mass markets and wholesale markets. We group our products and services among three major categories: strategic services, legacy services and affiliates and other services. Revenue from our strategic services represented 33% of our total revenue for the year ended December 31, 2010, and these services are a growing source of revenue.

We offer our customers, primarily consumers and small businesses, the ability to bundle together several products and services. In addition, through joint marketing relationships with our affiliates, we are also able to bundle our services with additional services offered by our affiliates. For example, we offer our mass markets customers integrated and unlimited local and long-distance services. These customers can also bundle two or more services such as broadband, DIRECTV video services, voice and Verizon Wireless services. We believe these customers value the convenience of, and price discounts associated with, receiving multiple services through a single company.

Most of our products and services are provided using our telecommunications network, which consists of voice and data switches, copper cables, fiber-optic broadband cables and other equipment. Our network serves approximately 8.9 million access lines and forms a portion of the public switched telephone network, or PSTN.

We offer our products and services through three main customer channels, which are made up of our business markets, mass markets and wholesale markets customers. Our business markets customers include enterprise and government customers. Enterprise customers consist of local, national and global businesses. We sell our products and services to business markets customers through direct sales, partnership relationships and arrangements with third-party sales agents. Our mass markets customers include consumers and small businesses. We sell our products and services to mass markets customers using a variety of channels, including our sales and call centers, our website, telemarketing and retail stores and kiosks. Our wholesale markets customers are other carriers and resellers that purchase our products and services in large quantities to sell to their customers or that purchase our access services that allow them to connect their customers and their networks to our network. We sell our products and services to wholesale customers through direct sales, partnership relationships and arrangements with third-party sales agents.

Table of Contents

Described below are our key products and services.

Strategic Services

Our business markets customers use our strategic services to access the Internet and Internet-based services, as well as to connect to private networks and to conduct internal and external data transmissions such as transferring files from one location to another. Our mass markets customers generally use our strategic services to access the Internet, Internet-based services, digital television and wireless services. Our wholesale customers use our facilities for colocation and use our private line services to connect their customers and their networks to our network. We focus our marketing and sales efforts on these growth services.

Private line. Private line is a direct circuit or channel specifically dedicated 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. Our business markets customers use these services to connect to private networks and to conduct internal and external data transmissions such as transferring files from one location to another. Our wholesale markets customers use these services to connect their customers and their networks to our network.

Broadband . Our broadband services allow customers to connect to the Internet through their existing telephone lines and fiber-optic cables at higher speeds than dial-up access. Our business markets and mass markets customers use these services to access the Internet and Internet-based services.

Video. Our video services include satellite digital television offered to our mass markets customers. These services are offered under an arrangement with DIRECTV that allows us to market, sell and bill for its services under its brand name. Our current arrangement with DIRECTV has an initial five-year term ending in 2014 and automatically renews for one-year terms thereafter unless terminated by one of the parties. Although DIRECTV will have the right to terminate the arrangement upon the closing of the CenturyLink merger, we expect to be able to continue to provide DIRECTV services after the merger.

Verizon Wireless services. Our wireless services are offered under an arrangement with Verizon Wireless that allows us to market, sell, and bill for its services under its brand name, primarily to mass markets customers who buy these services as part of a bundle with one or more of our other products and services. This arrangement allows us to sell the full complement of Verizon Wireless services. We began selling Verizon Wireless services in the third quarter of 2008. Our current arrangement with Verizon Wireless has a five-year term ending in 2013 and is terminable by either party thereafter. Although Verizon Wireless will have the right to terminate the arrangement upon the closing of the CenturyLink merger, we expect to be able to continue to provide Verizon Wireless services after the merger.

Legacy Services

Our legacy services include local, access, ISDN and traditional WAN services. We originate, transport and terminate local services. For our business and mass markets customers, local services consist of primarily basic local exchange and switching services. We also provide enhanced features with our local exchange services, such as caller ID, call waiting, call return, 3-way calling, call forwarding and voice mail. For our wholesale customers, local services include primarily unbundled network elements, or UNEs, which allow these customers to use our network or a combination of our network and their own networks to provide voice and data services to their customers. Our local services also include network transport, billing services and access to our network by other telecommunications providers and wireless carriers. These services allow other telecommunications companies to provide telecommunications services that originate or terminate on our network.

We also provide access services to our wholesale customers. Access services include fees that we charge to other telecommunications providers to connect their customers and their networks to our network so that they can provide long-distance, transport, data, wireless and Internet services.

Table of Contents

Affiliates and Other Services

We provide to our affiliates data services, local services and billing and collections services that we also provide to external customers. In addition, we provide to our affiliates: marketing, sales and advertising; computer system development and support services; network support and technical services; and other support services, such as legal, regulatory, finance and accounting, tax, human resources and executive support.

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

Importance, Duration and Effect of Patents, Trademarks and Copyrights

Either directly or through our affiliates, we own or have licenses to various patents, trademarks, trade names, copyrights and other intellectual property necessary to conduct our business. We believe it is unlikely that we could lose any intellectual property rights that are material to our business.

Competition

We compete in a rapidly evolving and highly competitive market, and we expect intense competition to continue. Regulatory developments and technological advances have increased opportunities for alternative communications service providers, which in turn have increased competitive pressures on our business. These alternate providers often face fewer regulations and have lower cost structures than we do. In addition, the telecommunications industry has experienced some consolidation and several of our competitors have consolidated with other telecommunications providers. The resulting consolidated companies are generally larger, have more financial and business resources and have greater geographical reach than we currently do.

As discussed below, competition for many of our services is based in part on bundled offerings. We believe customers value the convenience of, and price discounts associated with, receiving multiple services through a single company. As such, we continue to focus on expanding and improving our bundled offerings.

Strategic Services

In providing strategic services to our business markets customers, we compete with national telecommunications providers, smaller regional providers and wireless providers, as well as large integrators that provide customers with data services thereby taking traffic off of our network. Competition for business markets strategic services is driven by price and bundled offerings. Private line services also compete on network reach and reliability, while broadband services also compete on bandwidth and quality.

In providing strategic services to our mass markets customers, we compete primarily with cable companies, wireless providers and other broadband service providers. Competition for broadband services is based on price, bandwidth, service, promotions and bundled offerings. In reselling DIRECTV video services, we compete primarily with cable and other satellite companies as well as other sales agents and resellers. Competition is based on price, content, quality, promotions and bundled offerings. Many of our competitors for these strategic services are not subject to the same regulatory requirements as we are, and therefore they are able to avoid significant regulatory costs and obligations. The market for wireless services is highly competitive. In reselling Verizon Wireless services, we compete with national and regional carriers as well as other sales agents and resellers. We market and sell wireless services to customers who are buying these services as part of a bundle with one or more of our other services. Competition is based on coverage area, price, services, features, handsets, technical quality and customer service.

In providing private line services to our wholesale markets customers, we compete primarily with national telecommunications providers, such as AT&T Inc. and Verizon Communications Inc. Additionally we are experiencing increased competition for private line services from cable companies. Competition for private line services is based primarily on price, as well as network reach, bandwidth, quality, reliability and customer

Table of Contents

service. Demand for our private line services continues to increase, despite our customers' optimization of their networks, industry consolidation and technological migration. While we expect that these factors will continue to impact our private line services, we ultimately believe the growth in fiber based private line will offset our decline in copper based private line, although the timing of this technological migration is uncertain.

Legacy Services

Although our status as an incumbent local exchange carrier, or ILEC, continues to provide us some advantages in providing local services to our business and mass markets customers, we continue to face significant competition in this market. An increasing number of consumers are willing to substitute cable and wireless for traditional voice telecommunications services. This has led to an increase in the number and type of competitors within our industry and a decrease in our market share. As a result of this product substitution, we face greater competition in providing local services from wireless providers, resellers and sales agents (including ourselves) and from broadband service providers, including cable companies. We also continue to compete with traditional telecommunications providers, such as national carriers, smaller regional providers, competitive local exchange carriers and independent telephone companies.

Competition for business and mass markets customers is based primarily on pricing, packaging of services and features, quality of service and meeting customer care needs. We believe these customers value the convenience of, and price discounts associated with, receiving multiple services through a single company. Within the telecommunications industry, these services may include telephone, wireless, video and Internet access. Accordingly, we and our competitors continue to develop and deploy more innovative product bundling, enhanced features and combined billing options in an effort to retain and gain customers. While we rely on reseller or sales agency arrangements to provide some of our bundled services, some of our competitors are able to provide all of their bundled services directly, which may provide them a competitive advantage.

Some of our competitors for business and mass markets customers are subject to fewer regulations than we are, which affords them competitive advantages against us. Under federal regulations, telecommunication providers are able to interconnect their networks with ours, resell our services or lease separate parts of our network in order to provide competitive services. Generally, we have been required to provide these functions and services at wholesale rates, which allows our competitors to sell their services at lower prices. However, these rules have been and continue to be reviewed by state and federal regulators. For additional discussion of regulations affecting our business, see "Regulation" below. In addition, wireless and broadband service providers generally are subject to less or no regulation, which may allow them to operate with lower costs than we are able to operate.

The market for wholesale legacy services is highly competitive. Our UNE customers are experiencing the same competition with competitive local exchange carriers, or CLECs, for local services customers as we are, as discussed above. We also compete with some of our own wholesale markets customers that are deploying their own networks to provide customers with local services. By doing so, these competitors take traffic off of our network.

We face significant competition for access services from CLECs, cable companies, resellers and wireless service providers. Our access service customers face competitive pressures in their businesses that are similar to those we face with respect to strategic and legacy services. To the extent that these competitive pressures result in decreased demand for their services, demand for our access services also declines.

Regulation

We are subject to significant regulation by the FCC, which regulates interstate communications, and state utility commissions, which regulate intrastate communications. These agencies issue rules to protect consumers and promote competition; they set the rates that telecommunication companies charge each other for exchanging traffic; and they have established funds (called universal service funds) to support provision of services to high-cost areas. In most states, local voice service, switched and special access services, and interconnection services

Table of Contents

are subject to price regulation, although the extent of regulation varies by type of service and geographic region. In addition, we are required to maintain licenses with the FCC and with utility commissions in most states. Laws and regulations in many states restrict the manner in which a licensed entity can interact with affiliates, transfer assets, issue debt and engage in other business activities, and many mergers and acquisitions require approval by the FCC and some state commissions.

In this section, we describe potentially significant regulatory changes that we face, including: state commission review of the rates we charge for local telephone service and FCC proposals to reform universal service funds, change the rates carriers charge each other for exchanging traffic, and change the rates we can charge for special access services.

Interconnection

In our local service area, we are required by law to interconnect with other telecommunications providers and to allow competing local exchange carriers to resell our services and use our facilities as unbundled network elements. State commissions periodically conduct proceedings to change the rates we are allowed to charge for these services, and those proceedings can result in changes to our revenue from wholesale markets customers.

Intercarrier Compensation and Access Pricing

The FCC has initiated a number of proceedings that could affect the rates and charges for services that we sell to or purchase from other carriers and for traffic that we exchange with other carriers. The FCC has been considering comprehensive reform of these charges, known as “intercarrier compensation,” in a proceeding that could result in fundamental changes in the charges we or our affiliates collect from and pay to other carriers. This proceeding may not be completed for some time. State commissions also periodically open proceedings to change the rates that we or other local carriers charge to terminate and originate intrastate calls. The FCC, state commissions and federal courts are also reviewing intercarrier compensation issues relating to IP services, including whether we should pay intercarrier compensation to carriers for traffic bound for Internet service providers that cross local exchange boundaries (known as “VNXX traffic”) and whether VoIP providers must pay carrier access charges. In 2010, we received approximately \$350 million in switched access revenue (which includes a significant amount of related services not subject to these proceedings), and our affiliates’ paid a greater amount to other carriers for switched access.

The FCC also has an open proceeding to examine whether rates should be reduced for high-capacity facilities that local exchange carriers, like Qwest, sell to other companies. Some parties have proposed changes to the FCC’s rules that would significantly reduce our revenues from these facilities. This proceeding remains pending before the FCC. In 2010, we received approximately \$1.4 billion for interstate special access services (excluding digital subscriber line), but not all of that revenue is at issue in the FCC’s special access proceeding. Most proposals submitted in the proceeding would impact only lower-capacity services and not higher-capacity fiber-based services, and many proposals would impact services only in geographic areas where the FCC has granted us pricing flexibility. If the FCC does mandate lower prices, our affiliates’ will benefit from lower prices for the special access services they purchase from other carriers, which totaled \$550 million in 2010.

Universal Service

The FCC maintains a number of universal service programs that are intended to ensure affordable telephone service for all Americans, including low-income consumers and those living in rural areas that are costly to serve, and ensure access to advanced telecommunications services for schools, libraries and rural health care providers. These programs, which totaled over \$7 billion annually in recent years, are funded through contributions by interstate telecommunications carriers, which are generally passed through to their end-users. The FCC is actively considering a new contribution methodology, which, if adopted, could significantly increase our universal service contributions. While we would have the right to pass these charges on to our customers, the additional charges could affect the demand for certain telecommunications services.

Table of Contents

In 2010, we received approximately \$67 million in federal universal service high-cost subsidies. The FCC is actively considering changes in the structure and distribution methodology of its universal service programs. The FCC is also considering whether to reconfigure its universal service funds to support broadband services. The resolution of these proceedings ultimately could affect the amount of universal service support we receive.

In 2010, we received approximately \$82 million in state universal service high-cost subsidies. State commissions and legislatures may review and alter their respective state universal service programs, and, as a result, our distributions may be affected.

Network Neutrality

In December 2010, the FCC issued network neutrality rules applicable to providers of broadband Internet access services. In general, network neutrality refers to government policies designed to safeguard and promote an open Internet. As written, the FCC's rules do not materially impact our business operations, but the FCC indicated that it would decide in later cases the extent to which broadband providers like Qwest can charge content providers for enhancing or prioritizing their traffic when it is being delivered to Qwest's broadband customers.

Employees

	December 31,			Increase/(Decrease)		% Change	
	2010	2009	2008	2010 v	2009 v	2010 v	2009 v
				2009	2008	2009	2008
Management employees	11,871	12,248	13,404	(377)	(1,156)	(3)%	(9)%
Occupational employees	14,179	15,557	17,145	(1,378)	(1,588)	(9)%	(9)%
Total employees	<u>26,050</u>	<u>27,805</u>	<u>30,549</u>	<u>(1,755)</u>	<u>(2,744)</u>	<u>(6)%</u>	<u>(9)%</u>

Our occupational employees are covered by collective bargaining agreements with the Communications Workers of America, or CWA, and the International Brotherhood of Electrical Workers, or IBEW. Our current four-year agreements with the CWA and IBEW expire on October 6, 2012. See the discussion of risks relating to our labor relations in "Risk Factors—Other Risks Relating to Qwest" in Item 1A of this report.

Website Access and Important Investor Information

Our website address is www.qwest.com, and we routinely post important investor information in the "Investor Relations" section of our website at investor.qwest.com. The information contained on, or that may be accessed through, our website is not part of this annual report. You may obtain free electronic copies of our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports in the "Investor Relations" section of our website under the heading "SEC Filings." These reports are available on our website as soon as reasonably practicable after we electronically file them with the Securities and Exchange Commission, or SEC.

QCII has adopted written codes of conduct that serve as the code of ethics applicable to our directors, officers and employees, including our principal executive officer and senior financial officers, in accordance with Section 406 of the Sarbanes-Oxley Act of 2002, the rules of the SEC promulgated thereunder and the New York Stock Exchange rules. In the event that QCII makes any changes to, or provides any waivers from, the provisions of its code of conduct applicable to its and our principal executive officer and senior financial officers, QCII intends to disclose these events on QCII's and our website or in a report on Form 8-K within four business days of such event.

These codes of conduct, as well as copies of QCII's guidelines on significant governance issues and the charters of QCII's audit committee, compensation and human resources committee and nominating and governance committee, are available in the "Corporate Governance" section of QCII's and our website at

Table of Contents

investor.qwest.com/corporate-governance or in print to any stockholder who requests them by sending a written request to QCII's Corporate Secretary at Qwest Communications International Inc., 1801 California Street, Denver, Colorado 80202.

Special Note Regarding Forward-Looking Statements

This Form 10-K contains or incorporates by reference forward-looking statements about our financial condition, operating results 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 capital or other 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 SEC. You can find many 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 “Risk Factors” in Item 1A 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 1A. RISK FACTORS**Risks Relating to QCII's Pending Merger with CenturyLink**

QCII's merger with CenturyLink is subject to closing conditions, including government approvals, which could result in additional conditions that adversely affect QCII or which could cause the merger to be delayed or abandoned.

The completion of the CenturyLink merger is subject to certain closing conditions, including the absence of injunctions or other legal restrictions and the absence of a material adverse effect on either company. In addition, the merger remains subject to a number of regulatory approvals. QCII and CenturyLink have received most of the necessary approvals from state public service or public utility commissions, but they still need approvals from the FCC and several other state public service or public utility commissions. These regulatory entities could impose requirements or obligations as conditions for their approvals. Despite QCII's best efforts, QCII may not be able to satisfy the various closing conditions and obtain the necessary approvals. In addition, any required conditions to these approvals could adversely affect the combined company or could result in the delay or abandonment of the merger.

Failure to complete the CenturyLink merger could negatively impact QCII and us.

If the CenturyLink merger is not completed, QCII would still remain liable for significant transaction costs and the focus of QCII's management would have been diverted from seeking other potential strategic opportunities, in each case without realizing any benefits of a completed merger. Depending on the reasons for not completing the merger, QCII could also be required to pay CenturyLink a termination fee of \$350 million. For these and other reasons, a failed merger could adversely affect QCII's business, operating results or financial condition, which in turn could adversely affect our business or financial condition. In addition, the trading price of QCII's and our securities could be adversely affected to the extent that the current price reflects an assumption that the merger will be completed.

While the CenturyLink merger is pending, QCII and we are subject to business uncertainties and contractual restrictions that could adversely affect our business.

Our employees, customers and suppliers may have uncertainties about the effects of the merger. Although QCII and we have taken actions designed to reduce any adverse effects of these uncertainties, these uncertainties may impair our ability to attract, retain and motivate key employees and could cause customers, suppliers and others that deal with us to try to change our existing business relationships.

The pursuit of the merger and preparations for integration have placed and will continue to place a significant burden on many employees and internal resources. If, despite QCII's and our efforts, key employees depart because of these uncertainties and burdens, or because they do not wish to remain with a combined company, our business and operating results could be adversely affected.

While the merger is pending, some of our customers could delay or forgo purchasing decisions and suppliers could seek additional rights or benefits from us. In addition, the merger agreement restricts QCII and us from taking certain actions with respect to our business and financial affairs without CenturyLink's consent, and these restrictions could be in place for an extended period of time if the merger is delayed. For these and other reasons, the pendency of the merger could adversely affect our business, operating results or financial condition.

Table of Contents

If completed, QCII's merger with CenturyLink may not achieve the intended results.

The merger will involve the combination of two companies that currently operate as independent public companies. The combined company will need to devote management attention and resources to integrate QCII's and CenturyLink's businesses. In addition, the combined company may face difficulties with the integration process. For example:

- the combined company may not realize the anticipated cost savings and operating synergies at expected levels or in the expected timeframe;
- existing customers and suppliers may decide not to do business with the combined company;
- the costs of integrating QCII's policies, procedures, operations, technologies and systems with those of CenturyLink could be higher than expected;
- the integration process could consume significant time and attention on the part of the combined company's management, thereby diverting attention from day-to-day operations; or
- the combined company may not be able to integrate employees from the two companies while maintaining existing levels of sales, customer service and operational support.

For these and other reasons, the merger may not achieve the intended results.

Risks Affecting Our Business

Increasing competition, including product substitution, continues to cause access line losses, which has adversely affected and could continue to adversely affect our operating results and financial condition.

We compete in a rapidly evolving and highly competitive market, and we expect competition to continue to intensify. We are facing greater competition from cable companies, wireless providers, resellers and sales agents (including ourselves) and facilities-based providers using their own networks as well as those leasing parts of our network. 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 expanded broadband capabilities and strategic partnerships. We also remain focused on customer service and providing customers with simple and integrated solutions, including, among other things, product bundles and packages. However, we may not be successful in these efforts. We may not be able to distinguish our offerings and 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 or sales agent such as wireless and video services. Our operating results and financial condition would be adversely affected if these initiatives are unsuccessful or insufficient and if we otherwise are unable to sufficiently stem or offset our continuing access line losses and our revenue declines significantly without corresponding cost reductions. If this occurred, our ability to service debt and pay other obligations would also be adversely affected.

Unfavorable general economic conditions in the United States could negatively impact our operating results and financial condition.

Unfavorable general economic conditions, including the unstable economy and the current credit market environment, could negatively affect our business. While it is often difficult for us to predict the impact of general economic conditions on our business, these conditions could adversely affect the affordability of and consumer demand for some of our products and services and could cause customers to shift to lower priced products and services or to delay or forgo purchases of our products and services. One or more of these circumstances could cause our revenue to decline. Also, our customers may encounter financial hardships or may not be able to obtain adequate access to credit, which could affect their ability to make timely payments to us. If that were to occur, we could be required to increase our allowance for doubtful accounts, and the number of days

Table of Contents

outstanding for our accounts receivable could increase. In addition, as discussed below under the heading “Risks Affecting our Liquidity,” due to the unstable economy and the current credit market environment, 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. For these reasons, among others, if the current economic conditions persist or decline, this could adversely affect our operating results and financial condition, as well as our ability to service debt and pay other obligations.

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

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 experienced 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 condition, as well as our ability to service debt and pay other obligations.

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 and adversely affect our operating results and financial condition.

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. 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 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 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 our operating results and financial condition, as well as our ability to service debt and pay other obligations.

Our reseller and sales agency arrangements expose us to a number of risks, one or more of which may adversely affect our business and operating results.

We rely on reseller and sales agency arrangements with other companies to provide some of the services that we sell to our customers, including video services and wireless products and services. If we fail to extend or renegotiate these arrangements as they expire from time to time or if these other companies fail to fulfill their contractual obligations to us or our customers, we may have difficulty finding alternative arrangements and our customers may experience disruptions to their services. In addition, as a reseller or sales agent, we do not control the availability, retail price, design, function, quality, reliability, customer service or branding of these products and services, nor do we directly control all of the marketing and promotion of these products and services. To the extent that these other companies make decisions that negatively impact our ability to market and sell their products and services, our business plans and goals and our reputation could be negatively impacted. If these reseller and sales agency arrangements are unsuccessful due to one or more of these risks, our business and operating results may be adversely affected.

Third parties may claim we infringe upon their intellectual property rights, and defending against these claims could adversely affect our profit margins and our ability to conduct business.

From time to time, we receive notices from third parties or are named in lawsuits filed by third parties claiming we have infringed or are infringing upon their intellectual property rights. We may receive similar notices or be involved in similar lawsuits in the future. Responding to these claims may require us to expend

Table of Contents

significant time and money defending our use of affected technology, may require us to enter into licensing agreements requiring royalty payments that we would not otherwise have to pay or may require us to pay damages. If we are required to take one or more of these actions, our profit margins may decline. In addition, in responding to these claims, we may be required to stop selling or redesign one or more of our products or services, which could significantly and adversely affect the way we conduct business.

Risks Relating to Legal and Regulatory Matters

Any adverse outcome of 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 “Legal Proceedings” in Item 3 of this report, the KPNQwest matters present material and significant risks to QCII and us. In the aggregate, the plaintiffs in the KPNQwest matters have sought billions of euros (equating to 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.

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 as described in “Legal Proceedings” in Item 3 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 operating 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 regulation by the FCC, which regulates interstate communications, and state utility commissions, which regulate intrastate communications. Generally, we must obtain and maintain certificates of authority from the FCC and regulatory bodies in most states where we offer regulated services, and 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. See additional information about regulations affecting our business in “Business—Regulation” in Item 1 of this report.

