

QWEST CORP

FORM 10-Q (Quarterly Report)

Filed 8/11/2000 For Period Ending 6/30/2000

| | |
|-------------|---|
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

☒ Quarterly Report Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934

For the Quarterly Period Ended June 30, 2000

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 Number 1-3040

Qwest Corporation
(formerly U S WEST Communications, Inc.)

Colorado
(State or other jurisdiction of incorporation
of organization)

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

1801 California Street, Denver, Colorado 80202
(Address of principal executive offices and zip code)

Telephone Number (303) 992-1400
(Registrant's telephone number, including area code)

THE REGISTRANT, A WHOLLY-OWNED SUBSIDIARY OF Qwest Communications International Inc., MEETS THE CONDITIONS SET FORTH IN GENERAL INSTRUCTION H(1) (a) AND (b) OF FORM 10-Q AND IS THEREFORE FILING THIS FORM WITH REDUCED DISCLOSURE FORMAT PURSUANT TO GENERAL INSTRUCTION H(2).

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

Qwest Corporation Form 10-Q

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Qwest Corporation
Condensed Consolidated Statements of Operations
(dollars in millions)
(unaudited)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|------------------------------------|--------------------------------|---------|------------------------------|---------|
| | 2000 | 1999 | 2000 | 1999 |
| | ----- | ----- | ----- | ----- |
| Revenues: | | | | |
| Local services..... | \$2,074 | \$1,930 | \$4,119 | \$3,802 |
| Access services..... | 735 | 685 | 1,445 | 1,356 |
| Long-distance services..... | 96 | 150 | 202 | 321 |
| Other services..... | 117 | 77 | 207 | 151 |
| | ----- | ----- | ----- | ----- |
| Total revenues..... | 3,022 | 2,842 | 5,973 | 5,630 |
| | ----- | ----- | ----- | ----- |
| Operating expenses: | | | | |
| Employee-related expenses..... | 803 | 892 | 1,601 | 1,785 |
| Other operating expenses..... | 736 | 650 | 1,513 | 1,274 |
| Depreciation and amortization..... | 577 | 557 | 1,141 | 1,142 |
| Merger-related expenses..... | 116 | - | 120 | - |
| | ----- | ----- | ----- | ----- |
| Total operating expenses..... | 2,232 | 2,099 | 4,375 | 4,201 |
| | ----- | ----- | ----- | ----- |
| Operating income..... | 790 | 743 | 1,598 | 1,429 |
| Other expense: | | | | |
| Interest expense..... | 125 | 98 | 244 | 187 |
| Other expense-net..... | 13 | 12 | 19 | 24 |
| | ----- | ----- | ----- | ----- |
| Total other expense-net..... | 138 | 110 | 263 | 211 |
| | ----- | ----- | ----- | ----- |
| Earnings before income taxes..... | 652 | 633 | 1,335 | 1,218 |
| Provision for income taxes..... | 247 | 246 | 505 | 462 |
| | ----- | ----- | ----- | ----- |
| Net earnings..... | \$ 405 | \$ 387 | \$ 830 | \$ 756 |
| | ===== | ===== | ===== | ===== |

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

Qwest Corporation
Condensed Consolidated Balance Sheets
(dollars in millions)
(unaudited)

| | June 30, 2000 | December 31, 1999 |
|--------------------------------|------------------|----------------------|
| | ----- | ----- |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents..... | \$ 241 | \$ 61 |