Regulation of the telecommunications industry is changing rapidly, and the regulatory environment varies substantially from state to state. The state legislatures and state utility commissions in our local service area 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. 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. For instance, in 2011 the state utility commission in Arizona may consider a price cap plan that will

Table of Contents

govern the rates that we charge in that state. The FCC is also considering changing the rates that carriers can charge each other for originating, carrying and terminating traffic and for local access facilities. Also under review by the FCC and state commissions are the intercarrier compensation issues arising from the delivery of traffic destined for entities that offer conference and chat line services for free (known in the industry as “access stimulation,” or “traffic pumping”), and of traffic bound for Internet service providers that cross local exchange boundaries (known as “VNXX traffic”). The FCC and state commissions are also considering changes to funds they have established to subsidize service to high-cost areas. Changes to how those funds are distributed could result in us receiving less in universal service funding, and changes to how the funds are collected could make some of our services less competitive. 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 management, discharge and disposal of hazardous and environmentally sensitive materials. Although we believe that we are in compliance with these regulations, our management, discharge or disposal of hazardous and environmentally sensitive materials 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 December 31, 2010, our consolidated debt was approximately \$8.0 billion, which was included in QCII’s consolidated debt of approximately \$11.9 billion as of that date. Approximately \$3.5 billion of QCII’s debt, which includes approximately \$3.2 billion of our debt obligations, comes due over the next three years. 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, it is the current expectation of QCII’s Board of Directors that QCII will continue to pay a quarterly cash dividend. Cash used by QCII 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 the unstable economy and the current credit market environment, 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 weaken, if competitive pressures increase, if QCII or we are required to contribute a material amount of cash to QCII’s pension plan, if QCII or we are required to begin to pay other post-retirement benefits significantly earlier than is anticipated, or if QCII becomes subject to significant judgments or settlements in one or more of the matters discussed in “Legal Proceedings” in Item 3 of this report, but we would need to do so in a manner consistent with the terms of QCII’s merger agreement with CenturyLink. 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 \$1.035 billion 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

Table of Contents

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 legal matters discussed in “Legal Proceedings” in Item 3 of this report.

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 qualified pension plan could negatively impact QCII’s liquidity, which may in turn affect our business and liquidity.

Our employees participate in a qualified pension plan sponsored by QCII.

The funded status of this plan is the difference between the value of plan assets and the benefit obligation. The accounting unfunded status of QCII’s pension plan was \$585 million at December 31, 2010. Adverse changes in interest rates or market conditions, among other assumptions and factors, could cause a significant increase in QCII’s benefit obligation or a significant decrease in the value of plan assets. These adverse changes could require QCII to contribute a material amount of cash to its pension plan or could accelerate the timing of required cash payments. The amounts contributed by us through QCII are not segregated or restricted and may be used to provide benefits to employees of QCII’s other subsidiaries. QCII determines our cash contribution and, historically, has only required us to pay our portion of its required pension contribution. Based on current funding laws and regulations, QCII will not be required to make a cash contribution in 2011. QCII expects to begin making required contributions to the plan during 2012 and estimates that these 2012 contributions could be between \$300 million and \$350 million. Although potentially significant in the aggregate, QCII currently expects that contributions in 2013 and beyond will decrease annually from the 2012 expected contribution amount. However, the actual amount of required contributions in 2013 and beyond will depend on earnings on investments, discount rates, demographic experience, changes in the plan and funding laws and regulations. Any future material cash contributions in 2011 and beyond could have a negative impact on QCII’s liquidity by reducing its cash flows, which in turn could affect our liquidity.

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.

Table of Contents

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 operating results and financial condition 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 U.S. generally accepted accounting principles 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 Item 7 of this report, 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 taxpayer, QCII is subject to frequent and regular audits by the Internal Revenue Service 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.

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, QCII's tax audits and examinations may result in tax liabilities that differ materially from those that we have recorded in our 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.

We are a party to collective bargaining agreements with our labor unions, which represent a significant number of our employees. Our current four-year agreements with the Communications Workers of America, or CWA, and the International Brotherhood of Electrical Workers, or IBEW, expire on October 6, 2012. Although we believe that our relations with our employees and unions are satisfactory, no assurance can be given that we will be able to successfully extend or renegotiate our collective bargaining agreements as they expire from time

Table of Contents

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 significant 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.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

Table of Contents

ITEM 2. PROPERTIES

Our principal properties do not lend themselves to simple description by character and location. The components of our gross investment in property, plant and equipment consisted of the following as of December 31, 2010 and 2009:

	December 31,	
	2010	2009
Components of gross investment in property, plant and equipment:		
Land and buildings	7%	7%
Communications equipment	42%	42%
Other network equipment	47%	47%
General-purpose computers and other	4%	4%
Total	<u>100%</u>	<u>100%</u>

Land and buildings consists of land, land improvements, central office and certain administrative office buildings. Communications equipment consists primarily of switches, routers and transmission electronics. Other network equipment includes primarily conduit and cable. General-purpose computers and other consists principally of computers, office equipment, vehicles and other general support equipment. We own substantially all of our telecommunications equipment required for our business. However, we lease certain facilities and equipment under various capital lease arrangements when the leasing arrangements are more favorable to us than purchasing the assets. Due to favorable economics, we have increasingly turned to financing our assets through capital leases. Total gross investment in property, plant and equipment was approximately \$44.2 billion and \$43.7 billion as of December 31, 2010 and 2009, respectively, before deducting accumulated depreciation.

We own and lease administrative offices in major metropolitan locations primarily within our local service area. Substantially all of our communications equipment and other network equipment is located in buildings that we own or on land within our local service area.

For additional information, see Note 6—Property, Plant and Equipment to our consolidated financial statements in Item 8 of this report.

ITEM 3. LEGAL PROCEEDINGS

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. Only those matters to which we are a party represent contingencies for which we have accrued, or could reasonably anticipate accruing, liabilities if appropriate to do so. We are not a party to any of the matters discussed below and therefore have not accrued any liabilities for these matters.

In this section, when we refer to a class action as “putative” it is because a class has been alleged, but not certified in that matter. Until and unless a class has been certified by the court, it has not been established that the named plaintiffs represent the class of plaintiffs they purport to represent.

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 or employees with respect to certain of the matters described below, and QCII has been advancing legal fees and costs to certain former directors, officers or employees in connection with certain matters described below.

KPNQwest Litigation/Investigation

On September 29, 2010, the trustees in the Dutch bankruptcy proceeding for KPNQwest, N.V. (of which QCII was a major shareholder) filed a lawsuit in district court in Haarlem, the Netherlands, alleging tort and mismanagement claims under Dutch law. QCII and Koninklijke KPN N.V. (“KPN”) are defendants in this

Table of Contents

lawsuit along with a number of former KPNQwest supervisory board members and a former officer of KPNQwest, some of whom were formerly affiliated with QCII. 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, which is claimed to be approximately €4.2 billion (or approximately \$5.6 billion based on the exchange rate on December 31, 2010), plus statutory interest.

On September 13, 2006, Cargill Financial Markets, Plc and Citibank, N.A. filed a lawsuit in the District Court of Amsterdam, the Netherlands, against QCII, KPN, KPN Telecom B.V., and other former officers, employees or supervisory board members of KPNQwest, some of whom were formerly affiliated with QCII. 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 \$290 million based on the exchange rate on December 31, 2010).

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, 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. On December 5, 2008, the Enterprise Chamber appointed investigators to conduct the inquiry. VEB claims that certain individuals have assigned to it their claims for losses totaling approximately €40 million (or approximately \$55 million based on the exchange rate on December 31, 2010), which those individuals allegedly incurred on investments in KPNQwest securities. VEB has not yet filed any adjudicative action to assert those claims.

On June 7, 2010, a number of parties, including QCII and KPN, reached a settlement with VEB for €19 million (or approximately \$25 million based on the exchange rate on December 31, 2010), conditioned in part on the termination of the investigation by the Enterprise Chamber. Pursuant to the terms of the settlement, VEB formally requested that the Enterprise Chamber terminate the investigation. The Enterprise Chamber denied that request and directed the investigation to proceed. On an appeal of that decision, the Dutch Supreme Court reversed the Enterprise Chamber's decision and, among other things, referred the case back to the Enterprise Chamber to terminate the investigation.

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

QCII Stockholder Litigation

In the weeks following the April 22, 2010 announcement of QCII's pending merger with CenturyLink, purported QCII stockholders filed 17 lawsuits against QCII, its directors, certain of its officers, CenturyLink and SB44 Acquisition Company. The purported stockholder plaintiffs commenced these actions in three jurisdictions: the District Court for the City and County of Denver, the United States District Court for the District of Colorado, and the Delaware Court of Chancery. The plaintiffs generally allege that QCII's directors breached their fiduciary duties in approving the merger and seek to enjoin the merger and, in some cases, damages if the merger is completed. Many of the lawsuits also challenge the sufficiency of the disclosures in the preliminary joint proxy statement-prospectus relating to the merger, which was filed with the SEC on June 4, 2010.

QCII, and its directors, believe that all of these actions are without merit. The defendants nevertheless negotiated with the purported stockholder plaintiffs regarding a settlement of the claims asserted in all of these actions, including the claims that challenge the sufficiency of the disclosures in the preliminary joint proxy statement-prospectus. On July 16, 2010, the parties entered into a memorandum of understanding reflecting the terms of their agreement-in-principle for a settlement of all of the claims asserted in these actions. Pursuant to

Table of Contents

this agreement, defendants included additional disclosures in the final joint proxy statement-prospectus filed with the SEC on July 19, 2010. On December 17, 2010, the United States District Court for the District of Colorado preliminarily approved the settlement, and notice was subsequently provided to stockholders of the proposed final resolution. A final fairness hearing is scheduled for February 25, 2011. If the settlement is approved at the final hearing, all of these actions will be dismissed, with prejudice. The defendants intend to defend their positions in these matters vigorously to the extent they are not fully resolved by the settlement.

Other Matters

Several putative class actions relating to the installation of fiber-optic cable in certain rights-of-way were filed against several other subsidiaries of QCII on behalf of landowners on various dates and in various courts in Arizona, California, Colorado, Georgia, Illinois, Indiana, Kansas, Massachusetts, Mississippi, Missouri, Nevada, New Mexico, Oregon, South Carolina, Tennessee, Texas and Utah. For the most part, the complaints challenge the right to install fiber-optic cable in railroad rights-of-way. The complaints allege that the railroads own the right-of-way as an easement that did not include the right to permit the defendants to install fiber-optic cable in the right-of-way without the plaintiffs' consent. Most of the actions purport to be brought on behalf of state-wide classes in the named plaintiffs' respective states, although two of the currently pending actions purport to be brought on behalf of multi-state classes. Specifically, the Illinois state court action purports to be on behalf of landowners in Illinois, Iowa, Kentucky, Michigan, Minnesota, Nebraska, Ohio and Wisconsin, and the Indiana state court action purports to be on behalf of a national class of landowners. In general, the complaints seek damages on theories of trespass and unjust enrichment, as well as punitive damages. On July 18, 2008, a federal district court in Massachusetts entered an order preliminarily approving a settlement of all of the actions described above, except the action pending in Tennessee. On September 10, 2009, the court denied final approval of the settlement on grounds that it lacked subject matter jurisdiction. On December 9, 2009, the court issued a revised ruling that, among other things, denied a motion for approval as moot and dismissed the matter for lack of subject matter jurisdiction.

One of QCII's other subsidiaries, Qwest Communications Company, LLC, or QCC, 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 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.

A putative class action filed on behalf of certain of QCII's retirees was brought against QCII, the Qwest Group Life Insurance Plan and other related entities in federal district court in Colorado in connection with QCII's decision 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 our right to reduce the life insurance benefit under applicable law and plan documents. The plaintiffs subsequently amended their complaint to assert additional claims. In 2009, the court dismissed or granted summary judgment to QCII on all of the plaintiffs' claims. The plaintiffs have appealed the court's decision to the Tenth Circuit Court of Appeals.

QCII continues to evaluate the method it uses to assess the amount of USF payments that must be made on certain products, and during the year ended December 31, 2010 QCII recorded an adjustment to its liability of \$15 million related to previous years' USF payments. This ongoing evaluation may result in further adjustments to QCII's previous years' USF payments and charges to customers.

ITEM 4. RESERVED

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Not Applicable.

ITEM 6. SELECTED FINANCIAL DATA

The following selected consolidated financial data should be read in conjunction with, and are qualified by reference to, the consolidated financial statements and notes thereto in Item 8 of this report and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7 of this report. The comparability of the following selected financial data is significantly impacted by various changes in accounting principles including the adoption of Financial Accounting Standards Board, or FASB, Interpretation No., or FIN, 48, "Accounting for Uncertainty in Income Taxes" (Accounting Standards Codification, or ASC, 740), which was effective for us on January 1, 2007.

	Years Ended December 31,				
	2010	2009	2008	2007	2006
	(Dollars in millions)				
Operating revenue	\$ 9,271	\$ 9,731	\$10,388	\$10,691	\$10,721
Operating expenses	6,788	7,169	7,525	7,631	8,288
Income before income taxes	1,873	1,921	2,267	2,440	1,882
Net income ⁽¹⁾	1,082	1,197	1,438	1,527	1,203
Other data:					
Cash provided by operating activities	\$ 3,235	\$ 3,167	\$ 3,479	\$ 3,670	\$ 3,374
Cash used for investing activities	1,256	1,100	1,402	1,254	1,279
Cash used for financing activities	2,801	1,286	2,136	2,400	1,980
Expenditures for property, plant and equipment and capitalized software	1,240	1,106	1,404	1,270	1,410

	December 31,				
	2010	2009	2008	2007	2006
	(Dollars in millions)				
Balance sheet data:					
Total assets	\$13,686	\$15,038	\$15,443	\$16,522	\$17,404
Total borrowings—net ⁽²⁾	8,012	8,386	7,588	7,911	7,735
Total borrowings—net to total capital ratio ⁽³⁾	112%	96%	91%	85%	77%

- (1) See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Results of Operations" in Item 7 of this report for a discussion of unusual items affecting the results for 2010, 2009 and 2008. Results for 2007 and 2006 were affected by the changes in accounting principles described above the table.
- (2) Total borrowings—net is the sum of current portion of long-term borrowings and long-term borrowings—net on our consolidated balance sheets. For total obligations, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Future Contractual Obligations" in Item 7 of this report.
- (3) The total borrowings—net to total capital ratio is a measure of the percentage of total borrowings—net in our capital structure. The ratio is calculated by dividing total borrowings—net by total capital. Total borrowings—net is the sum of current portion of long-term borrowings and long-term borrowings—net on our consolidated balance sheets. Total capital is the sum of total borrowings—net and total stockholder's equity or deficit.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Certain statements in this report constitute forward-looking statements. See "Business—Special Note Regarding Forward-Looking Statements" in Item 1 of this report for additional factors relating to these statements, and see "Risk Factors" in Item 1A 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 offer data, Internet, video and voice services within 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.

On April 21, 2010, QCII entered into a merger agreement whereby CenturyLink will acquire QCII in a tax-free, stock-for-stock transaction. Under the terms of the agreement, QCII's stockholders will receive 0.1664 shares of CenturyLink common stock for each share of QCII's common stock they own at closing. Based on QCII's and CenturyLink's number of outstanding shares as of the date of the merger agreement, at closing CenturyLink shareholders are expected to own approximately 50.5% and QCII's stockholders are expected to own approximately 49.5% of the combined company. On July 15, 2010, QCII and CenturyLink received notification from the Department of Justice and the Federal Trade Commission that they received early termination of the waiting period under the Hart-Scott-Rodino Act, and as such have clearance from a federal antitrust perspective to proceed with the merger. On August 24, 2010, stockholders of each company approved all proposals relating to the merger. Completion of this transaction remains subject to a number of regulatory approvals as well as other customary closing conditions. QCII and CenturyLink have received most of the necessary approvals from state public service or public utility commissions, but they still need approvals from the FCC and several other state public service or public utility commissions. While the timing of the receipt of these approvals cannot be predicted with certainty, QCII currently expects to receive all required approvals in the first quarter and is planning toward an April 1st closing date. If the merger agreement is terminated under certain circumstances, QCII may be obligated to pay CenturyLink a termination fee of \$350 million.

We have not recognized certain expenses that are contingent on completion of QCII's merger. These expenses include compensation expense comprised of retention bonuses, severance and stock-based compensation for stock-based awards that will vest in connection with QCII's merger. These contingent expenses will be recognized in our consolidated financial statements commencing in the period in which the merger occurs. The final amount of compensation expense to be recognized is partially dependent upon personnel decisions that will be made as part of the integration planning. These amounts may be material.

Upon completion of the merger, our assets and liabilities will be revalued and recorded at fair value. The assignment of fair value will require a significant amount of judgment. The use of fair value measures will affect the comparability of our post-merger financial information and may make it more difficult to predict earnings in future periods. For example, we have certain deferred costs and deferred revenues on our balance sheet associated with installation activities and capacity leases whereby we incurred costs and received payments up front but are recognizing the related expenses and revenues over the estimated life of the customer or life of the contract. Based on the accounting guidance for business combinations, these existing deferred costs and deferred revenues are expected to be assigned little or no value in the purchase price allocation process and will thus be eliminated.

We could experience significant changes in our cost structure as the services provided to and purchased from our affiliates may change substantially in connection with QCII's pending merger.

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

Table of Contents

telecommunications network. Through its fiber-optic network, QCII provides some long-distance, data and Internet services that we do not provide. You can find additional information about these services that we do not provide in “Business” in Item 1 of this report.

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, and our traditional wide area network, or WAN, services, which consist of asynchronous transfer mode, or ATM, and frame relay.

Our operations are integrated into and are part of the segments of QCII and contribute to all three of QCII’s segments: business markets, mass markets and wholesale markets. We have the same Chief Operating Decision Maker, or CODM, as QCII. QCII’s CODM reviews our financial information only in connection with our quarterly and annual reports that we file with the SEC. Consequently, we do not provide our discrete financial information to the CODM on a regular basis. Additional information on our contributions to QCII’s segments is provided in Note 15—Contribution to QCII Segments to our consolidated financial statements in Item 8 of this report.

During the first quarter of 2010, we changed the definitions we use to classify expenses as cost of sales, selling expenses or general, administrative and other operating expenses and, as a result, certain expenses in our consolidated statements of operations for the prior year have been reclassified to conform to the current year presentation. Our new definitions of these expenses are as follows:

- *Cost of sales (exclusive of depreciation and amortization)* are expenses incurred in providing products and services to our customers and affiliates. These expenses include: employee-related expenses directly attributable to operating and maintaining our network (such as salaries, wages and certain benefits); equipment sales expenses (such as modem expenses); rents and utilities expenses incurred by our network operations; fleet expenses; and other expenses directly related to our network operations (such as professional fees and outsourced services).
- *Selling expenses* are expenses incurred in selling products and services to our customers and affiliates. These expenses include: employee-related expenses directly attributable to selling products or services (such as salaries, wages, internal commissions and certain benefits); marketing and advertising; external commissions; bad debt expense; and other selling expenses (such as professional fees and outsourced services).
- *General, administrative and other operating expenses* are corporate overhead and other operating expenses. These expenses include: employee-related expenses for administrative functions (such as salaries, wages and certain benefits); taxes and fees (such as property and other taxes and USF charges); rents and utilities expenses incurred by our administrative offices; and other general, administrative and other operating expenses (such as professional fees). These expenses also include our combined net periodic pension and post-retirement benefits expenses for all eligible employees and retirees allocated to us from QCII.

These definitions reflect changes primarily to reclassify expenses for: rent and utilities incurred by our network operations; fleet; network and supply chain management; and insurance and risk management from general, administrative and other operating expenses to cost of sales, where these expenses are more aligned with how we now manage our business. We believe these changes allow users of our financial statements to better understand our expense structure. 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. These changes resulted in the reclassification of \$199 million and \$212 million from the general, administrative and other operating expenses and selling expenses categories to cost of sales for the years ended December 31, 2009 and 2008, respectively.

Table of Contents

We anticipate that we will change our definitions again once QCII's merger with CenturyLink is complete in order to conform our definitions to those used by CenturyLink.

We have reclassified certain prior year amounts in our Annual Report on Form 10-K for the year ended December 31, 2009 to conform to the current year presentation.

During the first quarter of 2010 we updated our methodology for counting our subscribers and access lines where we provide the services. We now count broadband subscribers and access lines when we earn revenue associated with them. Our access line methodology includes only those access lines that we use to provide services to external customers and excludes lines used solely by us and our affiliates and residential lines that are used solely to provide broadband services. Our new broadband methodology also excludes business and wholesale markets customers from our broadband subscribers.

During the first quarter of 2010 we also updated our methodology for counting our partnership based video subscribers. We now count these subscribers when we earn revenue associated with them, regardless of whether we actually bill the subscribers for the services. Beginning in mid-2009 we began to earn an ongoing commission associated with video customers that we no longer bill so long as they remain active customers of DIRECTV. Because of the change in this commission we have begun to include them in our subscriber counts. This methodology change has increased our video subscribers by approximately 68,000 for the year ended December 31, 2010. We believe the methodology updates described above align our subscribers and access lines with our revenue and better reflect our ongoing operations.

We have restated our subscribers and access lines reported as of December 31, 2009 to conform to the current year presentation. The table below quantifies these changes by segment:

	December 31, 2009			
	Business Markets	Wholesale		
		Mass Markets (in thousands)	Markets	Total
Previously reported access lines	2,396	6,840	1,030	10,266
Affiliates and us	(403)	—	—	(403)
Alignment to billed units	10	25	27	62
Currently reported access lines	<u>2,003</u>	<u>6,865</u>	<u>1,057</u>	<u>9,925</u>
Previously reported broadband subscribers	—	2,970	—	2,970
Excluding business and wholesale customers	—	(143)	—	(143)
Alignment to billed units	—	(24)	—	(24)
Currently reported broadband subscribers	<u>—</u>	<u>2,803</u>	<u>—</u>	<u>2,803</u>
Previously reported video subscribers	—	872	—	872
Alignment to billed units	—	60	—	60
Currently reported video subscribers	<u>—</u>	<u>932</u>	<u>—</u>	<u>932</u>

Table of Contents

We have restated our subscribers and access lines reported as of December 31, 2008 to conform to the current year presentation. The table below quantifies these changes by segment:

	December 31, 2008			
	Business	Wholesale		
	Markets	Mass Markets	Markets	Total
	(in thousands)			
Previously reported access lines	2,636	7,796	1,133	11,565
Affiliates and us	(484)	—	—	(484)
Alignment to billed units	(6)	11	41	46
Currently reported access lines	<u>2,146</u>	<u>7,807</u>	<u>1,174</u>	<u>11,127</u>
Previously reported broadband subscribers	—	2,774	—	2,774
Excluding business and wholesale customers	—	(151)	—	(151)
Alignment to billed units	—	(49)	—	(49)
Currently reported broadband subscribers	<u>—</u>	<u>2,574</u>	<u>—</u>	<u>2,574</u>
Previously reported video subscribers	—	757	—	757
Alignment to billed units	—	15	—	15
Currently reported video subscribers	<u>—</u>	<u>772</u>	<u>—</u>	<u>772</u>

Our analysis presented below is organized to provide the information we believe will be useful for understanding the relevant trends affecting our business. This discussion should be read in conjunction with our consolidated financial statements and the notes thereto in Item 8 of this report.

Business Trends

Our financial results were impacted by several significant trends, which are described below. We expect that these trends will continue to affect our results of operations, cash flows or financial position.

- Strategic services.** We continue to see shifts in the makeup of our total revenue as customers move to strategic services, such as private line, broadband and DIRECTV video services, from legacy services, such as local and access services. Revenue from our strategic services represented 33% and 30% of our total revenue for the years ended December 31, 2010 and 2009, respectively, and this percentage continues to grow. With respect to broadband services, we continue to focus on increasing subscribers, particularly among consumer and small business customers. We reached approximately 2.9 million broadband subscribers at December 31, 2010 compared to approximately 2.8 million at December 31, 2009. Due to price compression, we believe the ability to continually increase connection speeds is competitively important. As a result, we continue to invest in our fiber to the node, or FTTN, deployment, which we launched to meet customer demand for higher broadband speeds. In addition to the FTTN deployment, we continue to expand our product offerings and enhance our marketing efforts as we compete in a competitive and maturing market in which a significant portion of consumers already have broadband services. We expect these efforts will improve our ability to compete and grow our broadband subscribers. Demand for the private line services we offer to business and wholesale customers continues to increase, despite our customers' optimization of their networks, industry consolidation and technological migration. While we expect that these factors will continue to impact our business, we ultimately believe the growth in fiber based private line will offset our decline in copper based private line, although the timing of this technological migration is uncertain.
- Legacy services.** Revenue from our legacy services represented 48% and 51% of our total revenue for the years ended December 31, 2010 and 2009, respectively and continues to decline. Our legacy services revenue has been, and we expect it will continue to be, adversely affected by access line losses. Intense competition and product substitution continue to drive our access line losses. For

Table of Contents

example, many consumers are substituting cable and wireless for traditional voice telecommunications services. This has increased the number and type of competitors within our industry and has decreased our market share. We expect that these factors will continue to impact our business. Product bundling and other product promotions, as described below, continue to be some of our responses to offset the loss of revenue as a result of access line losses.

- *Product bundling and product promotions.* We offer our customers, primarily consumers and small businesses, the ability to bundle multiple products and services. For example, through joint marketing and advertising efforts with our affiliates, these customers can bundle local services with other services such as broadband, video, long-distance and wireless. While video and wireless subscribers are an important piece of our customer retention strategy, they do not make a large contribution to strategic services revenue. 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 on our broadband service for qualifying customers who have our broadband product in their bundle, which we believe will positively affect our acquisition volume and drive customers to purchase more expanded offerings. 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.
- *Operating efficiencies.* We continue to evaluate our operating structure and focus. This involves balancing our workforce in response to our workload, productivity improvements, changes in the telecommunications industry and governmental regulations. Through planned reductions and normal employee attrition, we have reduced our workforce and employee-related expenses (net of severance) while achieving operational efficiencies and improving processes through automation and other innovative ways of operating our business.
- *Pension and post-retirement benefits expenses.* QCII is required to recognize in its consolidated financial statements certain expenses relating to its pension and post-retirement health care and life insurance benefits plans. These expenses are calculated based on several assumptions, including among other things discount rates and expected rates of return on plan assets that are set at December 31 of each year. Changes in these assumptions can cause significant changes in the combined net periodic benefits expenses QCII recognizes. QCII allocates the expenses of these plans to us and certain of its other affiliates. The allocation of expenses to us is based upon the demographics of our employees and retirees compared to all the remaining participants. Changes in QCII's assumptions can cause significant changes in the net periodic pension and post-retirement benefits expenses we recognize.
Based on current funding laws and regulations, QCII will not be required to make a cash contribution in 2011. QCII expects to begin making required contributions to the plan during 2012 and estimates that these 2012 contributions could be between \$300 million and \$350 million. Although potentially significant in the aggregate, QCII currently expects that contributions in 2013 and beyond will decrease annually from the 2012 expected contribution amount. However, the actual amount of required contributions in 2013 and beyond will depend on earnings on investments, discount rates, demographic experience, changes in the plan and funding laws and regulations. The amounts contributed by us through QCII are not segregated or restricted and may be used to provide benefits to other employees of QCII's subsidiaries. Historically, QCII has only required us to pay our portion of its pension contribution.
- *Disciplined capital expenditures.* Our capital expenditures continue to be focused on our strategic services such as broadband. In 2011, we anticipate that our fiber investment, which includes fiber to the cell site, or FTTCS, will increase. Our projected capital expenditures for 2011 will be up to \$1.3 billion. In addition, we may use lease financing in 2011 for some portion of our capital spending.

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 I of this report may also materially impact our business operations and financial results.

Table of Contents

Results of Operations

Overview

The following table summarizes our results of operations for the years ended December 31, 2010, 2009 and 2008 and the number of employees as of December 31, 2010, 2009 and 2008:

	Years Ended December 31,			Increase/(Decrease)		% Change	
	2010	2009	2008	2010 v 2009	2009 v 2008	2010 v 2009	2009 v 2008
	(Dollars in millions, except employees)						
Operating revenue	\$ 9,271	\$ 9,731	\$10,388	\$ (460)	\$ (657)	(5)%	(6)%
Operating expenses	6,788	7,169	7,525	(381)	(356)	(5)%	(5)%
Operating income	2,483	2,562	2,863	(79)	(301)	(3)%	(11)%
Other expense (income)—net	610	641	596	(31)	45	(5)%	8%
Income before income taxes	1,873	1,921	2,267	(48)	(346)	(2)%	(15)%
Income tax expense	791	724	829	67	(105)	9%	(13)%
Net income	<u>\$ 1,082</u>	<u>\$ 1,197</u>	<u>\$ 1,438</u>	<u>\$ (115)</u>	<u>\$ (241)</u>	<u>(10)%</u>	<u>(17)%</u>
Employees (as of December 31)	26,050	27,805	30,549	(1,755)	(2,744)	(6)%	(9)%

2010 COMPARED TO 2009

Operating Revenue

Operating revenue decreased primarily due to lower legacy services revenue as a result of continued access line losses and declining revenue from our traditional WAN services. In addition, operating revenue from affiliates also decreased due to reduced services provided to affiliates. These decreases in overall operating revenue were partially offset by increased revenue in our strategic services as a result of increased volume of broadband subscribers and rates on broadband services and increased volume in private line services.

The following table compares our operating revenue for the years ended December 31, 2010 and 2009:

	Years Ended December 31,		Increase/ (Decrease)	% Change
	2010	2009		
	(Dollars in millions)			
Operating revenue:				
Strategic services	\$3,059	\$2,900	\$ 159	5%
Legacy services	4,456	4,996	(540)	(11)%
Affiliates and other services	1,756	1,835	(79)	(4)%
Total operating revenue	<u>\$9,271</u>	<u>\$9,731</u>	<u>\$ (460)</u>	<u>(5)%</u>

Table of Contents

The following table summarizes our broadband and video subscribers and access lines by customer channel as of December 31, 2010 and 2009:

	<u>December 31,</u>		<u>Increase/ Decrease</u>	<u>% Change</u>
	<u>2010</u>	<u>2009</u>	<u>2010 v</u>	<u>2010 v</u>
		(in thousands)	<u>2009</u>	<u>2009</u>
Broadband subscribers	2,906	2,803	103	4%
Video subscribers	1,003	932	71	8%
Access lines:				
Mass markets	6,038	6,865	(827)	(12)%
Business markets	1,872	2,003	(131)	(7)%
Wholesale markets	945	1,057	(112)	(11)%
Total access lines	<u>8,855</u>	<u>9,925</u>	<u>(1,070)</u>	<u>(11)%</u>

Strategic Services

Strategic services revenue increased primarily due to higher broadband revenue resulting from an increase in subscribers and an improving mix of higher priced, higher speed services. Strategic services revenue also increased due to increased volumes in our private line services and revenue from our increased volume of Verizon Wireless subscribers, partially offset by decreased commissions on Verizon Wireless services.

Legacy Services

Legacy services revenue decreased primarily due to a decline in local and access services revenue due to access line loss, declining demand for UNEs and reduced access services usage related to product substitution, price compression and increased competition for the year ended December 31, 2010 compared to the same period in 2009. Legacy services also decreased due to lower revenue from our traditional WAN services, driven by industry consolidation and customer migration to more advanced technology services.

Affiliates and Other Services Revenue

Affiliates services revenue decreased primarily due to reduced telecommunication services and associated support provided as a result of a decline in customer demand for our affiliate's legacy telecommunication service offerings driven by technological migration and competition. In addition, we provided reduced support associated with an affiliate's winding down of its video and data products and related services. These decreases in services were partially offset by an increase in services we provided to support an affiliate's growth in its strategic service offerings. We estimate that the profit from services provided to our affiliates was approximately \$280 million and \$300 million before income taxes for the years ended December 31, 2010 and 2009, respectively.

Table of Contents

Operating Expenses

The following table provides further detail regarding our operating expenses for the years ended December 31, 2010 and 2009:

	Years Ended December 31,		Increase/ (Decrease)	% Change
	2010	2009	2010 v 2009	2010 v 2009
	(Dollars in millions)			
Cost of sales (exclusive of depreciation and amortization):				
Employee-related costs	\$1,027	\$1,084	\$ (57)	(5)%
Other	628	620	8	1%
Total cost of sales	1,655	1,704	(49)	(3)%
Selling:				
Employee-related costs	860	979	(119)	(12)%
Marketing, advertising and external commissions	364	401	(37)	(9)%
Other	233	265	(32)	(12)%
Total selling	1,457	1,645	(188)	(11)%
General, administrative and other operating:				
Employee-related costs	625	627	(2)	— %
Taxes and fees	382	393	(11)	(3)%
Real estate and occupancy costs	126	134	(8)	(6)%
Other	476	515	(39)	(8)%
Total general, administrative and other operating	1,609	1,669	(60)	(4)%
Affiliates	194	175	19	11%
Depreciation and amortization	1,873	1,976	(103)	(5)%
Total operating expenses	<u>\$6,788</u>	<u>\$7,169</u>	<u>\$ (381)</u>	(5)%

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 and outsourced services).

Employee-related expenses decreased primarily due to lower salaries, wages and severance expenses related to prior year employee reductions in our network operations, as we continue to adjust our workforce to reflect our workload.

Selling Expenses

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

Employee-related expenses decreased primarily due to lower salaries, wages, severance and internal commissions driven by lower sales headcount. The decrease in employee-related expenses was partially offset by increased expenses associated with QCII's acceleration of stock-based compensation.

Table of Contents

Marketing, advertising and external commissions decreased primarily due to reduced spending associated with direct mail and media. Marketing, advertising and external commissions also decreased due to improved consumer call center expenses resulting from a migration to using internal sales call centers from using third-party sales call centers.

Other expenses decreased primarily due to lower bad debt expense and professional fees.

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); taxes and fees (such as property and other taxes and USF charges); real estate and occupancy costs (such as rents, utility 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). General, administrative and other operating expenses also include our allocated share of QCII's combined net periodic pension and post-retirement expense for all eligible employees and retirees.

Employee-related expenses were flat primarily due to decreased pension and post-retirement benefits expenses offset by increased salaries and wages expenses associated with QCII's acceleration of stock-based compensation. On December 21, 2010, QCII accelerated the vesting of certain restricted stock and performance share awards issued under its Equity Incentive Plan in order to preserve certain economic benefits to its stockholders that otherwise would have been lost in connection with QCII's pending merger with CenturyLink. As the vast majority of affected employees are employed by us, QCII allocated substantially all of the expense associated with this accelerated vesting to us.

QCII allocates the expense or income of its benefit plans to us based upon demographics of our employees compared to all the remaining participants. The expense is a function of the amount of benefits earned, interest on benefit obligations, expected return on plan assets, amortization of costs and credits from prior benefit changes and amortization of actuarial gains and losses. We recorded combined net periodic expense of \$125 million in 2010 as compared to \$193 million in 2009. The 2009 expense is net of a \$12 million gain allocated to us as a result of QCII's decision to no longer provide pension benefit accruals for active management employees under the qualified and non-qualified pension plans on or after January 1, 2010. The decrease in combined net periodic benefits expenses in 2010 is primarily due to QCII's decision to no longer provide pension benefit accruals for active management employees under the qualified and non-qualified pension plans, the elimination of the qualified and non-qualified pension plan death benefits for eligible beneficiaries of certain retirees and reduced interest expense, partially offset by an increase in actuarial losses. Actuarial gains or losses reflect the differences between earlier actuarial assumptions and what actually occurred. We expect to record combined net periodic expense of approximately \$109 million in 2011. The expected decrease in combined net periodic expense in 2011 is primarily due to decreased interest cost partially offset by a decrease in the expected return on assets.

Other expenses decreased primarily due to lower professional and maintenance fees.

Affiliates Expenses

Affiliates expenses include charges for our use of long-distance services, wholesale Internet access and insurance, occupancy charges and certain retiree benefits. Affiliates expenses increased for the years ended December 31, 2010 as compared to the prior year period. This increase in affiliates expenses was primarily due to insurance premium discounts and refunds recognized in 2009.

Table of Contents

2009 COMPARED TO 2008

Operating Revenue

Operating revenue decreased primarily due to lower legacy services revenue as a result lower local services revenue due to continued access line losses, lower access services revenue and declining revenue from our traditional WAN services. Operating revenue also decreased due to lower revenue from affiliates and other services driven by reduced support associated with an affiliate's winding down of its wireless business. These decreases in overall operating revenue were partially offset by increased strategic services revenue as a result of increased broadband and video subscribers and our transition to selling Verizon Wireless services. We believe declining general economic conditions negatively impacted our revenue in 2009.

The following table compares our operating revenue for the years ended December 31, 2009 and 2008:

	<u>Years Ended December 31,</u>		<u>Increase/ (Decrease)</u>	<u>% Change</u>
	<u>2009</u>	<u>2008</u>	<u>2009 v 2008</u>	<u>2009 v 2008</u>
	(Dollars in millions)			
Operating revenue:				
Strategic services	\$2,900	\$ 2,789	\$ 111	4%
Legacy services	4,996	5,615	(619)	(11)%
Affiliates and other services	1,835	1,984	(149)	(8)%
Total operating revenue	\$9,731	\$10,388	\$ (657)	(6)%

The following table summarizes our total broadband and video subscribers and access lines by customer channel as of December 31, 2009 and 2008:

	<u>December 31,</u>		<u>Increase/ Decrease</u>	<u>% Change</u>
	<u>2009</u>	<u>2008</u>	<u>2009 v 2008</u>	<u>2009 v 2008</u>
	(in thousands)			
Total broadband subscribers	2,803	2,574	229	9%
Total video subscribers	932	772	160	21%
Access lines:				
Mass markets	6,865	7,807	(942)	(12)%
Business markets ⁽¹⁾	2,003	2,146	(143)	(7)%
Wholesale markets	1,057	1,174	(117)	(10)%
Total access lines	<u>9,925</u>	<u>11,127</u>	<u>(1,202)</u>	(11)%

Strategic Services

Strategic services revenue increased primarily due to an increase in broadband subscribers, partially offset by rate discounts. Strategic services revenue also increased due to selling Verizon Wireless services. An increase in video subscribers as of December 31, 2009 compared to December 31, 2008 also contributed to the increase in strategic services revenue.

Legacy Services

Legacy services revenue decreased primarily due to a decline in local and access services revenue due to access line losses and a declining demand for UNEs for the year ended December 31, 2009 compared to the same period in 2008. Legacy services revenue also decreased due to lower revenue from our traditional WAN services, driven by customer migration to more advanced technology services.

Table of Contents

Affiliates and Other Services Revenue

Affiliates services revenue decreased primarily due to reduced support provided to an affiliate associated with the affiliate's winding down of its wireless business as we transitioned to selling Verizon Wireless services. In addition, we had reduced support associated with an affiliate's winding down of its video and data products and related services. These decreases in affiliates services were partially offset by an increase in services we provided to support an affiliate's growth in strategic service offerings. We estimate that the profit from affiliates services was approximately \$300 million and \$380 million before income taxes for the years ended December 31, 2009 and 2008, respectively.

Operating Expenses

The following table provides further detail regarding our operating expenses for the years ended December 31, 2009 and 2008:

	Years Ended December 31,		Increase/ (Decrease)	% Change
	2009	2008	2009 v 2008	2009 v 2008
	(Dollars in millions)			
Cost of sales (exclusive of depreciation and amortization):				
Employee-related costs	\$1,084	\$1,231	\$ (147)	(12)%
Other	620	668	(48)	(7)%
Total cost of sales	1,704	1,899	(195)	(10)%
Selling:				
Employee-related costs	979	1,063	(84)	(8)%
Marketing, advertising and external commissions	401	456	(55)	(12)%
Other	265	293	(28)	(10)%
Total selling	1,645	1,812	(167)	(9)%
General, administrative and other operating:				
Employee-related costs	627	459	168	37%
Taxes and fees	393	372	21	6%
Real estate and occupancy costs	134	156	(22)	(14)%
Other	515	569	(54)	(9)%
Total general, administrative and other operating	1,669	1,556	113	7%
Affiliates	175	185	(10)	(5)%
Depreciation and amortization	1,976	2,073	(97)	(5)%
Total operating expenses	<u>\$7,169</u>	<u>\$7,525</u>	<u>\$ (356)</u>	(5)%

Cost of Sales (exclusive of depreciation and amortization)

Employee-related costs decreased primarily due to lower salaries, wages and benefits related to employee reductions in our network operations as we continued to manage our workforce to our workload. In addition, severance expense decreased because we terminated fewer employees in 2009 as compared to 2008.

Other cost of sales decreased primarily due to lower professional fees and network expenses due to our continued focus on managing costs associated with our network, along with decreased volumes.

Selling Expenses

Employee-related costs decreased due to lower salaries and wages related to prior period employee reductions, and decreased internal commissions driven by lower sales headcount and lower attainment of sales targets. These decreases were partially offset by increases in severance expenses.

Table of Contents

Marketing, advertising and external commissions decreased primarily due to reduced spending associated with direct mail and media, along with the migration to internal sales call centers from using third-party sales call centers.

Other selling costs decreased primarily due to lower professional fees as a result of a favorable rate change in credit processing fees and other cost savings initiatives.

General, Administrative and Other Operating Expenses

Employee-related costs increased primarily due to an increase in pension and post-retirement benefits expenses. We recorded combined net periodic benefits expense of \$193 million and net periodic benefits income of \$13 million for the years ended December 31, 2009 and 2008, respectively. The 2009 expense is net of a \$12 million gain allocated to us as a result of QCII's decision to no longer provide pension benefit accruals for active management employees under the qualified and non-qualified pension plans on or after January 1, 2010. The shift from recording combined net periodic income to recording combined net periodic expense was primarily due to a decrease in expected return on plan assets as a result of lower plan asset values and an increase in net actuarial losses. Actuarial gains or losses reflect the differences between earlier actuarial assumptions and what actually occurred.

Taxes and fees increased as a result of a \$40 million favorable property tax settlement and other favorable adjustments recorded in 2008. These increases were partially offset by lower USF charges resulting from continued access line erosion and a decrease in current year property taxes.

Real estate and occupancy costs decreased primarily due to lower fuel costs, resulting from fewer miles driven and lower fuel prices. Real estate and occupancy costs also decreased because we had fewer operating leases in 2009 as compared to 2008.

Other expenses decreased primarily due to lower professional fees, the 2008 impairments of certain assets related to QCII's transition to selling Verizon Wireless services and decreased supplies expense due to cost cutting measures.

Affiliates Expenses

Affiliates expenses decreased primarily due to reduced insurance costs driven by decreases in our workforce, and reduced support charges from our wireless affiliate partially offset by increases in wholesale Internet access in support of our broadband services.

Depreciation and Amortization

The following table provides detail regarding depreciation and amortization expense for the years ended December 31, 2010, 2009 and 2008:

	Years Ended December 31,			Increase/(Decrease)		% Change	
	2010	2009	2008	2010 v 2009	2009 v 2008	2010 v 2009	2009 v 2008
	(Dollars in millions)						
Depreciation and amortization:							
Depreciation	\$1,639	\$1,752	\$1,855	\$ (113)	\$ (103)	(6)%	(6)%
Amortization	234	224	218	10	6	4%	3%
Total depreciation and amortization	<u>\$1,873</u>	<u>\$1,976</u>	<u>\$2,073</u>	<u>\$ (103)</u>	<u>\$ (97)</u>	(5)%	(5)%

Table of Contents

Although our capital expenditures fluctuate from year to year, we continue to see decreased depreciation expense due to significantly lower capital expenditures and the changing mix of our investment in property, plant and equipment since 2002. If we do not significantly shorten our estimates of the useful lives of our assets, we expect that our depreciation expense will continue to decrease for the foreseeable future. Amortization expense increased due to an increase in internally developed capitalized software.

Effective January 1, 2009, we changed our estimates of the economic lives of certain copper cable and telecommunications equipment assets. These changes resulted in additional depreciation expense of approximately \$36 million and reduced net income, net of deferred taxes, by \$22 million for the year ended December 31, 2009 as compared to the year ended December 31, 2008. These assets were fully depreciated as of December 31, 2009.

Other Consolidated Results

The following table provides detail regarding other expense (income)—net and income tax expense for the years ended December 31, 2010, 2009 and 2008:

	Years Ended December 31,			Increase/(Decrease)		% Change	
				2010 v	2009 v	2010 v	2009 v
	2010	2009	2008	2009	2008	2009	2008
	(Dollars in millions)						
Other expense (income)—net:							
Interest expense on long-term borrowings—net	\$ 615	\$ 632	\$ 589	\$ (17)	\$ 43	(3)%	7%
Other—net	(5)	9	7	(14)	2	nm	29%
Total other expense (income)—net	<u>\$ 610</u>	<u>\$ 641</u>	<u>\$ 596</u>	<u>\$ (31)</u>	<u>\$ 45</u>	(5)%	8%
Income tax expense	\$ 791	\$ 724	\$ 829	\$ 67	\$ (105)	9%	(13)%

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

Other Expense (Income)—Net

Interest expense on long-term borrowings—net decreased in 2010 compared to 2009 primarily due to a decrease in interest expense on our interest rate hedges partially offset by increased interest expense as a result of higher average debt levels. Interest expense on long-term borrowings—net increased in 2009 compared to 2008 primarily due to the issuance of \$811 million of new debt in the second quarter of 2009, partially offset by decreased interest as a result of maturities and decreasing interest rates on floating rate debt.

Other—net includes, among other things, interest income, income tax penalties, other interest expense (such as interest on income taxes), and equity method investment losses. The change in other—net in 2010 compared to 2009 is due to more equity method investment losses in 2009. The change in other—net in 2009 compared to 2008 is due to more investment equity method investment losses in 2009, partially offset by a decrease in tax related interest from uncertain tax positions.

Income Tax Expense

The effective income tax rate is the provision for income taxes as a percentage of income before income taxes. Our effective income tax rate for 2010, 2009 and 2008 was 42%, 38% and 37%, respectively.

Income tax expense for the year ended December 31, 2010 increased by \$67 million as a result of the March 2010 enactments of the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 and the tax treatment of the expenses allocated to us when QCII accelerated the vesting of certain stock-based compensation.

Table of Contents

Among other things, the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 will disallow federal income tax deductions for retiree prescription drug benefits to the extent we receive reimbursements for those benefits under the Medicare Part D program. Although this tax increase does not take effect until 2013, under accounting principles generally accepted in the U.S. we recognize the full accounting impact in the period in which the laws are enacted, which increased our effective tax rate for the year ended December 31, 2010 by 2.9 percentage points.

On December 21, 2010, QCII accelerated the vesting of certain restricted stock and performance share awards issued under its Equity Incentive Plan in order to preserve certain economic benefits to its stockholders that otherwise would have been lost in connection with QCII's pending merger with CenturyLink. Certain of the expenses that were allocated to us for this acceleration are not deductible for income tax purposes, and as such they increased our effective tax rate for the year ended December 31, 2010 by 1.1 percentage points.

Income tax expense in 2009 compared to 2008 decreased due to the decrease in income before income taxes.

Liquidity and Capital Resources

We are a wholly owned subsidiary of QSC, which is a wholly owned subsidiary of 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 financial market's perception of us. QCII and its consolidated subsidiaries had total borrowings—net of \$11.947 billion and \$14.200 billion as of December 31, 2010 and 2009, respectively.

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 intercompany obligations vary from time to time and are classified as short-term borrowings.

Near-Term View

We expect that our cash on hand and expected net cash generated by operating activities will exceed our cash needs over the next 12 months. At December 31, 2010, we held cash and cash equivalents of \$192 million, and QCII had an additional \$180 million in cash and cash equivalents as well as \$1.035 billion available under its currently undrawn revolving credit facility (referred to as the Credit Facility). The Credit Facility will be terminated at the time of the closing of QCII's merger with CenturyLink.

During the year ended December 31, 2010, our net cash generated by operating activities totaled \$3.235 billion. For the coming 12 months, our expected financing and investing cash needs include:

- capital expenditures of approximately \$1.3 billion;
- \$825 million of debt maturing in September 2011; and
- dividends to QSC.