| | | |
|--|-----------|-----------|
| Accounts receivable-net..... | 1,902 | 1,811 |
| Inventories and supplies..... | 210 | 211 |
| Prepaid and other..... | 308 | 249 |
| | ----- | ----- |
| Total current assets..... | 2,661 | 2,332 |
| Property, plant and equipment-net..... | 17,228 | 16,049 |
| Other assets-net..... | 1,729 | 1,597 |
| | ----- | ----- |
| Total assets..... | \$ 21,618 | \$ 19,978 |
| | ===== | ===== |
| LIABILITIES AND STOCKHOLDER'S EQUITY | | |
| Current liabilities: | | |
| Short-term debt..... | \$ 2,328 | \$ 1,684 |
| Accounts payable..... | 1,694 | 1,721 |
| Accrued expenses and other current liabilities..... | 1,634 | 1,560 |
| Advance billings and customer deposits..... | 384 | 343 |
| | ----- | ----- |
| Total current liabilities..... | 6,040 | 5,308 |
| Long-term debt..... | 6,443 | 5,408 |
| Postretirement and other postemployment benefit obligations..... | 2,382 | 2,462 |
| Deferred income taxes..... | 1,474 | 1,331 |
| Deferred credits and other..... | 772 | 749 |
| Commitments and contingencies | | |
| Stockholder's equity: | | |
| Common stock-one share without par value, owned by parent..... | 8,139 | 8,140 |
| Cumulative deficit..... | (3,632) | (3,617) |
| Accumulated other comprehensive income..... | - | 197 |
| | ----- | ----- |
| Total stockholder's equity..... | 4,507 | 4,720 |
| | ----- | ----- |
| Total liabilities and stockholder's equity..... | \$ 21,618 | \$ 19,978 |
| | ===== | ===== |

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

Qwest Corporation
Condensed Consolidated Statements of Cash Flows
(dollars in millions)

(unaudited)

Six Months Ended
June 30,

| | 2000 | 1999 |
|---|----------|----------|
| | ----- | ----- |
| Cash provided by operating activities..... | \$ 2,026 | \$ 2,048 |
| | ----- | ----- |
| INVESTING ACTIVITIES | | |
| Expenditures for property, plant and equipment..... | (2,588) | (1,627) |
| Payments on disposals of property, plant and equipment..... | (35) | (18) |
| | ----- | ----- |
| Cash used for investing activities..... | (2,623) | (1,645) |
| | ----- | ----- |
| FINANCING ACTIVITIES | | |
| Net proceeds from short-term debt..... | 876 | 555 |
| Proceeds from issuance of long-term debt..... | 992 | 17 |
| Repayments of long-term debt..... | (270) | (280) |
| Dividends paid on common stock..... | (821) | (697) |
| | ----- | ----- |
| Cash provided by (used for) financing activities..... | 777 | (405) |
| | ----- | ----- |

CASH AND CASH EQUIVALENTS

| | | | | | | | |
|---------------------------|----------|--------|-------|----------|-------|-----------|----------|
| June 30, 2000 | | | | | | | |
| Revenues..... | \$ 2,410 | \$ 818 | \$ 68 | \$ 3,296 | \$ - | \$ (274) | \$ 3,022 |
| Margin..... | 1,510 | 578 | (672) | 1,416 | (213) | (551) (1) | 652 |
| Capital expenditures.. | 175(2) | 58(2) | 1,164 | 1,397 | - | (38) | 1,359 |
| 1999 | | | | | | | |
| Revenues..... | \$ 2,222 | \$ 719 | \$ 65 | \$ 3,006 | \$ - | \$ (164) | \$ 2,842 |
| Margin..... | 1,543 | 526 | (699) | 1,370 | (3) | (734) (1) | 633 |
| Capital expenditures.. | 93(2) | 9(2) | 831 | 933 | 38 | (74) | 897 |

(1) Adjustments made to arrive at consolidated income before income taxes include the following:

| | Three Months Ended June 30, | |
|--|-----------------------------|--------|
| | 2000 | 1999 |
| Taxes other than income taxes..... | \$ 95 | \$ 104 |
| Depreciation and amortization..... | 577 | 557 |
| Interest expense..... | 125 | 98 |
| Other amounts applicable to Qwest..... | (259) | (37) |
| Other expense-net..... | 13 | 12 |
| | \$ 551 | \$ 734 |

(2) Additional capital expenditures relating to these services are included in network services capital expenditures.