We have significant discretion in how we use our cash to pay for capital expenditures and for other costs of our business, as only a minority of our capital expenditures is dedicated to preservation activities or government mandates. We evaluate capital expenditure projects based on expected strategic impacts (such as forecasted revenue growth or productivity, expense and service impacts) and our expected return on investment. If we are not successful in maintaining or increasing our net cash generated by operating activities in the near term, we may use this discretion to decrease our capital expenditures, which may impact future years' operating results and cash flows. Also, we lease certain facilities and equipment under various capital lease arrangements when the

Table of Contents

leasing arrangements are more favorable to us than purchasing the assets. For the year ended December 31, 2010, we entered into capital leases for approximately \$116 million of assets, which allowed us to reduce our initial cash outlays. We may continue to use lease financing for some portion of our capital spending.

At December 31, 2010, our current liabilities exceeded our current assets by \$1.716 billion. This working capital deficit increased \$1.242 billion as compared to our working capital deficit at December 31, 2009. The increase was primarily due to dividends declared to QSC, capital expenditures and the reclassification of non-current borrowings to current, partially offset by net income before depreciation and amortization.

In general, we intend to refinance our debt as it matures, but would need to do so in a manner consistent with the terms of QCII's merger agreement with CenturyLink. Any time we deem conditions favorable, we may attempt to improve our liquidity position by accessing debt markets in a manner designed to create positive economic value. The unstable economy may impair our ability 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.

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 discussed below, we continue to generate substantial cash from operations. We believe that these cash flows, combined with continued access to the capital markets to refinance debt as it comes due, will provide sufficient liquidity to continue our planned investing and financing activities.

Debt

We have a significant amount of debt maturing in the next several years, including \$825 million maturing in 2011, \$1.500 billion maturing in 2012, \$750 million maturing in 2013 and \$600 million in 2014. We believe that we will continue to have access to capital markets to refinance our debt as necessary. In general, we intend to refinance our debt as it matures.

The Credit Facility, which makes available to QCII \$1.035 billion of additional credit subject to certain restrictions as described below, is currently undrawn and expires in September 2013. The Credit Facility has 13 lenders, with commitments ranging from \$25 million to \$100 million. QCII's merger agreement with CenturyLink allows QCII to draw on the facility with the intent to repay the borrowings within 90 days. 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, these 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 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 to those 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.

Table of Contents

The Credit Facility also contains various limitations, including a restriction on using any proceeds from the facility to pay settlements or judgments relating to the legal matters discussed in “Legal Proceedings” in Item 3 of this report. In addition, 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 settlements or judgments relating to the matters discussed in that note, QCII’s 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 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.

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), but would need to do so in a manner consistent with the terms of QCII’s merger agreement with CenturyLink, if:

- revenue and cash provided by operations significantly decline;
- unstable economic conditions continue to persist;
- competitive pressures increase;
- we are required to contribute a material amount of cash to QCII’s pension plan; or
- QCII becomes subject to significant judgments or settlements in one or more of the matters discussed in “Legal Proceedings” in Item 3 of this report.

Pension Plan

Benefits paid by QCII’s pension plan are paid through a trust. This pension plan is measured annually at December 31. The accounting unfunded status of the pension plan was \$585 million at December 31, 2010. Cash funding requirements can be significantly impacted by earnings on investments, the discount rate, changes in the plan and funding laws and regulations. As a result, it is difficult to determine future funding requirements with a high level of precision; however, in general, current funding laws require a company with a plan shortfall to fund the annual cost of benefits earned in addition to a seven-year amortization of the shortfall. Based on current funding laws and regulations, QCII will not be required to make a cash contribution in 2011. QCII expects to begin making required contributions to the plan during 2012 and estimates that these 2012 contributions could be between \$300 million and \$350 million. Although potentially significant in the aggregate, QCII currently expects that contributions in 2013 and beyond will decrease annually from the 2012 expected contribution amount. However, the actual amount of required contributions in 2013 and beyond will depend on earnings on investments, discount rates, demographic experience, changes in the plan and funding laws and regulations.

Substantially all of our employees participate in the QCII pension plan. Historically, QCII has only required us to pay our portion of its pension contribution. Our contributions are not segregated or restricted to pay amounts due to our employees and may be used to provide benefits to other employees of QCII’s affiliates. See additional information about QCII’s pension benefits in Note 11—Employee Benefits to our consolidated financial statements in Item 8 of this report.

Post-Retirement Benefits

Certain of QCII’s post-retirement health care and life insurance benefits plans are unfunded. As of December 31, 2010, the unfunded status of all of QCII’s post-retirement benefit plans was \$2.522 billion. A trust holds assets that are used to help cover the health care costs of retirees who are former occupational (also referred to as union) employees.

QCII did not make any cash contributions to this trust in 2010 and does not expect to make any significant cash contributions to this trust in the future. QCII therefore anticipates that the majority of the costs that have historically been paid out of this trust will need to be paid by us at some point in the future. As of December 31,

Table of Contents

2010, the fair value of the trust assets was \$801 million; however, a portion of these assets is comprised of investments with restricted liquidity. In 2009 QCII estimated that the trust would be adequate to provide continuing reimbursements for its occupational post-retirement health care costs for approximately five years. Based on returns on trust assets during 2010, QCII still believes that the more liquid assets in the trust will be adequate to provide continuing reimbursements for its occupational post-retirement health care costs for approximately five years. Thereafter, covered benefits for its eligible retirees who are former occupational employees will be paid either directly by us or from the trust as the remaining assets become liquid. This five year period could be substantially shorter or longer depending on returns on plan assets, the timing of maturities of illiquid plan assets and future changes in benefits. QCII's estimate of the annual long-term rate of return on the plan assets is 7.5% based on the currently held assets; however, actual returns could vary widely in any given year. The benefits reimbursed from plan assets were \$186 million in 2010.

Our employees may become eligible to participate in the QCII post-retirement plan. The amounts contributed by us through QCII are not segregated or restricted to pay amounts due to our employees and may be used to provide benefits to other employees of QCII's affiliates. Historically, QCII has only required us to pay our portion of its post-retirement contribution. See additional information about QCII's post-retirement benefits in Note 11—Employee Benefits to our consolidated financial statements in Item 8 of this report.

Historical View

The following table summarizes cash flow activities for the years ended December 31, 2010, 2009 and 2008:

	<u>Years Ended December 31,</u>			<u>Increase/(Decrease)</u>		<u>% Change</u>	
	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2010 v</u>	<u>2009 v</u>	<u>2010 v</u>	<u>2009 v</u>
				<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
	(Dollars in millions)						
Cash flows:							
Provided by operating activities	\$3,235	\$3,167	\$3,479	\$ 68	\$(312)	2%	(9)%
Used for investing activities	1,256	1,100	1,402	156	(302)	14%	(22)%
Used for financing activities	2,801	1,286	2,136	1,515	(850)	118%	(40)%

Operating Activities

Cash provided by operating activities increased in 2010 as compared to 2009 primarily due to decreased tax-related payments to QSC as a result of changes in bonus depreciation tax laws. Cash provided by operating activities also increased in 2010 as compared to 2009 due to lower payments for employee-related expenses resulting from reduced headcount. These increases in cash provided by operating activities were partially offset by a decline in cash received from customers as a result of decreased revenue.

Cash provided by operating activities decreased in 2009 as compared to 2008 primarily due to increased tax-related payments to QSC as a result of our utilization in 2008 of deferred tax assets acquired as a result of QCII merging into us two of QSC's other wholly owned subsidiaries.

Investing Activities

Cash used for investing activities increased in 2010 as compared to 2009 primarily due to increased capital expenditures. The increase in capital spending was due to a cautious investment climate in late 2008 and early 2009, increased spending on our strategic initiatives and timing of cash payments. We may continue to use lease financing in 2011 for some portion of our capital spending. Our capital expenditures continue to be focused on our strategic services such as broadband. In 2011, we anticipate that our fiber investment, which includes fiber to the cell site, or FTTCS, will increase. Our projected capital expenditures for 2011 will be up to \$1.3 billion.

Table of Contents

Cash used for investing activities decreased in 2009 as compared to 2008 primarily due to lower capital expenditures. Lower capital spending was the result of initiatives related to decreasing per unit capital costs, a slowdown in new housing construction, which was down 40% as compared to 2008, and other lower customer-driven capital requirements. We also took advantage of favorable interest rates and increased our capital leasing activity, which further reduced our cash payments for capital equipment.

Financing Activities

For the year ended December 31, 2010, we paid \$2.260 billion in dividends to QSC and we repaid \$534 million of long-term borrowings (including current maturities).

For the year ended December 31, 2009, we paid \$2.000 billion in dividends to QSC, issued \$811 million of new debt resulting in aggregate net proceeds of \$738 million and repaid \$25 million of long-term borrowings including current maturities.

For the year ended December 31, 2008, we paid \$2.000 billion in dividends to QSC, repaid \$347 million of long-term borrowings including current maturities, and received equity infusions of \$231 million.

We may continue to 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. We were in compliance with all provisions and covenants of our borrowings as of December 31, 2010. For additional information on our 2010 and 2009 financing activities, see Note 8—Borrowings to our consolidated financial statements in Item 8 of this report.

Letters of Credit

We maintain letter of credit arrangements with various financial institutions for up to \$57 million. We had outstanding letters of credit of approximately \$51 million as of December 31, 2010. On January 18, 2011, QCII entered into \$7 million of additional letters of credit.

Credit Ratings

Due to our general expectation that we will refinance our debt maturities, our credit ratings can have significant impact on our liquidity and capital resources. Debt ratings by the various rating agencies reflect each agency's opinion of the ability of the issuers to repay debt obligations as they come due. In general, lower ratings result in higher borrowing costs and impaired ability to borrow under acceptable terms. A security rating is not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time by the assigning rating organization.

The table below summarizes our long-term debt ratings as of December 31, 2010:

	December 31, 2010
Moody's	Baa3
S&P	BBB-
Fitch	BBB-

Since QCII's announcement of its pending merger with CenturyLink:

- on August 13, 2010, Moody's Investors Service upgraded our rating from Ba1 to Baa3 (investment grade);
- Standard & Poor's placed our rating on "CreditWatch" with developing implications, meaning that S&P could raise, maintain or lower the rating; and
- Fitch Ratings affirmed its previous rating of BBB- with a stable outlook.

Table of Contents

With respect to Moody's, a rating of Baa indicates that the security is subject to moderate credit risk, is considered medium grade and as such may possess certain speculative characteristics. The "1, 2, 3" modifiers show relative standing within the major categories, 1 being the highest, or best, modifier in terms of credit quality.

With respect to S&P and Fitch, a rating of BBB indicates that there are currently expectations of adequate protection. The capacity for payment of financial commitments is considered adequate but adverse changes in circumstances and economic conditions are more likely to impair this capacity. This is the lowest investment grade category. The plus and minus symbols show relative standing within major categories.

While we have been able to obtain financing historically and our ratings have improved since QCII's pending merger with CenturyLink was announced, given our current credit ratings our ability to raise additional capital under acceptable terms and conditions may be impaired.

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 have used derivative financial instruments to manage our interest rate risk exposure on our debt and we may employ them in the future.

Near-Term Maturities

As of December 31, 2010, we had \$825 million of long-term notes 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 notes would decrease annual pre-tax earnings by approximately \$8 million.

Floating-Rate Debt

As of December 31, 2010, we had \$750 million of floating interest rate debt outstanding, all of which was exposed to changes in interest rates. The exposure for these instruments is linked to the London Interbank Offered Rate, or LIBOR. A hypothetical increase of 100 basis points in LIBOR relative to this debt would decrease annual pre-tax earnings by approximately \$8 million.

Investments

As of December 31, 2010, our cash and investments managed by QSC included \$188 million invested in highly liquid cash-equivalent instruments and \$52 million invested in currently non-liquid auction rate securities. 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 \$2 million.

Table of Contents

Future Contractual Obligations

The following table summarizes our estimated future contractual obligations as of December 31, 2010:

	Payments Due by Period						
	2011	2012	2013	2014	2015	2016 and Thereafter	Total
	(Dollars in millions)						
Future contractual obligations ⁽¹⁾ :							
Debt and lease payments:							
Long-term debt	\$ 825	\$1,500	\$ 750	\$ 600	\$400	\$ 3,893	\$ 7,968
Capital lease and other obligations	52	46	39	28	16	3	184
Interest on long-term borrowings and capital leases ⁽²⁾	597	463	380	363	301	2,945	5,049
Operating leases	88	59	40	34	29	67	317
Total debt and lease payments	1,562	2,068	1,209	1,025	746	6,908	13,518
Other long-term liabilities	3	2	2	2	2	43	54
Purchase commitments:							
Telecommunications and information technology	2	2	2	1	1	1	9
Advertising, promotion and other services ⁽³⁾	64	41	31	27	24	44	231
Total purchase commitments	66	43	33	28	25	45	240
Non-qualified pension obligation ⁽⁴⁾	2	2	2	2	2	21	31
Total future contractual obligations	\$1,633	\$2,115	\$1,246	\$1,057	\$775	\$ 7,017	\$13,843

(1) The table does not include:

- costs that are contingent upon completion of QCII's pending merger with CenturyLink;
- our open purchase orders as of December 31, 2010. These purchase orders are generally at fair value, are generally cancelable without penalty and are part of normal operations;
- other long-term liabilities, such as accruals for legal matters and income taxes, that are not contractual obligations by nature. We cannot determine with any degree of reliability the years in which these liabilities might ultimately settle;
- affiliate cash funding requirements for pension benefits payable to certain eligible current and future retirees allocated to us by QCII. The accounting unfunded status of QCII's pension plan was \$585 million at December 31, 2010. Benefits paid by QCII's qualified pension plan are paid through a trust. Cash funding requirements for this trust are not included in this table as QCII is not able to reliably estimate required contributions to the trust. QCII's cash funding requirements can be significantly impacted by earnings on investments, the discount rate changes in the plan and funding laws and regulations. As a result, it is difficult to determine future funding requirements with a high level of precision; however, in general, current funding laws require a company with a plan shortfall to fund the annual cost of benefits earned in addition to a seven-year amortization of the shortfall. Based on current funding laws and regulations, QCII will not be required to make a cash contribution in 2011. QCII expects to begin making required contributions to the plan during 2012 and estimates that these 2012 contributions could be between \$300 million and \$350 million. Although potentially significant in the aggregate, QCII currently expects that contributions in 2013 and beyond will decrease annually from the 2012 expected contribution amount. However, the actual amount of required contributions in 2013 and beyond will depend on earnings on investments, discount rates, demographic experience, changes

in the plan and funding laws and regulations. Substantially all of our employees participate in the QCII pension plan. The amounts contributed by us through QCII are not segregated or restricted to pay amounts due to our employees and may be used to provide benefits to other employees of QCII's affiliates. Historically, QCII has only required us to pay our portion of its required pension contribution;

- affiliate post-retirement benefits payable to certain eligible current and future retirees. Although we had an affiliate liability recorded on our balance sheet as of December 31, 2010 representing our allocated net benefit obligation for post-retirement benefits, not all of this amount is a contractual obligation. Certain of these plans are unfunded and net payments made by us totaled \$112 million in 2010, including payments for benefits that are not contractual obligations. Assuming our future proportionate share of QCII's total post-retirement benefits payments is consistent with an average of our proportionate share over the prior three years, total undiscounted future payments estimated to be made by us for benefits that are both contractual obligations and non-contractual obligations are approximately \$4.0 billion over approximately 80 years. However, this estimate is impacted by various actuarial and market assumptions, and ultimate payments will differ from this estimate. In 1989, a trust was created and funded by QCII to help cover the health care costs of retirees who are former occupational employees. QCII did not make any cash contributions to this trust in 2010 and does not expect to make any significant cash contributions to this trust in the future. QCII anticipates that the majority of the costs that have historically been paid out of this trust will need to be paid by us at some point in the future. As of December 31, 2010, the fair value of the trust assets was \$801 million; however, a portion of these assets is comprised of investments with restricted liquidity. In 2009 QCII estimated that the trust would be adequate to provide continuing reimbursements for its occupational post-retirement health care costs for approximately five years. Based on returns on trust assets during 2010, QCII still believes that the more liquid assets in the trust will be adequate to provide continuing reimbursements for its occupational post-retirement health care costs for approximately five years. Thereafter, covered benefits for QCII's eligible retirees who are former occupational employees will be paid either directly by us or from the trust as the remaining assets become liquid. This five year period could be substantially shorter or longer depending on returns on plan assets, the timing of maturities of illiquid plan assets and future changes in benefits. QCII's estimate of the annual long-term rate of return on the plan assets is 7.5% based on the currently held assets; however, actual returns could vary widely in any given year. The benefits reimbursed from plan assets were \$186 million in 2010. See additional information on our benefits plans in Note 11—Employee Benefits to our consolidated financial statements in Item 8 of this report;
- contract termination fees. These fees are non-recurring payments, the timing and payment of which, if any, is uncertain. In the ordinary course of business and to optimize our cost structure, we enter into contracts with terms greater than one year to purchase goods and services. Assuming we exited these contracts in 2011, termination fees for these contracts would be \$31 million. In the normal course of business, we believe the payment of these fees is remote; and
- potential indemnification obligations to counterparties in certain agreements entered into in the normal course of business. The nature and terms of these arrangements vary. Historically, we have not incurred significant costs related to performance under these types of arrangements.

- (2) Interest paid in all years may differ due to future refinancing of debt. Interest on our floating rate debt was calculated for all years using the rates effective as of December 31, 2010.
- (3) We have various long-term, non-cancelable purchase commitments for advertising and promotion services, including advertising and marketing at sports arenas and other venues and events. We also have service related commitments with various vendors for data processing, technical and software support services. Future payments under certain service contracts will vary depending on our actual usage. In the table above we estimated payments for these service contracts based on the level of services we expect to receive.

Table of Contents

- (4) Non-qualified pension payment estimates assume we pay the same proportionate share of QCII's total payments as the average we paid over the prior three years.

Off-Balance Sheet Arrangements

We have no special purpose or limited purpose entities that provide off-balance sheet financing, liquidity, or market or credit risk support, and we do not engage in leasing, hedging, research and development services, or other relationships that expose us to any significant liabilities that are not reflected on the face of the consolidated financial statements or in the Future Contractual Obligations table above.

Critical Accounting Policies and Estimates

We have identified certain policies and estimates as critical to our business operations and the understanding of our past or present results of operations. For additional information on the application of these and other significant accounting policies, see Note 2—Summary of Significant Accounting Policies to our consolidated financial statements in Item 8 of this report. These policies and estimates are considered critical because they had a material impact, or they have the potential to have a material impact, on our consolidated financial statements and because they require significant judgments, assumptions or estimates. The preparation of our consolidated financial statements and related disclosures requires us to make estimates, intercompany allocations and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of our consolidated financial statements, and the reported amounts of revenue and expenses during the reporting period. We believe that the estimates, judgments and assumptions made when accounting for the items described below are reasonable, based on information available at the time they are made. However, there can be no assurance that actual results will not differ from those estimates.

Intercompany Revenue and Charges

We charge our affiliates based on tariffed rates for telecommunications and data services and either fully distributed cost or market rates for other services. Our fully distributed costs methodology includes employee costs, facilities costs, overhead costs and a return on investment component.

Our affiliates charge us for services rendered by their employees primarily by applying the fully distributed cost methodology discussed above. Our affiliates also contract services from third parties on our behalf. For these services, the third parties bill our affiliates who in turn charge us for our respective share of these third-party expenses.

The methodologies discussed above for determining affiliates revenue and charges are based on rules that the FCC adopted pursuant to the Communications Act, as amended by the Telecommunications Act. We believe the accounting estimates related to affiliates revenue and charges are “critical accounting estimates” because determining market rates and determining the allocation methodology and the supporting allocation factors: (i) requires judgment and is subject to refinement as facts and circumstances change or as new cost drivers are identified, (ii) are based on regulatory rules which are subject to change, and (iii) QCII occasionally changes which affiliates provide them services which can impact overall costs and related affiliates charges, all of which require significant judgment and assumptions.

Affiliates Transactions

We record intercompany charges at the amounts billed to us by our affiliates. Regulatory rules require certain expenses to be recorded at market price or fully distributed cost, as more fully described in Note 16—Related Party Transactions to our consolidated financial statements in Item 8 of this report. Our compliance with regulations is subject to review by regulators. Adjustments to intercompany charges that result from these reviews are recorded in the period they become known.

Table of Contents

Because of the significance of the services we provide to our affiliates and our other affiliates transactions, the result of operations, financial position, and cash flows presented herein are not necessarily indicative of the results of operations, financial position and cash flows we would have achieved had we operated as a stand-alone entity during the periods presented.

Loss Contingencies and Litigation Reserves

QCII and we are involved in several material legal proceedings, as described in more detail in “Legal Proceedings” in Item 3 of this report. We assess potential losses in relation to any such matters to which we are a party and in relation to other pending or threatened tax and legal matters. 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. To the extent these estimates are more or less than the actual liability resulting from the resolution of these matters, our earnings will be increased or decreased accordingly. If the differences are material, our consolidated financial statements could be materially impacted. If a loss is considered reasonably possible, we disclose the item and any determinable estimate of the loss if material but we do not recognize any expense for the potential loss.

For matters related to income taxes, if the impact of an uncertain tax position is more likely than not to be sustained upon audit by the relevant taxing authority, then we recognize a benefit for the largest amount that is more likely than not to be sustained. No portion of an uncertain tax position will be recognized if the position has less than a 50% likelihood of being sustained. Though the validity of any tax position is a matter of tax law, the body of statutory, regulatory and interpretive guidance on the application of the law is complex and often ambiguous. Because of this, whether a tax position will ultimately be sustained may be uncertain. The overall tax liability recorded for uncertain tax positions as of December 31, 2010 and 2009 considers the anticipated utilization of any applicable tax credits.

To the extent we have recorded tax liabilities that are more or less than the actual liability that ultimately results from the resolution of an uncertain tax position, our earnings will be increased or decreased accordingly. Also, as we become aware of new interpretations of relevant tax laws and as we discuss our interpretations with taxing authorities, we may in the future change our assessments of the sustainability of an uncertain tax position or of the amounts that may be sustained upon audit. We believe that the estimates, judgments and assumptions made in accounting for these matters are reasonable, based on information currently available. However, as our assessments change and as uncertain tax positions are resolved, the impact to our consolidated financial statements could be material.

Deferred Taxes

We are included in the consolidated federal income tax return of QCII. Under QCII’s tax allocation policy, QCII treats our consolidated results as if we were a separate taxpayer. The policy requires us to pay our tax liabilities in cash based upon our separate return taxable income. We are also included in the combined state tax returns filed by QCII, and the same payment and allocation policy applies.

Our provision for income taxes includes amounts for tax consequences deferred to future periods. We record deferred income tax assets and liabilities reflecting future tax consequences attributable to tax credit carryforwards and differences between the financial statement carrying value of assets and liabilities and the tax bases of those assets and liabilities. Deferred taxes are computed using enacted tax rates expected to apply in the year in which the differences are expected to affect taxable income. The effect on deferred income tax assets and liabilities of a change in tax rate is recognized in earnings in the period that includes the enactment date.

The measurement of deferred taxes often involves an exercise of judgment related to the computation and realization of tax basis. Our deferred tax assets and liabilities reflect our assessment that tax positions taken, and the resulting tax basis, are more likely than not to be sustained if they are audited by taxing authorities. Also,

Table of Contents

assessing tax rates that we expect to apply and determining the years when the temporary differences are expected to affect taxable income requires judgment about the future apportionment of our income among the states in which we operate. These matters, and others, involve the exercise of significant judgment. Any changes in our practices or judgments involved in the measurement of deferred tax assets and liabilities could materially impact our financial condition or results of operations.

Pension and Post-Retirement Benefits

Substantially all of our employees participate in the QCII pension plan. QCII also maintains a non-qualified pension plan for certain of our eligible highly compensated employees. In addition, certain employees may become eligible to participate in QCII's post-retirement health care and life insurance benefit plans. QCII allocates the expense relating to pension, non-qualified pension, and post-retirement health care and life insurance benefits and the associated obligations and assets to us and determines our cash contribution. The amounts contributed by us through QCII are not segregated or restricted to pay amounts due to our employees and may be used to provide benefits to other employees of QCII's affiliates. Historically, QCII has only required us to pay our portion of its required pension contribution. The allocation of expense to us is based upon demographics of our employees and retirees compared to all the remaining participants. However, significant year over year changes in QCII's funded status affecting accumulated other comprehensive income may not have a significant initial impact on the affiliate receivable or payable that is allocated to us.

In computing the pension and post-retirement health care and life insurance benefits expenses and obligations, the most significant assumptions QCII makes include discount rate, expected rate of return on plan assets, health care trend rates and QCII's evaluation of the legal basis for plan amendments. The plan benefits covered by collective bargaining agreements as negotiated with our employees' unions can also significantly impact the amount of expense we record.

Changes in any of the above factors QCII made in computing the pension and post-retirement health care and life insurance benefit expenses could impact general, administrative and other operating expenses and the affiliate benefits receivable or payable allocated to us as described above. For further discussion of the QCII pension, non-qualified pension and post-retirement benefit plans and the critical accounting estimates, see QCII's Annual Report on Form 10-K for the year ended December 31, 2010.

Revenue Recognition and Related Reserves

We recognize revenue for services when the related services are provided. Recognition of certain payments received in advance of services being provided is deferred until the service is provided. These advance payments received, primarily activation fees and installation charges, as well as the associated customer acquisition costs, are deferred and recognized over the expected customer relationship period, which ranges from eighteen months to over ten years depending on the service. Customer arrangements that include both equipment and services are evaluated to determine whether the elements are separable based on objective evidence. If the elements are deemed separable and separate earnings processes exist, total consideration is allocated to each element based on the relative fair values of the separate elements and the revenue associated with each element is recognized as earned. If these criteria are not satisfied, the total advance payment is deferred and recognized ratably over the longer of the contractual period or the expected customer relationship period.

We believe that the accounting estimates related to customer relationship periods and to the assessment of whether bundled elements are separable are "critical accounting estimates" because: (i) they require management to make assumptions about how long we will retain customers; (ii) the assessment of whether bundled elements are separable is subjective; (iii) the impact of changes in actual retention periods versus these estimates on the revenue amounts reported in our consolidated statements of operations could be material; and (iv) the assessment of whether bundled elements are separable may result in revenue being reported in different periods than significant portions of the related costs.

Table of Contents

As the telecommunications market experiences greater competition and customers shift from traditional land-based telecommunications services to wireless and Internet-based services, our estimated customer relationship period could decrease and we will accelerate the recognition of deferred revenue and related costs over a shorter estimated customer relationship period.

Economic Lives of Assets to be Depreciated or Amortized

We perform annual internal studies or reviews to determine depreciable lives for our property, plant and equipment. These studies utilize models that take into account actual usage, physical wear and tear, replacement history, assumptions about technology evolution, and, in certain instances, actuarially determined probabilities to calculate the remaining life of our asset base.

Due to rapid changes in technology and the competitive environment, selecting the estimated economic life of telecommunications plant, equipment and software requires a significant amount of judgment. We regularly review data on utilization of equipment, asset retirements and salvage values to determine adjustments to our depreciation rates. The effect of a one year increase or decrease in the estimated remaining useful lives of our property, plant and equipment would have decreased depreciation by approximately \$230 million or increased depreciation by approximately \$310 million, respectively. The effect of a one half year increase or decrease in the estimated remaining useful lives of our capitalized software would have decreased amortization by approximately \$30 million or increased amortization by approximately \$40 million, respectively.

Recoverability of Long-Lived Assets

We periodically perform evaluations of the recoverability of the carrying value of our long-lived assets using gross undiscounted cash flow projections. These evaluations require identification of the lowest level of identifiable, largely independent, cash flows for purposes of grouping assets and liabilities subject to review. The cash flow projections include long-term forecasts of revenue growth, gross margins and capital expenditures. All of these items require significant judgment and assumptions. We believe our estimates are reasonable, based on information available at the time they were made. However, if our estimates of our future cash flows had been different, we may have concluded that some of our long-lived assets were not recoverable, which would likely have caused us to record a material impairment charge. Also, if our future cash flows are significantly lower than our projections we may determine at some future date that some of our long-lived assets are not recoverable.

Derivative Financial Instruments

As of December 31, 2010, we did not have any derivative financial instruments. However, we sometimes use derivative financial instruments, specifically interest rate swap contracts, to manage interest rate risks. We execute these instruments with financial institutions we deem creditworthy and monitor our exposure to these counterparties. 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 due to changes in interest rates.

We recognize all derivatives on our 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. Cash flows from derivative instruments that are cash flow hedges or fair value hedges are classified in cash flows from operations.

Table of Contents

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 in our 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 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 consolidated statements of operations the changes in fair value of the derivative and the underlying hedged item. However, if the terms of this type of derivative match the terms of the underlying hedged item such that we qualify to assume no ineffectiveness, then the fair value of the derivative is measured and the change in the fair value for the period is assumed to equal the change in the fair value of the underlying hedged item for the period, with no impact in other expense (income)—net.

We assess quarterly whether each derivative is highly effective in offsetting changes in fair values or cash flows of the hedged item or whether our initial assumption of no ineffectiveness is still valid. If we determine that a derivative is not highly effective as a hedge, a derivative has ceased to be a highly effective hedge or our assumption of no ineffectiveness is no longer valid, then 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.

For additional information on our derivative financial instruments, see Note 9—Derivative Financial Instruments to our consolidated financial statements in Item 8 of this report.

Recently Issued Accounting Pronouncements

In October 2009, the FASB issued Accounting Standards Update, or ASU, Number 2009-13, “Revenue Recognition (ASC 605) Multiple-Deliverable Revenue Arrangements a consensus of the FASB Emerging Issues Task Force.” This ASU establishes a new selling price hierarchy to use when allocating the sales price of a multiple element arrangement between delivered and undelivered elements. This ASU is generally expected to result in revenue recognition for more delivered elements than under current rules. We are required to adopt this ASU prospectively for new or materially modified agreements as of January 1, 2011. The adoption of this ASU will not have a material effect on our financial position or results of operations.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information in “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Risk Management” in Item 7 of this report is incorporated herein by reference.

ITEM 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholder
Qwest Corporation:

We have audited the accompanying consolidated balance sheets of Qwest Corporation and subsidiaries (the Company) as of December 31, 2010 and 2009, and the related consolidated statements of operations, stockholder's (deficit) equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2010. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Qwest Corporation and subsidiaries as of December 31, 2010 and 2009, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2010, in conformity with U.S. generally accepted accounting principles.

KPMG LLP

Denver, Colorado
February 21, 2011

QWEST CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS

	Years Ended December 31,		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
	(Dollars in millions)		
Operating revenue:			
Operating revenue	\$7,700	\$8,075	\$ 8,576
Operating revenue—affiliates	<u>1,571</u>	<u>1,656</u>	<u>1,812</u>
Total operating revenue	<u>9,271</u>	<u>9,731</u>	<u>10,388</u>
Operating expenses:			
Cost of sales (exclusive of depreciation and amortization)	1,655	1,704	1,899
Selling	1,457	1,645	1,812
General, administrative and other operating	1,609	1,669	1,556
Affiliates	194	175	185
Depreciation and amortization	<u>1,873</u>	<u>1,976</u>	<u>2,073</u>
Total operating expenses	<u>6,788</u>	<u>7,169</u>	<u>7,525</u>
Operating income	2,483	2,562	2,863
Other expense (income)—net:			
Interest expense on long-term borrowings—net	615	632	589
Other—net	<u>(5)</u>	<u>9</u>	<u>7</u>
Total other expense (income)—net	<u>610</u>	<u>641</u>	<u>596</u>
Income before income taxes	1,873	1,921	2,267
Income tax expense	<u>791</u>	<u>724</u>	<u>829</u>
Net income	<u>\$1,082</u>	<u>\$1,197</u>	<u>\$ 1,438</u>

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

QWEST CORPORATION
CONSOLIDATED BALANCE SHEETS

	December 31,	
	2010	2009
	(Dollars in millions)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 192	\$ 1,014
Accounts receivable—net of allowance of \$48 and \$53, respectively	720	774
Accounts receivable—affiliates	193	71
Deferred income taxes—net	159	167
Prepaid expenses and other	197	245
Total current assets	1,461	2,271
Property, plant and equipment—net	10,132	10,638
Capitalized software—net	913	880
Prepaid pension—affiliates	899	952
Other	281	297
Total assets	<u>\$ 13,686</u>	<u>\$ 15,038</u>
LIABILITIES AND STOCKHOLDER'S (DEFICIT) EQUITY		
Current liabilities:		
Current portion of long-term borrowings	\$ 871	\$ 515
Accounts payable	463	419
Accounts payable—affiliates	242	201
Dividends payable—Qwest Services Corporation	140	100
Accrued expenses and other	909	941
Current portion of post-retirement, other post-employment benefits and other—affiliates	180	176
Deferred revenue and advance billings	372	393
Total current liabilities	3,177	2,745
Long-term borrowings—net of unamortized debt discount and other of \$140 and \$155, respectively	7,141	7,871
Post-retirement, other post-employment benefits and other—affiliates	2,501	2,573
Deferred income taxes—net	1,327	1,127
Other	371	410
Total liabilities	<u>14,517</u>	<u>14,726</u>
Commitments and contingencies (Note 17)		
Stockholder's (deficit) equity:		
Common stock—one share without par value, owned by Qwest Services Corporation	11,425	11,346
Accumulated deficit	(12,256)	(11,034)
Total stockholder's (deficit) equity	<u>(831)</u>	<u>312</u>
Total liabilities and stockholder's (deficit) equity	<u>\$ 13,686</u>	<u>\$ 15,038</u>

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

QWEST CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2010	2009	2008
	(Dollars in millions)		
Operating activities:			
Net income	\$ 1,082	\$ 1,197	\$ 1,438
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	1,873	1,976	2,073
Deferred income taxes	241	(137)	215
Provision for bad debt—net	70	85	83
Other non-cash charges—net	5	17	41
Changes in operating assets and liabilities:			
Accounts receivable	(22)	48	3
Accounts receivable—affiliates	(9)	55	(68)
Prepaid expenses and other current assets	67	10	29
Accounts payable, accrued expenses and other current liabilities	(3)	28	(112)
Accounts payable, accrued expenses and other current liabilities—affiliates	(66)	(163)	(71)
Deferred revenue and advance billings	(29)	(39)	(36)
Other non-current assets and liabilities including affiliates	26	90	(116)
Cash provided by operating activities	<u>3,235</u>	<u>3,167</u>	<u>3,479</u>
Investing activities:			
Expenditures for property, plant and equipment and capitalized software	(1,240)	(1,106)	(1,404)
Changes in interest in investments managed by Qwest Services Corporation	(17)	13	(13)
Other	1	(7)	15
Cash used for investing activities	<u>(1,256)</u>	<u>(1,100)</u>	<u>(1,402)</u>
Financing activities:			
Proceeds from long-term borrowings	—	738	—
Repayments of long-term borrowings, including current maturities	(534)	(25)	(347)
Repayments of long-term borrowings, including current maturities—affiliates	—	—	(22)
Dividends paid to Qwest Services Corporation	(2,260)	(2,000)	(2,000)
Equity infusions from Qwest Services Corporation	—	—	231
Other	(7)	1	2
Cash used for financing activities	<u>(2,801)</u>	<u>(1,286)</u>	<u>(2,136)</u>
Cash and cash equivalents:			
(Decrease) increase in cash and cash equivalents	(822)	781	(59)
Beginning balance	1,014	233	292
Ending balance	<u>\$ 192</u>	<u>\$ 1,014</u>	<u>\$ 233</u>

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

QWEST CORPORATION
CONSOLIDATED STATEMENTS OF STOCKHOLDER'S (DEFICIT) EQUITY
AND COMPREHENSIVE INCOME

	<u>Common Stock</u>	<u>Accumulated Deficit</u>	<u>Total</u>	<u>Comprehensive Income</u>
	(Dollars in millions)			
Balance as of December 31, 2007	\$11,132	\$ (9,762)	\$ 1,370	
Net income	—	1,438	1,438	\$ 1,438
Dividends declared on common stock	—	(2,200)	(2,200)	
Other comprehensive income—net of taxes:				
Unrealized loss on derivative instruments, net of deferred taxes of \$3	—	(6)	(6)	(6)
Unrealized loss on auction rate securities and other, net of deferred taxes of \$5	—	(8)	(8)	(8)
Total comprehensive income—net				<u>\$ 1,424</u>
Equity infusions from Qwest Services Corporation	231	—	231	
Other net asset transfers	(37)	(2)	(39)	
Balance as of December 31, 2008	11,326	(10,540)	786	
Net income	—	1,197	1,197	\$ 1,197
Dividends declared on common stock	—	(1,700)	(1,700)	
Other comprehensive income—net of taxes:				
Unrealized gain on derivative instruments, net of deferred taxes of \$4	—	7	7	7
Unrealized gain on auction rate securities and other, net of deferred taxes of \$1	—	2	2	2
Total comprehensive income—net				<u>\$ 1,206</u>
Other net asset transfers	20	—	20	
Balance as of December 31, 2009	11,346	(11,034)	312	
Net income	—	1,082	1,082	\$ 1,082
Dividends declared on common stock	—	(2,300)	(2,300)	
Other comprehensive income—net of taxes:				
Unrealized loss on derivative instruments, net of deferred taxes of \$1	—	(1)	(1)	(1)
Unrealized loss on auction rate securities and other, net of deferred taxes of \$2	—	(3)	(3)	(3)
Total comprehensive income—net				<u>\$ 1,078</u>
Other net asset transfers	79	—	79	
Balance as of December 31, 2010	<u>\$11,425</u>	<u>\$ (12,256)</u>	<u>\$ (831)</u>	

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

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the Years Ended December 31, 2010, 2009 and 2008

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: Business and Background

We offer data, Internet, video and voice services within 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.

CenturyLink Merger

On April 21, 2010, QCII entered into a merger agreement whereby CenturyLink, Inc. (“CenturyLink”) will acquire QCII in a tax-free, stock-for-stock transaction. Under the terms of the agreement, QCII’s stockholders will receive 0.1664 shares of CenturyLink common stock for each share of QCII’s common stock they own at closing. Based on QCII’s and CenturyLink’s number of outstanding shares as of the date of the merger agreement, at closing CenturyLink shareholders are expected to own approximately 50.5% and QCII’s stockholders are expected to own approximately 49.5% of the combined company. On July 15, 2010, QCII and CenturyLink received notification from the Department of Justice and the Federal Trade Commission that they received early termination of the waiting period under the Hart-Scott-Rodino Act, and as such have clearance from a federal antitrust perspective to proceed with the merger. On August 24, 2010, stockholders of each company approved all proposals relating to the merger. Completion of this transaction remains subject to a number of regulatory approvals as well as other customary closing conditions. QCII and CenturyLink have received most of the necessary approvals from state public service or public utility commissions, but they still need approvals from the Federal Communications Commission (“FCC”) and several other state public service or public utility commissions. While the timing of the receipt of these approvals cannot be predicted with certainty, QCII currently expects to receive all required approvals in the first quarter and is planning toward an April 1st closing date. If the merger agreement is terminated under certain circumstances, QCII may be obligated to pay CenturyLink a termination fee of \$350 million.

We are wholly owned by QSC, which is wholly owned by QCII. Our operations are included in the consolidated operations of 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:

- Data integration;
- Dedicated Internet access;
- Hosting services;
- Long-distance services that allow calls that cross telecommunications geographical areas;
- Managed services;
- Multi-protocol label switching; and
- Voice over Internet Protocol, or VoIP.

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

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

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 and our traditional wide area network (“WAN”) services, which consist of asynchronous transfer mode (“ATM”) and frame relay.

Note 2: Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements include our accounts and the accounts of our subsidiaries over which we exercise control. All intercompany amounts and transactions with our consolidated subsidiaries have been eliminated.

Reclassifications

During the first quarter of 2010, we changed the definitions we use to classify expenses as cost of sales, selling expenses or general, administrative and other operating expenses and, as a result, certain expenses in our consolidated statements of operations for the prior year have been reclassified to conform to the current year presentation. Our new definitions of these expenses are as follows:

- *Cost of sales (exclusive of depreciation and amortization)* are expenses incurred in providing products and services to our customers and affiliates. These expenses include: employee-related expenses directly attributable to operating and maintaining our network (such as salaries, wages and certain benefits); equipment sales expenses (such as modem expenses); rents and utilities expenses incurred by our network operations; fleet expenses; and other expenses directly related to our network operations (such as professional fees and outsourced services).
- *Selling expenses* are expenses incurred in selling products and services to our customers and affiliates. These expenses include: employee-related expenses directly attributable to selling products or services (such as salaries, wages, internal commissions and certain benefits); marketing and advertising; external commissions; bad debt expense; and other selling expenses (such as professional fees and outsourced services).
- *General, administrative and other operating expenses* are corporate overhead and other operating expenses. These expenses include: employee-related expenses for administrative functions (such as salaries, wages and certain benefits); taxes and fees (such as property and other taxes and universal service funds (“USF”) charges); rents and utilities expenses incurred by our administrative offices; and other general, administrative and other operating expenses (such as professional fees). These expenses also include our combined net periodic pension and post-retirement benefits expenses for all eligible employees and retirees allocated to us from QCII.

These definitions reflect changes primarily to reclassify expenses for: rent and utilities incurred by our network operations; fleet; network and supply chain management; and insurance and risk management from general, administrative and other operating expenses to cost of sales, where these expenses are more aligned with how we now manage our business. We believe these changes allow users of our financial statements to better understand our expense structure. 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. These changes resulted in the reclassification of \$199 million and \$212 million from the general, administrative and other operating expenses and selling expenses categories to cost of sales for the years ended December 31, 2009 and 2008, respectively.

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

We have also reclassified certain other prior year amounts in our Annual Report on Form 10-K for the year ended December 31, 2009 to conform to the current year presentation.

Use of Estimates

Our consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles. These accounting principles require us to make certain estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions we 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, affiliates transactions, intercompany allocations, recoverability of assets (including deferred tax assets), impairment assessments, pension, post-retirement and other post-employment benefits, taxes, certain liabilities and other provisions and contingencies are reasonable, based on information available at the time they were made. These estimates, intercompany allocations, judgments and assumptions can affect the reported amounts of assets, liabilities and components of stockholder's deficit or equity as of the dates of the consolidated balance sheets, as well as the reported amounts of revenue, expenses and components of cash flows during the periods presented in our consolidated statements of operations and our 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 12—Income Taxes and Note 17—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, if the impact of an uncertain tax position is more likely than not to be sustained upon audit by the relevant taxing authority, then we recognize a benefit for the largest amount that is more likely than not to be sustained. No portion of an uncertain tax position will be recognized if the position has less than a 50% likelihood of being sustained. Interest is recognized on the amount of unrecognized benefit from uncertain tax positions.

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

Affiliates Transactions

We record intercompany charges at the amounts billed to us by our affiliates. Regulatory rules require certain expenses to be recorded at market price or fully distributed cost, as more fully described in Note 16—Related Party Transactions. Our compliance with regulations is subject to review by regulators. Adjustments to intercompany charges that result from these reviews are recorded in the period they become known.

Because of the significance of the services we provide to our affiliates and our other affiliates transactions, the results of operations, financial position, and cash flows presented herein are not necessarily indicative of the results of operations, financial position and cash flows we would have achieved had we operated as a stand-alone entity during the periods presented.

In the normal course of business, we transfer assets to and from our parent, QSC which are recorded through our equity. It is QCII's and our policy to record asset transfers based on carrying values.

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

Revenue Recognition

We recognize revenue for services when the related services are provided. Recognition of certain payments received in advance of services being provided is deferred until the service is provided. These advance payments include activation fees and installation charges, which we recognize as revenue over the expected customer relationship period, which ranges from eighteen months to over ten years depending on the service. We also defer costs for customer acquisitions. The deferral of customer acquisition costs is limited to the amount of revenue deferred on advance payments. Costs in excess of advance payments are recorded as expense in the period such costs are incurred. Expected customer relationship periods are estimated using historical experience. Termination fees or other fees on existing contracts that are negotiated in conjunction with new contracts are deferred and recognized over the new contract term.

Customer arrangements that include both equipment and services are evaluated to determine whether the elements are separable based on objective evidence. If the elements are deemed separable and separate earnings processes exist, the revenue associated with each element is allocated to each element based on the relative fair values of the separate elements. The revenue associated with each element is then recognized as earned. For example, if we receive an advance payment when we sell equipment and continuing service together, we immediately recognize as revenue the amount attributable to the equipment sale as long as all the conditions for revenue recognition have been satisfied. Any portion of the advance payment in excess of the relative fair value of the equipment is recognized ratably over the longer of the contractual period or the expected customer relationship period. If separate earnings processes do not exist, the total advance payment is deferred and recognized ratably over the longer of the contractual period or the expected customer relationship period.

We offer some products and services that are provided by third-party vendors. We review the relationship between us, the vendor and the end customer to assess whether revenue should be reported on a gross or net basis. For example, the revenue from DIRECTV and Verizon Wireless services that we offer through sales agency relationships is reported on a net basis. In assessing whether revenue should be reported on a gross or net basis, we consider whether we act as a principal in the transaction, take title to the products, have risk and rewards of ownership, and act as an agent or broker.

Allocation of Bundle Discounts

We offer bundle discounts to our customers who receive certain groupings of services. These bundle discounts are recognized concurrently with the associated revenue and are allocated to the various services in the bundled offerings. The allocation is based on the relative fair value of services included in each bundle combination.

USF, Gross Receipts Taxes and Other Surcharges

In determining whether to include in our revenue and expenses the taxes and surcharges collected from customers and remitted to governmental authorities, including USF charges, sales, use, value added and some excise taxes, we assess, among other things, whether we are the primary obligor or principal taxpayer for the taxes assessed in each jurisdiction where we do business. In jurisdictions where we determine that we are the principal taxpayer, we record the taxes on a gross basis and include them in our revenue and general, administrative and other operating expenses. In jurisdictions where we determine that we are merely a collection agent for the government authority, we record the taxes on a net basis and do not include them in our revenue and general, administrative and other operating expenses.

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

Our revenue and general, administrative and other operating expenses included taxes and surcharges accounted for on a gross basis of \$186 million, \$182 million and \$199 million for the years ended December 31, 2010, 2009 and 2008, respectively.

Advertising Costs

Costs related to advertising are expensed as incurred. Advertising expense was \$292 million, \$328 million and \$394 million for the years ended December 31, 2010, 2009 and 2008, respectively, and is included in selling expenses and general, administrative and other operating expenses in our consolidated statements of operations.

Legal Costs

In the normal course of our business, we incur costs to hire and retain external legal counsel to advise us on regulatory, litigation and other matters. We expense these costs as the related services are received.

Income Taxes

We are included in the consolidated federal income tax return of QCII. Under QCII's tax allocation policy, QCII treats our consolidated results as if we were a separate taxpayer. The policy requires us to pay our tax liabilities in cash based upon our separate return taxable income. We are also included in QCII's combined state tax returns, and the same payment and allocation policies apply.

The provision for income taxes consists of an amount for taxes currently payable, an amount for tax consequences deferred to future periods, adjustments to our liabilities for uncertain tax positions and amortization of investment tax credits. We record deferred income tax assets and liabilities reflecting future tax consequences attributable to differences between the financial statement carrying value of assets and liabilities and the tax bases of those assets and liabilities. Deferred taxes are computed using enacted tax rates expected to apply in the year in which the differences are expected to affect taxable income. The effect on deferred income tax assets and liabilities of a change in tax rate is recognized in earnings in the period that includes the enactment date.

We use the deferral method of accounting for federal investment tax credits earned prior to the repeal of such credits in 1986. We also defer certain transitional investment tax credits earned after the repeal, as well as investment tax credits earned in certain states. We amortize these credits ratably over the estimated service lives of the related assets as a credit to our income tax expense in our consolidated statements of operations.

Cash and Cash Equivalents

Cash and cash equivalents include highly liquid investments that are readily convertible into cash and are not subject to significant risk from fluctuations in interest rates. As a result, the value at which cash and cash equivalents are reported in our consolidated financial statements approximates their fair value. In evaluating investments for classification as cash equivalents, we require that individual securities have original maturities of three months or less and that individual investment funds have dollar-weighted average maturities of ninety days or less. To preserve capital and maintain liquidity, we invest with financial institutions we deem to be of sound financial condition and in high quality and relatively risk-free investment products. Our cash investment policy limits the concentration of investments with specific financial institutions or among certain products and includes criteria related to credit worthiness of any particular financial institution.