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| | Total Communications and Related Services | | | | | | |
|--------------------------------------|---|-----------------------|---------------------|----------|----------------------|-----------------------|----------|
| (in millions) | Retail Services | Wholesale Services | Network Services | Other | Reconciling Items | Consolidated Total | |
| Six Months Ended June 30, 2000 | | | | | | | |
| Revenues..... | \$ 4,734 | \$ 1,565 | \$ 142 | \$ 6,441 | \$ - | \$ (468) | \$ 5,973 |
| Margin..... | 2,978 | 1,160 | (1,333) | 2,805 | \$(188) | (1,282) (1) | 1,335 |
| Capital expenditures.. | 329(2) | 82(2) | 2,214 | 2,625 | - | (37) | 2,588 |
| 1999 | | | | | | | |
| Revenues..... | \$ 4,390 | \$ 1,409 | \$ 115 | \$ 5,914 | \$ - | \$ (284) | \$ 5,630 |
| Margin..... | 3,047 | 1,055 | (1,384) | 2,718 | (36) | (1,464) (1) | 1,218 |
| Capital expenditures.. | 204(2) | 40(2) | 1,469 | 1,713 | 38 | (124) | 1,627 |

(1) Adjustments made to arrive at consolidated income before income taxes include the following:

| | Six Months Ended June 30, | |
|--|---------------------------|----------|
| | 2000 | 1999 |
| Taxes other than income taxes..... | \$ 201 | \$ 190 |
| Depreciation and amortization..... | 1,141 | 1,142 |
| Interest expense..... | 244 | 187 |
| Other amounts applicable to Qwest..... | (323) | (79) |
| Other expense-net..... | 19 | 24 |
| | \$ 1,282 | \$ 1,464 |

(2) Additional capital expenditures relating to these services are included in network services capital expenditures.

In addition to the revenues disclosed above, intersegment revenues were:

| Three Months Ended June 30, | | Six Months Ended June 30, | |
|-----------------------------|------|---------------------------|------|
| 2000 | 1999 | 2000 | 1999 |

| | | | | |
|-------------------------|-------|------|-------|-------|
| Retail services..... | \$ 30 | \$ 8 | \$ 54 | \$ 14 |
| Wholesale services..... | 28 | 12 | 47 | 19 |
| Network services..... | 11 | 17 | 27 | 31 |

NOTE 3: COMMITMENTS AND CONTINGENCIES

CONTINGENCIES

In May 1996, the Oregon Public Utilities Commission ("OPUC") approved a stipulation terminating prematurely our alternative form of regulation ("AFOR") plan and it then undertook a

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review of our earnings. In May 1997, the OPUC ordered us to reduce our annual revenues by \$97 million, effective May 1997, and to issue a one-time refund, including interest, of approximately \$102 million to reflect the revenue reduction for the period May 1996 through April 1997.

We filed an appeal of the order and asked for an immediate stay of the refund with the Oregon Circuit Court which granted our request, pending a full review of the OPUC's order. In February 1998, the Oregon Circuit Court entered a judgment in our favor on most of the appealed issues. The OPUC appealed to the Oregon Court of Appeals in March 1998, and the appeal remains pending. We continue to charge interim rates, subject to refund, during the pendency of that appeal.

In September 1999, the Company and OPUC staff entered into a tentative settlement agreement whereby we would refund approximately \$270 million to current and former Oregon customers of the Company and issue temporary bill credits of \$63 million annually until the OPUC sets final rates. In April 2000, the OPUC announced its acceptance of the settlement agreement. We have reserved for the proposed refunds.

We have pending regulatory actions in local regulatory jurisdictions which call for price decreases, refunds or both. These actions are generally routine and incidental to our business. We will continue to monitor and evaluate risks associated with our local regulatory jurisdictions.