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

Book overdrafts occur when checks have been issued but have not been presented to our controlled disbursement bank accounts for payment. These bank accounts allow us to delay funding of issued checks until the checks are presented for payment. A delay in funding results in a temporary source of financing. The activity related to book overdrafts is included in “other” in financing activities in our consolidated statements of cash flows. Book overdrafts are included in accounts payable on our consolidated balance sheets. As of December 31, 2010 and 2009, the book overdraft balance was \$20 million and \$27 million, respectively.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts Receivable are recognized based upon the amount due from customers for the services provided or at cost for purchased and other receivables less an allowance for doubtful accounts. The allowance for doubtful accounts receivable reflects our best estimate of probable losses inherent in our receivable portfolio determined on the basis of historical experience, specific allowances for known troubled accounts and other currently available evidence. We generally consider our accounts past due if they are outstanding over 30 days. Our collection process varies by the customer segment, amount of the receivable, and our evaluation of the customer’s credit risk. Our past due accounts are written off against our allowance for doubtful accounts when collection is considered to be not probable. Any recoveries of accounts previously written off are generally recognized as a reduction in bad debt expense in the period received. The carrying value of accounts receivable net of the allowance for doubtful accounts approximates fair value.

Property, Plant and Equipment

Property, plant and equipment are carried at cost, plus the estimated value of any associated legally or contractually required retirement obligations. Property, plant and equipment are depreciated primarily using the straight-line group method. Under the straight-line group method, assets dedicated to providing telecommunications services (which comprise the majority of our property, plant and equipment) that have similar physical characteristics, use and expected useful lives are categorized in the year acquired on the basis of equal life groups for purposes of depreciation and tracking. Generally, under the straight-line group method, when an asset is sold or retired, the cost is deducted from property, plant and equipment and charged to accumulated depreciation without recognition of a gain or loss. A gain or loss is recognized in our consolidated statements of operations only if a disposal is abnormal or unusual. Leasehold improvements are amortized over the shorter of the useful lives of the assets or the lease term. Expenditures for maintenance and repairs are expensed as incurred. Interest is capitalized during the construction phase of network and other internal-use capital projects. Employee-related costs for construction of network and other internal use assets are also capitalized during the construction phase. Property, plant and equipment supplies used internally are carried at average cost, except for significant individual items for which cost is based on specific identification.

We perform annual internal studies or reviews to determine depreciable lives for our property, plant and equipment. Our studies utilize models that take into account actual usage, physical wear and tear, replacement history, assumptions about technology evolution and, in certain instances, actuarially determined probabilities to calculate the remaining life of our asset base.

We have asset retirement obligations associated with the legally or contractually required removal of a limited group of property, plant and equipment assets from leased properties, and the disposal of certain hazardous materials present in our owned properties. When an asset retirement obligation is identified, usually in association with the acquisition of the asset, we record the fair value of the obligation as a liability. The fair value of the obligation is also capitalized as property, plant and equipment and then amortized over the estimated remaining useful life of the associated asset. Where the removal obligation is not legally binding, the net cost to remove assets is expensed in the period in which the costs are actually incurred.

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

Capitalized Software

Internally used software, whether purchased or developed by us, is capitalized and amortized using the straight-line group method over its estimated useful life. We capitalize certain costs associated with software such as costs of employees devoting time to the projects and external direct costs for materials and services. Costs associated with internally developed software to be used internally are expensed until the point at which the project has reached the development stage. Subsequent additions, modifications or upgrades to internal-use software are capitalized only to the extent that they allow the software to perform a task it previously did not perform. Software maintenance and training costs are expensed in the period in which they are incurred. We review the economic lives of our capitalized software annually.

Impairment of Long-Lived Assets

We review long-lived assets, other than intangible assets with indefinite lives, for impairment at the QCII level whenever facts and circumstances indicate that the carrying amounts of the assets may not be recoverable. For measurement purposes, long-lived assets are grouped with other assets and liabilities, including other assets and liabilities of QCII. An impairment loss is recognized only if the carrying amount of the asset group is not recoverable and exceeds its fair value. Recoverability of the asset group to be held and used is measured by comparing the carrying amount of the asset group to the estimated undiscounted future net cash flows expected to be generated by the asset group. If the asset group's carrying value is not recoverable, an impairment charge is recognized for the amount by which the carrying amount of the asset group exceeds its fair value. We determine fair values by using a combination of comparable market values and discounted cash flows, as appropriate.

Derivative Financial Instruments

As of December 31, 2010 we did not have any derivative financial instruments. However, we sometimes use derivative financial instruments, specifically interest rate swap contracts, to manage interest rate risks. We execute these instruments with financial institutions we deem creditworthy and monitor our exposure to these counterparties. 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 due to changes in interest rates.

We recognize all derivatives on our 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. Cash flows from derivative instruments that are fair value hedges or cash flow hedges are classified in cash flows from operations.

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 in our 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

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

immediately in other expense (income)—net in our 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 consolidated statements of operations the changes in fair value of the derivative and the underlying hedged item. However, if the terms of this type of derivative match the terms of the underlying hedged item such that we qualify to assume no ineffectiveness, then the fair value of the derivative is measured and the change in the fair value for the period is assumed to equal the change in the fair value of the underlying hedged item for the period, with no impact in other expense (income)—net.

We assess quarterly whether each derivative is highly effective in offsetting changes in fair values or cash flows of the hedged item or whether our initial assumption of no ineffectiveness is still valid. If we determine that a derivative is not highly effective as a hedge, a derivative has ceased to be a highly effective hedge or our assumption of no ineffectiveness is no longer valid, then 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. See Note 9—Derivative Financial Instruments for additional information.

Fair Value of Financial Instruments

Our financial instruments consist of cash and cash equivalents, auction rate securities, accounts receivable, accounts payable, interest rate hedges and long-term notes including the current portion. The carrying values of cash and cash equivalents, auction rate securities, accounts receivable, accounts payable and interest rate hedges approximate their fair values. The carrying value of our long-term notes, including the current portion, reflects original cost net of unamortized discounts and other. See Note 3—Fair Value of Financial Instruments for a more detailed discussion of the fair value of our other financial instruments.

Pension and Post-Retirement Benefits

Substantially all of our employees participate in the QCII pension plan. QCII also maintains a non-qualified pension plan for certain of our eligible highly compensated employees. In addition, certain employees may become eligible to participate in QCII's post-retirement health care and life insurance benefit plans. QCII allocates the expense relating to pension, non-qualified pension, and post-retirement health care and life insurance benefits and the associated obligations and assets to us and determines our cash contribution. The amounts contributed by us through QCII are not segregated or restricted to pay amounts due to our employees and may be used to provide benefits to other employees of QCII's affiliates. Historically, QCII has only required us to pay our portion of its required pension contribution. The allocation of expense to us is based upon the demographics of our employees and retirees compared to all the remaining participants. However, significant year over year changes in QCII's funded status affecting accumulated other comprehensive income may not have a significant initial impact on the affiliate receivable or payable that is allocated to us.

For further information on QCII pension, non-qualified pension, post-retirement and other post-employment benefit plans, see QCII's Annual Report on Form 10-K for the year ended December 31, 2010.

Recently Issued Accounting Pronouncements

In October 2009, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") Number 2009-13, "Revenue Recognition (ASC 605) Multiple-Deliverable Revenue Arrangements a consensus of the FASB Emerging Issues Task Force." This ASU establishes a new selling price hierarchy to use when allocating the sales price of a multiple element arrangement between delivered and undelivered elements.

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

This ASU is generally expected to result in revenue recognition for more delivered elements than under current rules. We are required to adopt this ASU prospectively for new or materially modified agreements entered into on or after January 1, 2011. The adoption of this ASU will not have a material effect on our financial position or results of operations.

Note 3: Fair Value of Financial Instruments

Our financial instruments consisted of cash and cash equivalents, auction rate securities, accounts receivable, accounts payable, interest rate hedges and long-term notes including the current portion. The carrying values of the following items approximate their fair values: cash and cash equivalents, auction rate securities, accounts receivable, accounts payable and interest rate hedges. The carrying value of our long-term notes, including the current portion, reflects original cost net of unamortized discounts and other and was \$7.828 billion as of December 31, 2010. For additional information, see Note 8—Borrowings.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between independent and knowledgeable parties who are willing and able to transact for an asset or liability at the measurement date. We use valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs when determining fair value and then we rank the estimated values based on the reliability of the inputs used following the fair value hierarchy set forth by the FASB.

The table below presents the fair values for auction rate securities, interest rate hedges and long-term notes including the current portion, as well as the input levels used to determine these fair values as of December 31, 2010 and 2009:

	<u>Level</u>	<u>Fair value as of December 31,</u>	
		<u>2010</u>	<u>2009</u>
		<u>(Dollars in millions)</u>	
Assets:			
Auction rate securities	3	\$ 52	\$ 41
Fair value hedges	3	—	2
Total assets		<u>\$ 52</u>	<u>\$ 43</u>
Liabilities:			
Long-term notes, including the current portion	1 & 2	\$ 8,482	\$ 8,495
Cash flow hedges	3	—	3
Total liabilities		<u>\$ 8,482</u>	<u>\$ 8,498</u>

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

The three levels of the fair value hierarchy as defined by the FASB are as follows:

<u>Input Level</u>	<u>Description of Input</u>
Level 1	Inputs are based upon unadjusted quoted prices for identical instruments traded in active markets.
Level 2	Inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
Level 3	Inputs are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are therefore determined using model-based techniques that include option pricing models, discounted cash flow models, and similar techniques.

We determined the fair value of our auction rate securities using a probability-weighted discounted cash flow model that takes into consideration the weighted average of the following factors:

- coupon rate of 5.44%;
- probability that we will be able to sell the securities in an auction or that the securities will be redeemed early of 75.23%;
- probability that a default will occur of 20.98% with a related recovery rate of 55.00%; and
- discount rate of 7.81%.

We determined the fair value of our interest rate hedges using projected future cash flows, discounted at the mid-market implied forward London Interbank Offered Rate ("LIBOR"). For additional information on our derivative financial instruments, see Note 9—Derivative Financial Instruments.

We determined the fair values of our long-term notes, including the current portion, based on quoted market prices where available or, if not available, based on discounted future cash flows using current market interest rates.

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

The table below presents a rollforward of the instruments valued using Level 3 inputs for the years ended December 31, 2010 and 2009:

	Instruments Valued Using Level 3 Inputs			
	Auction rate	Investment	Fair value	Cash flow
	securities	fund	hedges	hedges
	(Dollars in millions)			
Balance at December 31, 2008	\$ 43	\$ 9	\$ —	\$ (8)
Transfers into (out of) Level 3	—	—	—	—
Additions	—	1	—	—
Dispositions and settlements	(4)	(11)	—	—
Realized and unrealized gains:				
Included in long-term borrowings—net	—	—	2	—
Included in other (expense) income—net	—	1	—	—
Included in other comprehensive income	2	—	—	5
Balance at December 31, 2009	<u>41</u>	<u>—</u>	<u>2</u>	<u>(3)</u>
Transfers into (out of) Level 3	—	—	—	—
Additions	16	—	—	—
Dispositions and settlements	—	—	(7)	—
Realized and unrealized gains:				
Included in long-term borrowings—net	—	—	5	—
Included in other (expense) income—net	—	—	—	—
Included in other comprehensive (loss) income	(5)	—	—	3
Balance at December 31, 2010	<u>\$ 52</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

Note 4: Investments

QSC manages the majority of our cash and investments. Our proportionate ownership of these investments, including illiquid investments, can change because we record our portion of the entire portfolio of cash and investments managed by QSC. Our allocated portion changes as our cash balances change compared to the cash balances of our affiliate companies. These changes are reflected on a net basis in cash flows from investing activities on our consolidated statements of cash flows.

As of December 31, 2010 and 2009, our investments included auction rate securities of \$52 million and \$41 million, respectively, which are classified as non-current, available-for-sale investments and are included in other non-current assets at their estimated fair value on our 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, we invested in these securities for

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

short periods of time as part of our cash management program. However, the uncertainties in the credit markets have prevented us and other investors from liquidating holdings of these securities in auctions since the third quarter of 2007. Because we are uncertain as to when the liquidity issues relating to these investments will improve, we continued to classify these securities as non-current as of December 31, 2010. These securities:

- are structured obligations of special purpose reinsurance entities associated with life insurance companies and are referred to as “Triple X” securities;
- currently pay interest every 28 days at one-month LIBOR plus 200 basis points;
- are rated A;
- are insured against loss of principal and interest by two bond insurers, one of which had a credit rating of B and the other of which was not rated and in the fourth quarter of 2009 was prohibited by its regulator from making any claim payments;
- are collateralized by the issuers; and
- mature between 2033 and 2036.

The following table summarizes the fair value of these auction rate securities, the cumulative net unrealized loss, net of deferred income taxes, related to these securities and the cost basis of these securities as of December 31, 2010 and 2009:

	December 31,	
	2010	2009
	(Dollars in millions)	
Auction rate securities—fair value	\$ 52	\$ 41
Classification	Non-current, available-for-sale investments	
Balance sheet location (reported at estimated fair value)	Other non-current assets	
Cumulative net unrealized loss, net of deferred income taxes	\$ 9	\$ 6
Auction rate securities—cost basis	\$ 68	\$ 51

The following table summarizes our unrealized gain (loss), net of deferred income taxes, due to the change in the amount of auction rate securities allocated to us by QSC for the years ended December 31, 2010 and 2009:

	Years Ended December 31,	
	2010	2009
	(Dollars in millions)	
Unrealized (loss) gain, net of deferred income taxes	\$ (3)	\$ 2

These unrealized losses were recorded in accumulated other comprehensive income, which is included in accumulated deficit in our consolidated balance sheets. We consider the decline in fair value to be a temporary impairment because we believe it is more likely than not that we will ultimately recover the entire \$68 million cost basis, in part because the securities are rated investment grade, the securities are collateralized and the issuers continue to make required interest payments. At some point in the future, we may determine that the decline in fair value is other than temporary if, among other factors:

- the issuers cease making required interest payments;
- we believe it is more likely than not that we will be required to sell these securities before their values recover; or
- we change our intent to hold the securities due to events such as a change in the terms of the securities.

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

Note 5: Accounts Receivable

The following table presents details of our accounts receivable balances as of December 31, 2010 and 2009:

	December 31,	
	2010	2009
	(Dollars in millions)	
Total accounts receivable—net:		
Trade receivables	\$ 469	\$ 530
Earned and unbilled receivables	140	147
Purchased and other receivables	159	150
Total accounts receivable	768	827
Less: allowance for doubtful accounts	(48)	(53)
Accounts receivable non-affiliates—net	720	774
Accounts receivable—affiliates	193	71
Total accounts receivable—net	<u>\$ 913</u>	<u>\$ 845</u>

We are exposed to concentrations of credit risk from customers within our local service area and from other telecommunications service providers. We generally do not require collateral to secure our receivable balances. We have agreements with other telecommunications service providers whereby we agree to bill and collect on their behalf for services rendered by those providers to our customers within our local service area. We purchase accounts receivable from other telecommunications service providers primarily on a recourse basis and include these amounts in our accounts receivable balance. We have not experienced any significant loss associated with these purchased receivables.

The following table presents details of our allowance for doubtful accounts for the years ended December 31, 2010, 2009 and 2008:

	Balance at beginning of period	Charged to expense- net	Deductions	Balance at end of period
	(Dollars in millions)			
Allowance for doubtful accounts:				
2010	\$ 53	\$ 70	\$ 75	\$ 48
2009	52	85	84	53
2008	55	83	86	52

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

Note 6: Property, Plant and Equipment

The components of our property, plant and equipment as of December 31, 2010 and 2009 are as follows:

	Depreciable Lives	December 31,	
		2010	2009
		(Dollars in millions)	
Property, plant and equipment—net:			
Land	N/A	\$ 97	\$ 97
Buildings	15-30 years	2,897	2,868
Communications equipment	7-10 years	18,380	18,297
Other network equipment	8-45 years	20,932	20,626
General purpose computers and other	5-11 years	1,752	1,719
Construction in progress	N/A	99	53
Total property, plant and equipment		44,157	43,660
Less: accumulated depreciation		(34,025)	(33,022)
Property, plant and equipment—net		\$ 10,132	\$ 10,638

We recorded depreciation expense of \$1.639 billion, \$1.752 billion and \$1.855 billion for the years ended December 31, 2010, 2009 and 2008, respectively. Although our capital expenditures fluctuate from year to year, we continue to see decreased depreciation expense due to significantly lower capital expenditures and the changing mix of our investment in property, plant and equipment since 2002.

Effective January 1, 2009, we changed our estimates of the economic lives of certain copper cable and telecommunications equipment assets. These changes resulted in additional depreciation expense of approximately \$36 million and reduced net income, net of deferred taxes, by \$22 million for the year ended December 31, 2009 as compared to the year ended December 31, 2008. These assets were fully depreciated as of December 31, 2009.

Asset Retirement Obligations

As of December 31, 2010, our asset retirement obligations balance was primarily related to estimated future costs of removing circuit equipment from leased properties and estimated future costs of properly disposing of asbestos and other hazardous materials upon remodeling or demolishing buildings. Asset retirement obligations are included in other long-term liabilities on our consolidated balance sheets. The following table provides asset retirement obligation activity for the years ended December 31, 2010, 2009 and 2008:

	December 31,		
	2010	2009	2008
(Dollars in millions)			
Asset retirement obligations:			
Balance as of January 1	\$31	\$32	\$30
Accretion expense	2	2	2
Liabilities incurred	—	—	—
Liabilities settled and other	(3)	(2)	(1)
Change in estimate	1	(1)	1
Balance as of December 31	<u>\$31</u>	<u>\$31</u>	<u>\$32</u>

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

Note 7: Capitalized Software

Internally used software, whether purchased or developed by us, is capitalized and amortized using the straight-line group method over its estimated useful life. As of December 31, 2010 and 2009, our capitalized software had carrying costs of \$2.674 billion and \$2.479 billion, respectively, and accumulated amortization was \$1.761 billion and \$1.599 billion, respectively. We recorded amortization expense of \$234 million, \$224 million and \$218 million for the years ended December 31, 2010, 2009 and 2008, respectively, for capitalized software based on a life range of four to seven years.

The weighted average remaining life of our capitalized software was 3.6 years as of December 31, 2010.

The estimated future amortization expense for capitalized software is as follows:

	Estimated Amortization (Dollars in millions)
Estimated future amortization expense:	
2011	\$ 212
2012	189
2013	167
2014	142
2015	102
2016 and thereafter	101
Total estimated future amortization expense	<u>\$ 913</u>

Note 8: Borrowings

Current Portion of Long-Term Borrowings

As of December 31, 2010 and 2009, the current portion of our long-term borrowings consisted of:

	December 31, 2010	2009
	(Dollars in millions)	
Current portion of long-term borrowings:		
Long-term notes	\$ 825	\$ 500
Long-term capital lease and other obligations	46	15
Total current portion of long-term borrowings	<u>\$ 871</u>	<u>\$ 515</u>

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

Long-Term Borrowings

As of December 31, 2010 and 2009, our long-term borrowings consisted of the following (for all notes with unamortized discount or premium, the face amount of the notes and the unamortized discount or premium are presented separately):

	December 31,	
	2010	2009
	(Dollars in millions)	
Long-term borrowings:		
Notes with various rates ranging from 3.552% to 8.875% including LIBOR plus 3.25% and maturities from 2011 to 2043	\$7,968	\$8,468
Unamortized discount	(154)	(165)
Fair value hedge adjustment	14	10
Capital lease and other obligations	184	73
Less: current portion	(871)	(515)
Total long-term borrowings	<u>\$7,141</u>	<u>\$7,871</u>

Our long-term notes and bonds had the following interest rates and contractual maturities as of December 31, 2010:

	Contractual Maturities					
	2011	2012	2013	2014	2015	2016 and Thereafter
	(Dollars in millions)					
Interest rates:						
Up to 5%	\$—	\$ —	\$750	\$—	\$—	\$ —
Above 5% to 6%	—	—	—	—	—	—
Above 6% to 7%	—	—	—	—	—	1,500
Above 7% to 8%	825	—	—	600	400	1,582
Above 8% to 9%	—	1,500	—	—	—	811
Total notes and bonds	<u>\$825</u>	<u>\$1,500</u>	<u>\$750</u>	<u>\$600</u>	<u>\$400</u>	<u>\$ 3,893</u>

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

Our long-term notes and bonds contractual maturities as of December 31, 2010:

	Maturities						Total
	2011	2012	2013 (Dollars in millions)	2014	2015	2016 and Thereafter	
Notes and bonds:							
Floating Rate Notes	\$—	\$ —	\$750	\$—	\$—	\$ —	\$ 750
7.875% Notes	825	—	—	—	—	—	825
8.875% Notes	—	1,500	—	—	—	—	1,500
6.5% Notes	—	—	—	—	—	500	500
6.875% Debentures	—	—	—	—	—	1,000	1,000
7.125% Debentures	—	—	—	—	—	250	250
7.2% Debentures	—	—	—	—	—	250	250
7.25% Debentures	—	—	—	—	—	500	500
7.375% Debentures	—	—	—	—	—	55	55
7.5% Notes	—	—	—	600	—	—	600
7.5% Debentures	—	—	—	—	—	484	484
7.625% Notes	—	—	—	—	400	—	400
7.75% Debentures	—	—	—	—	—	43	43
8.375% Notes	—	—	—	—	—	811	811
Total notes and bonds	<u>\$825</u>	<u>\$1,500</u>	<u>\$750</u>	<u>\$600</u>	<u>\$400</u>	<u>\$ 3,893</u>	<u>\$7,968</u>

Covenants

The indentures governing our notes contain certain covenants including, but not limited to: (i) a prohibition on certain liens on our assets; and (ii) a limitation on mergers or sales of all, or substantially all, of our assets, which limitation requires that a successor assume the obligation with regard to these notes. These indentures do not contain any cross-default provisions. We were in compliance with all of the provisions and covenants of our borrowing agreements as of December 31, 2010.

QCII and its other subsidiaries were in compliance with all of the provisions and covenants of their borrowing agreements as of December 31, 2010.

New Issuance

In April 2009, we issued approximately \$811 million aggregate principal amount of 8.375% Senior Notes due 2016. We are using or used the net proceeds of \$738 million for general corporate purposes, including repayment of indebtedness and funding or refinancing investments in our telecommunication assets.

The notes are unsecured obligations and rank equally in right of payment with all other unsecured and unsubordinated indebtedness. The covenant and default terms are substantially the same as those associated with our other long-term borrowings.

Repayments

In June 2010, we paid at maturity the \$500 million aggregate principal amount of our 6.95% Term Loan due 2010.

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

Registered Exchange Offer

In November 2009, QC commenced a registered exchange offer for its 8.375% Notes due 2016 pursuant to the registration rights agreement that it entered into in connection with the issuance of these notes. QC completed the registered exchange offer in December 2009.

Interest Rate Hedges

During 2009 and 2008, QC entered into interest rate hedges as discussed in Note 9—Derivative Financial Instruments.

Interest Expense

Interest expense includes interest on long-term borrowings. Other interest expense, such as interest on income taxes, is included in other—net in our consolidated statements of operations. The following table presents the amount of gross interest expense, capitalized interest and cash paid for interest during the years ended December 31, 2010, 2009 and 2008:

	Years Ended December 31,		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
	(Dollars in millions)		
Interest expense on long-term borrowings—net:			
Gross interest expense	\$ 627	\$ 642	\$ 603
Capitalized interest	(12)	(10)	(14)
Total interest expense on long-term borrowings—net	<u>\$ 615</u>	<u>\$ 632</u>	<u>\$ 589</u>
Cash paid for interest—net:			
Cash interest paid on long-term borrowings and interest rate swaps	\$ 640	\$ 621	\$ 628
Cash received from counterparties on interest rate swaps	(37)	(24)	(46)
Cash paid for interest—net	<u>\$ 603</u>	<u>\$ 597</u>	<u>\$ 582</u>

Note 9: Derivative Financial Instruments

Interest Rate Hedges

During 2009 and 2008, we entered into the interest rate hedges described below as part of our short-term and long-term debt strategies.

In August 2009, we entered into interest rate hedges on \$400 million of the outstanding \$1.500 billion aggregate principal amount of our 8.875% Notes due in 2012. We designated these interest rate hedges as fair value hedges. We terminated these interest rate hedges in the third quarter of 2010. Upon termination, we received \$10 million in cash for the fair value of the hedges and accrued interest. The accumulated \$7 million increase in the carrying value of the notes is being amortized to interest expense using the effective interest method over the remaining term of the notes.

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. We designated these interest rate hedges as cash flow hedges. These hedges expired in March 2010. We did not recognize any gain or loss in earnings for hedge ineffectiveness during the lives of the hedges.

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

As of December 31, 2010, we had no outstanding interest rate hedge contracts. The interest rate hedges that were previously outstanding had immaterial effects on our consolidated statements of operations and balance sheets in all periods presented.

Note 10: Severance

For the years ended December 31, 2010, 2009 and 2008, we recorded severance expenses of \$65 million, \$109 million and \$127 million, respectively. A portion of our severance expenses is included in each of cost of sales, selling expenses and general, administrative and other operating expenses in our consolidated statements of operations. As of December 31, 2010 and 2009, our severance liability was \$28 million and \$75 million, respectively, and is included in accrued expenses and other in our consolidated balance sheets.

Note 11: Employee Benefits

Pension and Post-Retirement Benefits

We are required to disclose the amount of our contributions to QCII relative to the QCII pension and post-retirement benefit plans. No pension or post-retirement occupational health care trust contributions were made during 2010 or 2009. The unfunded status of QCII's pension plan for accounting purposes was \$585 million and \$790 million as of December 31, 2010 and 2009, respectively. The unfunded status of its post-retirement benefit plans for accounting purposes was \$2.522 billion and \$2.525 billion as of December 31, 2010 and 2009, respectively. QCII allocates its pension, non-qualified pension and post-retirement benefit obligations to us using the amount of its funded or unfunded status and its related accumulated other comprehensive income balance. Therefore, significant year over year changes in QCII's funded status affecting accumulated other comprehensive income may not have a significant initial impact on the assets or obligations that are allocated to us.

We recognized an allocated \$53 million and \$104 million in pension expense for the years ended December 31, 2010 and 2009, respectively. Our allocated pension income for 2008 was \$28 million. Our allocated post-retirement benefit expense for 2010, 2009, and 2008 was \$72 million, \$89 million and \$15 million, respectively. These allocated amounts represent our share of the pension and post-retirement benefit expenses based on the actuarially determined amounts. Our allocated portion of QCII's total pension and post-retirement benefit expenses were 101%, 99% and 92% for the years ended December 31, 2010, 2009 and 2008, respectively. QCII allocates the expenses of these plans to us and its other affiliates. The allocation of expense to us is based upon demographics of our employees compared to all remaining participants. The combined net pension and post-retirement benefits (income) expenses is included in general, administrative and other operating expenses.

QCII sponsors a noncontributory qualified defined benefit pension plan (referred to as QCII's pension plan) for substantially all management and occupational employees. In addition to this tax qualified pension plan, QCII also maintains a non-qualified pension plan for certain eligible highly compensated employees. These plans also provide survivor and disability benefits to certain employees. In November 2009, QCII amended the pension plan and the non-qualified pension plans to no longer provide pension benefit accruals for active management employees after December 31, 2009. In addition, management employees hired after January 1, 2009 are not eligible to participate in the plans. Active management employees who participate in these plans retain their accrued pension benefit earned as of December 31, 2009, and certain participants will continue to earn interest credits on their benefit after December 31, 2009. Employees are eligible to receive their vested accrued benefit when they separate from Qwest. The plans also provided a death benefit for eligible beneficiaries of certain retirees; however, QCII has eliminated this benefit effective March 1, 2010 for retirees who retired prior to January 1, 2004 and whose deaths occur after February 28, 2010. QCII previously eliminated the death benefit for eligible beneficiaries of certain retirees who retired after December 31, 2003.

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

QCII maintains post-retirement benefit plans that provide health care and life insurance benefits for certain eligible retirees. The benefit obligation for QCII's occupational health care and life insurance post-retirement plans is estimated based on the terms of QCII's written benefit plans. In calculating this obligation, QCII considers numerous assumptions, estimates and judgments, including but not limited to, discount rates, health care cost trend rates and plan amendments. In 2008, we negotiated our current four-year collective bargaining agreements which covered approximately 14,200 of our unionized employees as of December 31, 2010. The plan was amended to reflect changes affecting eligible post-1990 retirees who are former occupational employees, including: (i) a Letter of Agreement that states such post-1990 retirees will begin contributing to the cost of health care benefits in excess of specified limits on the company-funded portion of retiree health care costs (also referred to as "caps") beginning January 1, 2009 and (ii) a provision that such post-1990 retirees will pay increased out-of-pocket costs through plan design changes starting January 1, 2009, including the elimination of Medicare Part B premium reimbursements for post-1990 retirees who are former occupational employees. These changes have been considered in calculating the benefit obligation under QCII's occupational health care plan.

The terms of the post-retirement health care and life insurance plans between QCII and its eligible management employees and its eligible post-1990 management retirees are established by QCII and are subject to change at its discretion. QCII has a practice of sharing some of the cost of providing health care benefits with its management employees and post-1990 management retirees. The benefit obligation for the management post-retirement health care benefits is based on the terms of the current written plan documents and is adjusted for anticipated continued cost sharing with management employees and post-1990 management retirees. However, QCII's contribution under its post-1990 management retirees' health care plan is capped at a specific dollar amount. Effective January 1, 2009, QCII amended its post-1990 management retiree plan to, among other things, (i) require retirees to pay increased out-of-pocket costs and (ii) eliminate the reimbursement of Medicare Part B premiums.

A putative class action purportedly filed on behalf of certain of QCII retirees was brought against QCII and certain other defendants in Federal District Court in Colorado in connection with QCII's decision to reduce life insurance benefits for these retirees during 2006 and 2007. See Note 17—Commitments and Contingencies—Other Matters for additional information.

Medicare Prescription Drug, Improvement and Modernization Act of 2003

QCII sponsors post-retirement health care plans with several benefit options that provide prescription drug benefits that QCII deems actuarially equivalent to or exceeding Medicare Part D. QCII recognizes the impact of the federal subsidy received under the Medicare Prescription Drug, Improvement and Modernization Act of 2003 in the calculation of its post-retirement benefit obligation and net periodic post-retirement benefit expense.

Other Benefit Plans

Health Care and Life Insurance

We provide health care and life insurance benefits to essentially all of our active employees. We are largely self-funded for the cost of the health care plan. Our active health care benefit expenses were \$224 million, \$233 million and \$272 million for the years ended December 31, 2010, 2009 and 2008, respectively. Occupational employee benefits are based on negotiated collective bargaining agreements. Management employees and occupational employees are required to partially fund the health care benefits provided by us, in addition to paying their own out-of-pocket costs. Participating management employees contributed \$33 million, \$32 million and \$35 million in 2010, 2009 and 2008, respectively. Participating occupational employees contributed \$11 million, \$10 million and \$4 million in 2010, 2009 and 2008, respectively. The basic group life insurance plan is fully insured and the premiums are paid by us.

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

401(k) Plan

QCII sponsors a qualified defined contribution benefit plan covering substantially all management and occupational employees. Under this plan, employees may contribute a percentage of their annual compensation to the plan up to certain maximums, as defined by the plan and by the Internal Revenue Service (“IRS”). Currently, QCII, on our behalf, matches a percentage of our employees’ contributions in cash. We recognized \$51 million, \$54 million and \$59 million in expense related to this plan for the years ended December 31, 2010, 2009 and 2008, respectively.

Deferred Compensation Plans

QCII sponsors non-qualified unfunded deferred compensation plans for various groups that include certain of our current and former highly compensated employees. One of these plans is open to new participants. Participants in these plans may, at their discretion, invest their deferred compensation in various investment choices including QCII’s common stock. The values of assets and liabilities related to these plans are not significant.

Note 12: Income Taxes

We are included in the consolidated federal income tax returns and the combined state income tax returns of QCII. QCII treats our consolidated results as if we were a separate taxpayer. Our tax allocation policy requires us to pay our tax liabilities in cash based upon separate return taxable income. Because we are included in the consolidated federal income tax returns and the combined state income tax returns of QCII, any tax audits involving QCII will also involve us. The IRS examines all of QCII’s federal income tax returns because QCII is included in the coordinated industry case program.

As of December 31, 2010, the QCII federal income tax returns for tax years 2006-2007 and prior have been examined by the IRS. We received \$11 million in the third quarter of 2010 as our share of the settlements, and we recorded a \$4 million asset transfer with QSC to recognize the difference between the settlements recorded and the actual cash payment. In 2010, QCII filed amended federal income tax returns for 2006-2007 to make protective claims with respect to items reserved in QCII’s audit settlements and to correct items not addressed in prior audits. Those amended federal income tax returns are subject to adjustment in an IRS audit.

In 2009, QCII filed amended federal income tax returns for 2002-2005 to make protective claims with respect to items reserved in our audit settlements and to correct items not addressed in prior audits. Those amended federal income tax returns are subject to adjustment in an IRS audit. Additionally, our federal income tax returns filed for tax years after 2008 are still subject to adjustment in an IRS audit.

QCII also files combined income tax returns in many states, and these combined returns remain open for adjustments to its federal income tax returns. In addition, certain combined state income tax returns filed since 1996 are still open for state specific adjustments.

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

A reconciliation of the unrecognized tax benefits for the years ended December 31, 2010 and 2009 follows:

	Unrecognized Tax Benefits	
	2010	2009
	(Dollars in millions)	
Balance as of January 1	\$ 13	\$ 95
Additions for current year tax positions	—	—
Additions for prior year tax positions	—	—
Reductions for prior year tax positions	—	(35)
Settlements	(13)	(47)
Reductions related to expirations of statute of limitations	—	—
Balance as of December 31	<u>\$ —</u>	<u>\$ 13</u>

In accordance with our accounting policy, interest expense and penalties related to income taxes are included in the other—net line of our consolidated statements of operations. For the year ended December 31, 2010, we recognized \$1 million of interest benefit related to uncertain tax positions. For the years ended December 31, 2009 and 2008, we recognized \$9 million and \$20 million, respectively, for interest expense related to uncertain tax positions. As of December 31, 2010 and 2009, we had recorded liabilities for interest related to uncertain tax positions in the amounts of \$6 million and \$6 million, respectively. We made no accrual for penalties related to income tax positions.

Income Tax Expense

The components of the income tax expense from continuing operations are as follows:

	Years Ended December 31,		
	2010	2009	2008
	(Dollars in millions)		
Income tax expense:			
Current tax provision:			
Federal	\$ 470	\$ 740	\$ 537
State and local	80	121	77
Total current tax provision	550	861	614
Deferred tax expense (benefit):			
Federal	208	(109)	180
State and local	33	(28)	35
Total deferred tax expense (benefit)	241	(137)	215
Income tax expense	<u>\$ 791</u>	<u>\$ 724</u>	<u>\$ 829</u>

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

The effective income tax rate for continuing operations differs from the statutory tax rate as follows:

	Years Ended December 31,		
	2010	2009	2008
	(in percent)		
Effective income tax rate:			
Federal statutory income tax rate	35.0%	35.0%	35.0%
State income taxes—net of federal effect	3.9	3.1	3.2
Medicare subsidiary	2.7	—	—
Excess compensation	1.0	—	—
Other	(0.4)	(0.4)	(1.6)
Effective income tax rate	<u>42.2%</u>	<u>37.7%</u>	<u>36.6%</u>

Deferred Tax Assets and Liabilities

The components of the deferred tax assets and liabilities are as follows:

	December 31,	
	2010	2009
	(Dollars in millions)	
Deferred tax assets and liabilities:		
Deferred tax liabilities:		
Property, plant and equipment	\$(2,031)	\$(1,977)
Receivable from an affiliate due to pension plan participation	(340)	(360)
Other	(94)	(57)
Total deferred tax liabilities	<u>(2,465)</u>	<u>(2,394)</u>
Payable to affiliate due to post-retirement benefit plan participation	1,031	1,139
Other	266	295
Total deferred tax assets	<u>1,297</u>	<u>1,434</u>
Net deferred tax liabilities	<u><u>\$(1,168)</u></u>	<u><u>\$ (960)</u></u>

We have performed an evaluation of the recoverability of our deferred tax assets. It is our opinion that it is more likely than not that the deferred tax assets will be realized and should not be reduced by a valuation allowance.

Other Income Tax Information

We paid \$677 million, \$968 million, including \$103 million as our share of QCII's 2002-2005 tax years settlement with the IRS, and \$629 million to QSC related to income taxes in 2010, 2009, and 2008, respectively. As of December 31, 2010 and 2009 we had approximately \$8 million and \$25 million, respectively, in amounts relating to taxes payable to QSC reflected in accounts payable-affiliates on our consolidated balance sheets.

Income tax expense in 2010 compared to 2009 increased by \$55 million as a result of the March 2010 enactments of the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010. Among other things, these laws will disallow federal income tax deductions for retiree prescription

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

drug benefits to the extent we receive reimbursements for those benefits under the Medicare Part D program. Although this tax increase does not take effect until 2013, under accounting principles generally accepted in the U.S. we recognize the full accounting impact in the period in which the laws are enacted.

In 2010, we increased our state tax rate based on a review of our state apportionment factors and the current tax rate of the states where we conduct business. This change resulted in a \$2 million state deferred tax expense, net of federal effect.

In 2009, we reduced our state tax rate based on a review of our state apportionment factors and the current tax rate of the states where we conduct business. This change resulted in a \$4 million state deferred tax benefit, net of federal effect.

We had unamortized investment tax credits of \$61 million, \$68 million and \$76 million as of December 31, 2010, 2009 and 2008, respectively, which are included in other long-term liabilities on our consolidated balance sheets. These investment credits are amortized over the lives of the related assets. Amortization of investment tax credits of \$8 million, \$8 million and \$7 million are included in the provision for income taxes for the years ended December 31, 2010, 2009 and 2008, respectively.

Note 13: Stockholder's (Deficit) Equity

We have one share of common stock (no par value) issued and outstanding, which is owned by QSC.

Equity Infusions

In 2010 and 2009, we did not receive any equity infusions.

In 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. We received cash equity infusions from QSC of \$190 million in connection with the transfer. We also received other cash equity infusions of \$41 million in 2008.

Other Net Asset Transfers

During 2010, we recorded a \$56 million equity transaction for excess tax deductions, the difference between the acceleration of stock-based compensation expense for both performance and restricted shares and the tax deduction.

During 2009, QCII executed a settlement with the IRS relating to its audit of the 2002-2005 tax years. We paid \$103 million in the fourth quarter of 2009 as our share of the settlement and recorded a \$48 million asset transfer with QSC to recognize the difference between the settlement recorded and the actual cash payment. In 2008, QCII executed a settlement with the IRS relating to its audit of the 1998-2001 tax years. We paid an immaterial amount in the fourth quarter of 2008 as our share of the settlement. We recorded a \$62 million asset transfer with QSC to recognize the difference between the settlement recorded and the actual cash payment.

In addition, in the normal course of business, we transfer assets and liabilities to and from QSC and its affiliates. It is our policy to record these asset transfers based on carrying values.

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

Dividends

We declared and paid the following cash dividends to QSC:

	Years Ended December 31,		
	2010	2009	2008
	(Dollars in millions)		
Cash dividend declared to QSC	\$2,300	\$1,700	\$2,200
Cash dividend paid to QSC	\$2,260	\$2,000	\$2,000

On February 15, 2011, we paid a cash dividend to QSC of \$150 million. On January 26, 2011, we declared a cash dividend to QSC of \$1.000 billion.

The timing of cash payments for declared dividends to QSC is at our discretion in consultation with QSC. 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.

Note 14: Stock-Based Compensation

Our employees participate in QCII's Equity Incentive Plan ("EIP") and Employee Stock Purchase Plan ("ESPP"). For more information about these plans, see QCII's Annual Report on Form 10-K for the year ended December 31, 2010.

Stock-Based Compensation Expense

Stock-based compensation expense is included in cost of sales, selling expenses and general, administrative and other operating expenses in our consolidated statements of operations. We recognize compensation expense relating to awards granted to our employees under the EIP using the straight-line method over the applicable vesting periods. We recognize compensation expense when our employees purchase QCII's common stock under the ESPP for the difference between the employees' purchase prices and the fair market values of QCII's stock.

For the years ended December 31, 2010, 2009 and 2008, our total stock-based compensation expense was approximately \$121 million, \$48 million and \$43 million, respectively. We recognized an income tax benefit of \$30 million, \$19 million and \$17 million associated with our stock compensation expense during the years ended December 31, 2010, 2009 and 2008, respectively.

As of December 31, 2010, QCII had \$39 million of total unrecognized compensation expense related to unvested stock options, restricted stock and performance shares under the EIP. QCII expects to recognize this amount over the remaining weighted average service period of 1.8 years. We expect to recognize most of this \$39 million of unrecognized compensation expense related to unvested stock-based compensation since we have the vast majority of the employees participating in the stock-based compensation plans. There is no unrecognized compensation expense related to the ESPP. QCII will continue to record stock-based compensation and it will continue to allocate a portion of these costs to us. However, based on the many factors that affect the allocation, the amount that is ultimately allocated to us as a result of stock-based compensation recorded at QCII may fluctuate.

On December 21, 2010, QCII accelerated the vesting of certain restricted stock and performance share awards issued under its Equity Incentive Plan in order to preserve certain economic benefits to its stockholders that otherwise would have been lost in connection with QCII's pending merger with CenturyLink. As the vast majority of affected employees are employed by us, QCII allocated substantially all of the \$63 million expense associated with this accelerated vesting to us.

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

Note 15: Contribution to QCII Segments

Our operations are integrated into and are part of the segments of QCII. Our business contributes to all three of QCII's segments: business markets, mass markets and wholesale markets. QCII's Chief Operating Decision Maker ("CODM"), who is also our CODM, reviews our financial information only in connection with our quarterly and annual reports that we file with the Securities and Exchange Commission ("SEC"). Consequently, we do not provide our discrete financial information to the CODM on a regular basis.

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. We generate the majority of our revenue by providing data, Internet and voice services using our network as described further below. We also generate revenue from services we provide to our affiliates.

Strategic services include broadband services and DIRECTV video services that we offer to consumers; private line services that we offer to other telecommunications providers and business customers; and Verizon Wireless services that customers buy as part of a bundle with one or more of our other products and services.

Legacy services include local services and access services. Local services primarily consist of local exchange and switching services. Local services also include 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. Legacy services also include other data services such as ISDN, frame relay and ATM that we offer primarily to business customers.

Affiliates and other services include providing to our affiliates data services, local services and billing and collections services that we also provide to external customers. In addition, we provide to our affiliates: marketing, sales and advertising; computer system development and support services; network support and technical services; and other support services, such as legal, regulatory, finance and accounting, tax, human resources and executive support. We also generate other revenue from USF surcharges and the leasing and subleasing of space in our office buildings, warehouses and other properties.

Revenue from our products and services for the years ended December 31, 2010, 2009 and 2008 is summarized in the following table:

	Years Ended December 31,		
	2010	2009	2008
	(Dollars in millions)		
Operating revenue:			
Strategic services	\$3,059	\$2,900	\$ 2,789
Legacy services	4,456	4,996	5,615
Affiliates and other services	1,756	1,835	1,984
Total operating revenue	<u>\$9,271</u>	<u>\$9,731</u>	<u>\$10,388</u>

Revenue from affiliates was 17% of total revenue for each of the years ended December 31, 2010, 2009 and 2008, respectively. We do not have any single customer that provides more than 10% of our total operating revenue. Substantially all of our revenue comes from customers located in the United States.

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

Note 16: Related Party Transactions

We provide to our affiliates data, Internet and voice services, as well as local and billing and collections services that we also provide to external customers. In addition, we provide to our affiliates, marketing, sales and advertising, computer system and development support services, network support and technical services and other support services.

Below are details of the services we provided to our affiliates:

- *Telecommunications services.* Data, Internet and voice services in support of our affiliates' service offerings.
- *Billing and collections services.* Billing and collections services in support of an affiliate's long-distance business.
- *Marketing, sales and advertising.* Marketing, sales and advertising support joint marketing of our services, including the development of marketing and advertising plans, sales unit forecasts, market research, product management, sales training and compensation plans.
- *Computer system and development support services.* Information technology services primarily include the labor cost of developing, testing and implementing the system changes necessary to support order entry, provisioning, billing, network and financial systems, as well as the cost of improving, maintaining and operating our operations support systems and shared internal communications networks.
- *Network support and technical services.* Network support and technical services relate to forecasting demand volumes and developing plans around network utilization and optimization, developing and implementing plans for overall product development, provisioning and customer care.
- *Other support services.* Other support services include legal, regulatory, finance and accounting, tax, human resources and executive support. In addition, we sublease space in our office buildings, warehouses and other properties.

We charge our affiliates for services based on market price or fully distributed cost ("FDC"). We charge our affiliates market price for services that we also provide to external customers, while other services that we provide only to our affiliates are priced by applying an FDC methodology. FDC rates include salaries and wages, payroll taxes, employee benefits, miscellaneous expenses, and charges for the use of our buildings, computing and software assets. Whenever possible, costs are directly assigned to our affiliates for the services they use. If costs cannot be directly assigned, they are allocated among all affiliates based upon cost causative measures; or if no cost causative measure is available, these costs are allocated based on a general allocator. We believe these cost allocation methodologies are reasonable. From time to time, QC adjusts the basis for allocating the costs of a shared service among affiliates. Such changes in allocation methodologies are generally billed prospectively.

We also purchase services from our affiliates including long-distance, wholesale Internet access and insurance. Our affiliates charge us for these services based on market price or FDC.

In 2010 and 2009, we paid approximately \$24 million and \$27 million, respectively, in administrative fees in the ordinary course of business to United Healthcare Services, Inc., which provides health benefit plans to most of our employees and is a subsidiary of UnitedHealth Group. QCII's director, Anthony Welters, serves as Executive Vice President of UnitedHealth Group and as President of its Public and Senior Markets Group.