OTHER CONTINGENCIES. Through July 2000, U S WEST and the Company have been served with four class action complaints purportedly on behalf of over 300,000 customers in the states of Colorado, Arizona, Oregon and New Mexico. The complaints allege, inter alia, that from 1993 to the present, U S WEST, in violation of alleged statutory and common law obligations, willfully delayed the provision of local telephone service to the purported class members. In addition, the complaints allege that U S WEST misrepresented the date on which such local telephone service was to be provided to the purported class members. The complaints seek compensatory damages for purported class members, disgorgement of profits and punitive damages. Management believes that we have substantial defenses to the claims asserted and intends to vigorously defend against these actions.

We and our parent, Qwest, have been named as a defendant in various other litigation matters. Management intends to vigorously defend against these outstanding claims. Management believes it has adequate accrued loss contingencies and that, although the ultimate outcome of these claims cannot be ascertained at this time, current pending or threatened litigation matters are not expected to have a material adverse impact on our condensed consolidated results of operations or financial position.

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ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (dollars in millions)

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Form 10-Q contains financial projections, synergy estimates and other "forward-looking statements" as that term is used in federal securities laws about Qwest Corporation's (the "Company") financial condition, results of operations and business. These statements include, among others:

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

These statements may be made expressly in this Form 10-Q. You can find many of these statements by looking for words such as "believes," "expects," "anticipates," "estimates," or similar expressions used in this Form 10-Q.

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.

The most important facts that could prevent us from achieving our stated goals include, but are not limited to, the following:

- potential fluctuation in our quarterly results;
- volatility of Qwest's stock price;
- intense competition in the communications services market;
- changes in demand for our products and services;
- dependence on new product development and acceleration of the deployment of advanced new services, such as broadband data, wireless and video services, which could require substantial expenditure of financial and other resources in excess of contemplated levels;
- rapid and significant changes in technology and markets;
- adverse changes in the regulatory or legislative environment affecting Qwest's business and delays in Qwest's ability to begin long-distance services between local access and transport areas ("LATAs") in the 14 state U S WEST, Inc. ("U S WEST") region;
- failure to maintain necessary rights of way; and
- failure to achieve the projected synergies and financial results expected to result from the acquisition of U S WEST timely or at all and difficulties in combining the operations of Qwest and U S WEST.

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Because the statements are subject to risks and uncertainties, actual results may differ materially from those expressed or implied by the forward-looking statements. We caution you not to place undue reliance on the statements, which speak only as of the date of this Form 10-Q.

The cautionary statements contained or referred to in this section should be considered in connection with any subsequent written or oral forward-looking statements that we or persons acting on our behalf may issue. We do not undertake any obligation to review or confirm analysts' expectations or estimates or to release publicly any revisions to any forward-looking statements to reflect events or circumstances after the date of this Form 10-Q or to reflect the occurrence of unanticipated events.

RESULTS OF OPERATIONS

Three and Six Months Ended June 30, 2000 Compared with 1999

REVENUES (in millions)

| | Three Months Ended June 30, | | Increase/ Decrease) | | Six Months Ended June 30, | | Increase/ (Decrease) | |
|---------------------------------|--------------------------------|----------|------------------------|--------|------------------------------|----------|-------------------------|--------|
| | 2000 | 1999 | | | 2000 | 1999 | | |
| Local services..... | \$ 2,074 | \$ 1,915 | \$ 159 | 8.3% | \$ 4,119 | \$ 3,786 | \$ 333 | 8.8% |
| Access services | 735 | 700 | 35 | 5.0 | 1,445 | 1,372 | 73 | 5.3 |
| Long-distance services | 96 | 150 | (54) | (36.0) | 202 | 321 | (119) | (37.1) |
| Other services | 117 | 77 | 40 | 51.9 | 207 | 151 | 56 | 37.1 |

LOCAL SERVICES. Local services revenues include retail and wholesale basic monthly service fees, fees for calling services such as voice messaging and caller identification, wireless revenues, subscriber line charges ("SLCs"), MegaBit(TM) data services, local number portability ("LNP") charges, public phone revenues, interconnection, paging and installation and connection charges. State public utility commissions ("PUCs") regulate most local service rates.