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

Note 17: Commitments and Contingencies
Commitments
Future Contractual Obligations

The following table summarizes our estimated future contractual obligations as of December 31, 2010:

	Payments Due by Period					2016 and Thereafter	Total
	2011	2012	2013	2014	2015		
	(Dollars in millions)						
Future contractual obligations ⁽¹⁾ :							
Debt and lease payments:							
Long-term debt	\$ 825	\$1,500	\$ 750	\$ 600	\$400	\$ 3,893	\$ 7,968
Capital lease and other obligations	52	46	39	28	16	3	184
Interest on long-term borrowings and capital leases ⁽²⁾	597	463	380	363	301	2,945	5,049
Operating leases	88	59	40	34	29	67	317
Total debt and lease payments	1,562	2,068	1,209	1,025	746	6,908	13,518
Other long-term liabilities	3	2	2	2	2	43	54
Purchase commitments:							
Telecommunications and information technology	2	2	2	1	1	1	9
Advertising, promotion and other services ⁽³⁾	64	41	31	27	24	44	231
Total purchase commitments	66	43	33	28	25	45	240
Non-qualified pension obligation ⁽⁴⁾	2	2	2	2	2	21	31
Total future contractual obligations	\$1,633	\$2,115	\$1,246	\$1,057	\$775	\$ 7,017	\$13,843

(1) The table does not include:

- costs that are contingent upon completion of QCII's pending merger with CenturyLink;
- our open purchase orders as of December 31, 2010. These purchase orders are generally at fair value, are generally cancelable without penalty and are part of normal operations;
- other long-term liabilities, such as accruals for legal matters and income taxes, that are not contractual obligations by nature. We cannot determine with any degree of reliability the years in which these liabilities might ultimately settle;
- affiliate cash funding requirements for pension benefits payable to certain eligible current and future retirees allocated to us by QCII. The accounting unfunded status of QCII's pension plan was \$585 million at December 31, 2010. Benefits paid by QCII's qualified pension plan are paid through a trust. Cash funding requirements for this trust are not included in this table as QCII is not able to reliably estimate required contributions to the trust. QCII's cash funding requirements can be significantly impacted by earnings on investments, the discount rate changes in the plan and funding laws and regulations. As a result, it is difficult to determine future funding requirements with a high level of precision; however, in general, current funding laws require a

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

company with a plan shortfall to fund the annual cost of benefits earned in addition to a seven-year amortization of the shortfall. Based on current funding laws and regulations, QCII will not be required to make a cash contribution in 2011. QCII expects to begin making required contributions to the plan during 2012 and estimates that these 2012 contributions could be between \$300 million and \$350 million. Although potentially significant in the aggregate, QCII currently expects that contributions in 2013 and beyond will decrease annually from the 2012 expected contribution amount. However, the actual amount of required contributions in 2013 and beyond will depend on earnings on investments, discount rates, demographic experience, changes in the plan and funding laws and regulations. Substantially all of our employees participate in the QCII pension plan. The amounts contributed by us through QCII are not segregated or restricted to pay amounts due to our employees and may be used to provide benefits to other employees of QCII's affiliates. Historically, QCII has only required us to pay our portion of its required pension contribution;

- affiliate post-retirement benefits payable to certain eligible current and future retirees. Although we had an affiliate liability recorded on our balance sheet as of December 31, 2010 representing our allocated net benefit obligation for post-retirement benefits, not all of this amount is a contractual obligation. Certain of these plans are unfunded and net payments made by us totaled \$112 million in 2010, including payments for benefits that are not contractual obligations. Assuming our future proportionate share of QCII's total post-retirement benefits payments is consistent with an average of our proportionate share over the prior three years, total undiscounted future payments estimated to be made by us for benefits that are both contractual obligations and non-contractual obligations are approximately \$4.0 billion over approximately 80 years. However, this estimate is impacted by various actuarial and market assumptions, and ultimate payments will differ from this estimate. In 1989, a trust was created and funded by QCII to help cover the health care costs of retirees who are former occupational employees. QCII did not make any cash contributions to this trust in 2010 and does not expect to make any significant cash contributions to this trust in the future. QCII anticipates that the majority of the costs that have historically been paid out of this trust will need to be paid by us at some point in the future. As of December 31, 2010, the fair value of the trust assets was \$801 million; however, a portion of these assets is comprised of investments with restricted liquidity. In 2009 QCII estimated that the trust would be adequate to provide continuing reimbursements for its occupational post-retirement health care costs for approximately five years. Based on returns on trust assets during 2010, QCII still believes that the more liquid assets in the trust will be adequate to provide continuing reimbursements for its occupational post-retirement health care costs for approximately five years. Thereafter, covered benefits for QCII's eligible retirees who are former occupational employees will be paid either directly by us or from the trust as the remaining assets become liquid. This five year period could be substantially shorter or longer depending on returns on plan assets, the timing of maturities of illiquid plan assets and future changes in benefits. QCII's estimate of the annual long-term rate of return on the plan assets is 7.5% based on the currently held assets; however, actual returns could vary widely in any given year. The benefits reimbursed from plan assets were \$186 million in 2010;
- contract termination fees. These fees are non-recurring payments, the timing and payment of which, if any, is uncertain. In the ordinary course of business and to optimize our cost structure, we enter into contracts with terms greater than one year to purchase goods and services. Assuming we exited these contracts in 2011, termination fees for these contracts would be \$31 million. In the normal course of business, we believe the payment of these fees is remote; and

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

- potential indemnification obligations to counterparties in certain agreements entered into in the normal course of business. The nature and terms of these arrangements vary. Historically, we have not incurred significant costs related to performance under these types of arrangements.
- (2) Interest paid in all years may differ due to future refinancing of debt. Interest on our floating rate debt was calculated for all years using the rates effective as of December 31, 2010.
- (3) We have various long-term, non-cancelable purchase commitments for advertising and promotion services, including advertising and marketing at sports arenas and other venues and events. We also have service related commitments with various vendors for data processing, technical and software support services. Future payments under certain service contracts will vary depending on our actual usage. In the table above we estimated payments for these service contracts based on the level of services we expect to receive.
- (4) Non-qualified pension payment estimates assume we pay the same proportionate share of QCII's total payments as the average we paid over the prior three years.

Capital Leases

We lease certain facilities and equipment under various capital lease arrangements. Depreciation of assets under capital leases is included in depreciation and amortization expense. Payments on capital leases are included in repayments of long-term borrowings, including current maturities in the consolidated statements of cash flows.

The table below summarizes our capital lease activity as of and for the years ended December 31, 2010, 2009 and 2008:

	Years Ended December 31,		
	2010	2009	2008
	(Dollars in millions)		
Capital leases:			
Assets acquired through capital leases	\$116	\$ 61	\$ 10
Assets included in property, plant and equipment	223	109	107
Accumulated depreciation	51	25	64
Depreciation expense	28	20	21
Cash payments towards capital leases	25	24	25

The future minimum payments under capital leases as of December 31, 2010 are included in our consolidated balance sheet as follows:

	Future Minimum Payments
	(Dollars in millions)
Capital lease obligations:	
Total minimum payments	\$ 195
Less: amount representing interest and executory costs	(31)
Present value of minimum payments	164
Less: current portion	(36)
Long-term portion	\$ 128

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

Operating Leases

Certain office facilities, real estate and equipment are subject to operating leases. We also have easement (or right-of-way) agreements with railroads and public transportation authorities that are accounted for as operating leases. For the years ended December 31, 2010, 2009 and 2008, rent expense under these operating leases was \$200 million, \$206 million and \$223 million, respectively, and sublease rental income over the same periods was \$15 million, \$18 million and \$19 million, respectively. Operating leases as reported in the table in “Future Contractual Obligations” above have not been reduced by minimum sublease rental income of \$49 million, which we expect to realize under non-cancelable subleases.

Letters of Credit and Guarantees

On our behalf, QCII maintains letter of credit arrangements with various financial institutions. As of December 31, 2010, the amount of letters of credit outstanding was \$51 million, and we had no outstanding guarantees. On January 18, 2011, QCII entered into \$7 million of additional letters of credit.

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. Only those matters to which we are a party represent contingencies for which we have accrued, or could reasonably anticipate accruing, liabilities if appropriate to do so. We are not a party to any of the matters discussed below and therefore have not accrued any liabilities for these matters.

In this section, when we refer to a class action as “putative” it is because a class has been alleged, but not certified in that matter. Until and unless a class has been certified by the court, it has not been established that the named plaintiffs represent the class of plaintiffs they purport to represent.

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 or employees with respect to certain of the matters described below, and QCII has been advancing legal fees and costs to certain former directors, officers or employees in connection with certain matters described below.

KPNQwest Litigation/Investigation

On September 29, 2010, the trustees in the Dutch bankruptcy proceeding for KPNQwest, N.V. (of which QCII was a major shareholder) filed a lawsuit in district court in Haarlem, the Netherlands, alleging tort and mismanagement claims under Dutch law. QCII and Koninklijke KPN N.V. (“KPN”) are defendants in this lawsuit along with a number of former KPNQwest supervisory board members and a former officer of KPNQwest, some of whom were formerly affiliated with QCII. 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, which is claimed to be approximately €4.2 billion (or approximately \$5.6 billion based on the exchange rate on December 31, 2010), plus statutory interest.

On September 13, 2006, Cargill Financial Markets, Plc and Citibank, N.A. filed a lawsuit in the District Court of Amsterdam, the Netherlands, against QCII, KPN, KPN Telecom B.V., and other former officers, employees or supervisory board members of KPNQwest, some of whom were formerly affiliated with QCII. The

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

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 \$290 million based on the exchange rate on December 31, 2010).

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, 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. On December 5, 2008, the Enterprise Chamber appointed investigators to conduct the inquiry. VEB claims that certain individuals have assigned to it their claims for losses totaling approximately €40 million (or approximately \$55 million based on the exchange rate on December 31, 2010), which those individuals allegedly incurred on investments in KPNQwest securities. VEB has not yet filed any adjudicative action to assert those claims.

On June 7, 2010, a number of parties, including QCII and KPN, reached a settlement with VEB for €19 million (or approximately \$25 million based on the exchange rate on December 31, 2010), conditioned in part on the termination of the investigation by the Enterprise Chamber. Pursuant to the terms of the settlement, VEB formally requested that the Enterprise Chamber terminate the investigation. The Enterprise Chamber denied that request and directed the investigation to proceed. On an appeal of that decision, the Dutch Supreme Court reversed the Enterprise Chamber's decision and, among other things, referred the case back to the Enterprise Chamber to terminate the investigation.

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

QCII Stockholder Litigation

In the weeks following the April 22, 2010 announcement of QCII's pending merger with CenturyLink, purported QCII stockholders filed 17 lawsuits against QCII, its directors, certain of its officers, CenturyLink and SB44 Acquisition Company. The purported stockholder plaintiffs commenced these actions in three jurisdictions: the District Court for the City and County of Denver, the United States District Court for the District of Colorado, and the Delaware Court of Chancery. The plaintiffs generally allege that QCII's directors breached their fiduciary duties in approving the merger and seek to enjoin the merger and, in some cases, damages if the merger is completed. Many of the lawsuits also challenge the sufficiency of the disclosures in the preliminary joint proxy statement-prospectus relating to the merger, which was filed with the SEC on June 4, 2010.

QCII, and its directors, believe that all of these actions are without merit. The defendants nevertheless negotiated with the purported stockholder plaintiffs regarding a settlement of the claims asserted in all of these actions, including the claims that challenge the sufficiency of the disclosures in the preliminary joint proxy statement-prospectus. On July 16, 2010, the parties entered into a memorandum of understanding reflecting the terms of their agreement-in-principle for a settlement of all of the claims asserted in these actions. Pursuant to this agreement, defendants included additional disclosures in the final joint proxy statement-prospectus filed with the SEC on July 19, 2010. On December 17, 2010, the United States District Court for the District of Colorado preliminarily approved the settlement, and notice was subsequently provided to stockholders of the proposed

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

final resolution. A final fairness hearing is scheduled for February 25, 2011. If the settlement is approved at the final hearing, all of these actions will be dismissed, with prejudice. The defendants intend to defend their positions in these matters vigorously to the extent they are not fully resolved by the settlement.

Other Matters

Several putative class actions relating to the installation of fiber-optic cable in certain rights-of-way were filed against several other subsidiaries of QCII on behalf of landowners on various dates and in various courts in Arizona, California, Colorado, Georgia, Illinois, Indiana, Kansas, Massachusetts, Mississippi, Missouri, Nevada, New Mexico, Oregon, South Carolina, Tennessee, Texas and Utah. For the most part, the complaints challenge the right to install fiber-optic cable in railroad rights-of-way. The complaints allege that the railroads own the right-of-way as an easement that did not include the right to permit the defendants to install fiber-optic cable in the right-of-way without the plaintiffs' consent. Most of the actions purport to be brought on behalf of state-wide classes in the named plaintiffs' respective states, although two of the currently pending actions purport to be brought on behalf of multi-state classes. Specifically, the Illinois state court action purports to be on behalf of landowners in Illinois, Iowa, Kentucky, Michigan, Minnesota, Nebraska, Ohio and Wisconsin, and the Indiana state court action purports to be on behalf of a national class of landowners. In general, the complaints seek damages on theories of trespass and unjust enrichment, as well as punitive damages. On July 18, 2008, a federal district court in Massachusetts entered an order preliminarily approving a settlement of all of the actions described above, except the action pending in Tennessee. On September 10, 2009, the court denied final approval of the settlement on grounds that it lacked subject matter jurisdiction. On December 9, 2009, the court issued a revised ruling that, among other things, denied a motion for approval as moot and dismissed the matter for lack of subject matter jurisdiction.

One of QCII's other subsidiaries, Qwest Communications Company, LLC ("QCC"), 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 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.

A putative class action filed on behalf of certain of QCII's retirees was brought against QCII, the Qwest Group Life Insurance Plan and other related entities in federal district court in Colorado in connection with QCII's decision 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 our right to reduce the life insurance benefit under applicable law and plan documents. The plaintiffs subsequently amended their complaint to assert additional claims. In 2009, the court dismissed or granted summary judgment to QCII on all of the plaintiffs' claims. The plaintiffs have appealed the court's decision to the Tenth Circuit Court of Appeals.

QCII continues to evaluate the method it uses to assess the amount of USF payments that must be made on certain products, and during the year ended December 31, 2010 QCII recorded an adjustment to its liability of \$15 million related to previous years' USF payments. This ongoing evaluation may result in further adjustments to QCII's previous years' USF payments and charges to customers.

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

Note 18: Quarterly Financial Data (Unaudited)

	Quarterly Financial Data				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
	(Dollars in millions)				
2010					
Operating revenue	\$2,347	\$2,313	\$2,311	\$2,300	\$9,271
Operating income	661	649	616	557	2,483
Income tax expense	253	187	181	170	791
Net income	252	304	286	240	1,082
2009					
Operating revenue	\$2,507	\$2,463	\$2,402	\$2,359	\$9,731
Operating income	693	675	620	574	2,562
Income tax expense	209	186	180	149	724
Net income	340	305	293	259	1,197

Fourth Quarter 2010

Net income for the fourth quarter of 2010 was affected by an increase in stock-based compensation expense of \$63 million due to QCII's decision to accelerate the vesting of certain restricted stock and performance share awards issued under its Equity Incentive Plan in order to preserve certain economic benefits to its stockholders that otherwise would have been lost in connection with QCII's pending merger with CenturyLink.

Income tax expense for the fourth quarter of 2010 was affected by the tax treatment of the expenses incurred when QCII accelerated the vesting of certain stock-based compensation.

First Quarter 2010

Income tax expense for the first quarter of 2010 increased by \$55 million as a result of the March 2010 enactments of the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010. Among other things, these laws disallow, beginning in 2013, federal income tax deductions for retiree prescription drug benefits to the extent we receive reimbursements for those benefits under the Medicare Part D program.

Note 19: Other Financial Information

Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets as of December 31, 2010 and 2009 consisted of the following:

	December 31,	
	2010	2009
	(Dollars in millions)	
Prepaid expenses and other current assets:		
Deferred activation and installation charges	\$ 91	\$ 99
Prepaid expenses and other	106	146
Total prepaid expenses and other current assets	<u>\$ 197</u>	<u>\$ 245</u>

QWEST CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
For the Years Ended December 31, 2010, 2009 and 2008

Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities as of December 31, 2010 and 2009 consisted of the following:

	December 31,	
	2010	2009
	(Dollars in millions)	
Accrued expenses and other current liabilities:		
Accrued interest	\$ 126	\$ 143
Employee compensation	298	283
Accrued property and other taxes	203	211
DIRECTV payable	147	128
Other	135	176
Total accrued expenses and other current liabilities	<u>\$ 909</u>	<u>\$ 941</u>

Note 20: Labor Union Contracts

We are a party to collective bargaining agreements with our labor unions, the Communications Workers of America and the International Brotherhood of Electrical Workers. Our current four-year collective bargaining agreements expire on October 6, 2012. As of December 31, 2010, employees covered under these collective bargaining agreements totaled approximately 14,200, or 54% of all our employees.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Conclusion Regarding the Effectiveness of Disclosure 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 December 31, 2010. 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 fourth quarter of 2010 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management's Report on Internal Control Over Financial Reporting

This section of this Annual Report on Form 10-K will not be deemed incorporated by reference by any general statement incorporating by reference this Annual Report on Form 10-K into any filing under the Securities Act of 1933 or under the Securities Exchange Act of 1934, except to the extent that we specifically incorporate this information by reference, and will not otherwise be deemed filed under these Acts.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in *Internal Control—Integrated Framework*, our management concluded that our internal control over financial reporting was effective as of December 31, 2010.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

We have omitted this information pursuant to General Instruction I(2).

ITEM 11. EXECUTIVE COMPENSATION

We have omitted this information pursuant to General Instruction I(2).

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

We have omitted this information pursuant to General Instruction I(2).

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

We have omitted this information pursuant to General Instruction I(2).

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Pre-Approval Policies and Procedures

The Audit Committee of the Board of Directors of QCII is responsible for the appointment, compensation and oversight of the work of our independent registered public accounting firm. Under the Audit Committee's charter, the Audit Committee pre-approves all audit and permissible non-audit services provided by our independent registered public accounting firm. The approval may be given as part of the Audit Committee's approval of the scope of the engagement of our independent registered public accounting firm or on an individual basis. The pre-approval of non-audit services may be delegated to one or more of the Audit Committee's members, but the decision must be reported to the full Audit Committee. Our independent registered public accounting firm may not be retained to perform the non-audit services specified in Section 10A(g) of the Exchange Act.

Fees Paid to the Independent Registered Public Accounting Firm

QCII first engaged KPMG LLP to be our independent registered public accounting firm in May 2002. The aggregate fees billed or allocated to us for each of the years ended December 31, 2010 and 2009, for professional accounting services, including KPMG's audit of our annual consolidated financial statements, are set forth in the table below.

	<u>2010</u>	<u>2009</u>
	<u>(Dollars in thousands)</u>	
Audit fees	\$ 2,555	\$ 2,815
Audit-related fees	104	74
Total fees	<u>\$ 2,659</u>	<u>\$ 2,889</u>

KPMG did not provide to us any professional services for tax compliance, tax advice or tax planning in 2010 or 2009.

Table of Contents

For purposes of the preceding table, the professional fees are classified as follows:

Audit fees—These are fees billed for the year shown for professional services performed for the audit of the consolidated financial statements included in our Form 10-K filing for that year, the review of condensed consolidated financial statements included in our Form 10-Q filings made during that year, comfort letters, consents and assistance with and review of documents filed with the SEC. Audit fees for each year shown include amounts that have been billed through the date of this filing and any additional amounts that are expected to be billed thereafter.

Audit-related fees—These are fees billed for assurance and related services that were performed in the year shown and that are traditionally performed by our independent registered public accounting firm. More specifically, these services include regulatory filings and employee benefit plan audits. Audit-related fees for each year shown include amounts that have been billed through the date of this filing.

The Audit Committee approved in advance all of the services performed by KPMG described above.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) Documents filed as part of this report:

(1) Report of Independent Registered Public Accounting Firm	<u>Page</u> 48
Financial Statements covered by the Report of Independent Registered Public Accounting Firm:	
Consolidated Statements of Operations for the years ended December 31, 2010, 2009 and 2008	49
Consolidated Balance Sheets as of December 31, 2010 and 2009	50
Consolidated Statements of Cash Flows for the years ended December 31, 2010, 2009 and 2008	51
Consolidated Statements of Stockholder's (Deficit) Equity and Comprehensive Income for the years ended December 31, 2010, 2009 and 2008	52
Notes to the Consolidated Financial Statements for the years ended December 31, 2010, 2009 and 2008	53

(a)(3) and (b) Exhibits required by Item 601 of Regulation S-K:

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 ⁷ / 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).

Table of Contents

<u>Exhibit Number</u>	<u>Description</u>
(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).
(4.10)	Sixth Supplemental Indenture, dated April 13, 2009, 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 April 13, 2009, File No. 001-03040).
(10.1)	Registration Rights Agreement, dated April 13, 2009, among Qwest Corporation and the initial purchasers listed therein (incorporated by reference to Qwest Corporation's Current Report on Form 8-K filed April 13, 2009, File No. 001-03040).
(10.2)	Aircraft Time Sharing Agreement, dated December 1, 2008, 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, 2008, File No. 001-15577).
(10.3)	First Amendment to Aircraft Time Sharing Agreement, dated July 29, 2010, by and between Qwest Corporation and Edward A. Mueller (incorporated by reference to Qwest Communications International Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2010, File No. 001-15577).
12	Calculation of Ratio of Earnings to Fixed Charges.
23	Consent of Independent Registered Public Accounting Firm.
24	Power of Attorney.
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.

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Denver, State of Colorado, on February 21, 2011.

**QWEST CORPORATION,
A COLORADO CORPORATION**

By: /s/ R. W. WILLIAM J OHNSTON
R. William Johnston
Senior Vice President, Controller and
Chief Accounting Officer
(Principal Accounting Officer and
Duly Authorized Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on the 21st day of February 2011.

Signature

Title

/s/ E D W A R D A . M U E L L E R

Edward A. Mueller

Director and Chief Executive Officer
(Principal Executive Officer)

/ s/ J OSEPH J. E UTENEUER

Joseph J. Euteneuer

Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

*

Teresa A. Taylor

Director

*By: /s / J OSEPH J. E UTENEUER

Joseph J. Euteneuer
As Attorney-In-Fact

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

	Years Ended December 31,				
	2010	2009	2008	2007	2006
	(Dollars in millions)				
Income before income taxes	\$1,873	\$1,921	\$2,267	\$2,440	\$1,882
Add: estimated fixed charges	689	705	671	682	700
Add: estimated amortization of capitalized interest	10	11	12	10	10
Less: interest capitalized	(12)	(10)	(14)	(12)	(12)
Total earnings available for fixed charges	<u>\$2,560</u>	<u>\$2,627</u>	<u>\$2,936</u>	<u>\$3,120</u>	<u>\$2,580</u>
Estimate of interest factor on rentals	\$ 62	\$ 63	\$ 68	\$ 62	\$ 72
Interest expense, including amortization of premiums, discounts and debt issuance costs ⁽¹⁾	615	632	589	608	616
Interest capitalized	12	10	14	12	12
Total fixed charges	<u>\$ 689</u>	<u>\$ 705</u>	<u>\$ 671</u>	<u>\$ 682</u>	<u>\$ 700</u>
Ratio of earnings to fixed charges	3.7	3.7	4.4	4.6	3.7

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

Consent of Independent Registered Public Accounting Firm

The Board of Directors
Qwest Corporation:

We consent to the incorporation by reference in the registration statement on Form S-3 (333-156101) of Qwest Corporation (the Company) of our report dated February 21, 2011, with respect to the consolidated balance sheets of Qwest Corporation as of December 31, 2010 and 2009, and the related consolidated statements of operations, stockholder's (deficit) equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2010, which report appears in the December 31, 2010 Annual Report on Form 10-K of Qwest Corporation.

KPMG LLP

Denver, Colorado
February 21, 2011

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below hereby constitutes and appoints Edward A. Mueller, Joseph J. Euteneuer and Stephen E. Brilz, or any one of them, as his or her attorney-in-fact and agent, with full power of substitution, for him or her in any and all capacities, hereby giving and granting to said attorney-in-fact and agent full power and authority to do and perform all and every act and thing whatsoever requisite and necessary to be done in and about the premises as fully, to all intents and purposes, as he or she might or could do if personally present at the doing thereof, hereby ratifying and confirming all that said attorney-in-fact and agent may or shall lawfully do, or cause to be done, in connection with the proposed filing by Qwest Corporation, a Colorado corporation, with the Securities and Exchange Commission, under the provisions of the Securities Exchange Act of 1934, as amended, of an annual report on Form 10-K for the fiscal year ended December 31, 2010, including but not limited to, such full power and authority to do the following: (i) execute and file such annual report; (ii) execute and file any amendment or amendments thereto; (iii) receive and respond to comments from the Securities and Exchange Commission related in any way to such annual report or any amendment or amendments thereto; and (iv) execute and deliver any and all certificates, instruments or other documents related to the matters enumerated above, as the attorney-in-fact in his sole discretion deems appropriate.

This power of attorney has been duly executed below by the following persons as of the 21st day of February, 2011.

/ s / E DWARD A. M UELLER

Edward A. Mueller

/s/ T ERESA A. T AYLOR

Teresa A. Taylor

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Edward A. Mueller, certify that:

1. I have reviewed this annual report on Form 10-K 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: February 21, 2011

/s/ E DWARD A. M UELLER

Edward A. Mueller
Chief Executive Officer

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Joseph J. Euteneuer, certify that:

1. I have reviewed this annual report on Form 10-K 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: February 21, 2011

/s/ J OSEPH J. E UTENEUER

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 Annual Report of Qwest on Form 10-K for the year ended December 31, 2010, 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-K. 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: February 21, 2011

By: /s/ E DWARD A. M UELLER
Edward A. Mueller
Chief Executive Officer

Dated: February 21, 2011

By: /s/ J OSEPH J. E UTENEUER
Joseph J. Euteneuer
Executive Vice President and Chief Financial Officer