Revenue growth for the quarter ended June 30, 2000 was primarily attributable to greater wireless sales (\$63 million), increased demand for basic telephone services (\$49 million) and increased sales of calling services (\$16 million). Revenue growth for the six months ended June 30, 2000 was primarily attributable to greater wireless sales (\$129 million), increased demand for basic telephone services (\$74 million) and increased sales of calling services (\$39 million). Also contributing to revenue growth were greater revenues from interconnection, increases in the subscriber base of our MegaBit (TM) data services, paging services and LNP charges. Offsetting these increases in revenue were regulatory rate changes and accruals for regulatory proceedings of \$36 million and \$17 million for the three and six months ended June 30, 2000, respectively.

ACCESS SERVICES. Access services revenues are derived primarily from charging interexchange carriers ("IXCs"), such as AT&T and WorldCom, for use of our local network to connect customers to their long-distance networks. Also included in access services revenues are special access and private line revenues from end-users buying dedicated local exchange capacity to support their private networks.

Increased demand for private line and special access services, as well as demand from IXCs resulted in increases of \$78 million and \$153 million for the quarter and six months ended June 30, 2000, respectively. Access minutes of use increased 2.7% and 3.7% for the three and six months ended June 30, 2000. Offsetting demand increases were FCC and state mandated rate reductions aggregating \$29 million and \$64 million for the quarter and six months ended June 30, 2000, respectively.

LONG-DISTANCE SERVICES. Long-distance services revenues are derived from customer calls to locations outside of their local calling area but within the same LATA. The decreases in long-distance services revenues for the three and six months ended June 30, 2000 were primarily attributable to greater competition and strategic price reductions resulting in revenue declines of a \$48 million and \$105 million, respectively. Mandated rate reductions of \$9 million and \$19 million for the three and six months ended June 30, 2000 also contributed to the revenue declines.

We believe we will continue to experience further declines in long-distance services revenues as regulatory actions provide for increased levels of competition. We are responding to competition through competitive pricing of intraLATA long-distance services and increased promotional efforts to retain customers. See "Special Note Regarding Forward-Looking Statements" on page 10.

OTHER SERVICES. Other services revenues include billing and collection services for IXCs, collocation services for other competitive local exchange carriers ("CLECs") and sales of customer equipment. The increases for the three and six months ended June 30, 2000 were primarily attributable to increased billing and collection revenues.

OPERATING EXPENSES (in millions)

| | Three Months ended June 30, | | Increase/ (Decrease) | | Six Months Ended June 30, | | Increase/ (Decrease) | |
|------------------------------------|--------------------------------|--------|-------------------------|---------|------------------------------|----------|-------------------------|---------|
| | 2000 | 1999 | | | 2000 | 1999 | | |
| Employee-related expenses..... | \$ 803 | \$ 892 | \$ (89) | (10.0)% | \$ 1,601 | \$ 1,785 | \$ (184) | (10.3)% |
| Other operating expenses..... | 736 | 650 | 86 | 13.2 | 1,513 | 1,274 | 239 | 18.7 |
| Depreciation and amortization..... | 577 | 557 | 20 | 3.6 | 1,141 | 1,142 | (1) | (0.1) |
| Merger-related expenses..... | 116 | - | 116 | 100.0 | 120 | - | 120 | 100.0 |
| Other expense-net..... | 138 | 110 | 28 | 25.4 | 263 | 211 | 52 | 24.6 |

Employee-related expenses. Employee-related expenses include salaries and wages, benefits, payroll taxes and contract labor.

Employee-related expenses decreased primarily due to improvements in benefit-related costs, primarily in our pension plan, mainly attributable to favorable returns on pension plan assets. Pension credits were \$72 million for the second quarter of 2000 compared to \$46 million for the second quarter of 1999. Pension credits were \$141 million for the six months ended June 30, 2000 compared to \$64 million for the comparable 1999 period. Partially offsetting the decreases in expenses was increased employee levels related to growth in several sectors of the business, primarily wireless and data communications. Additionally, increased commitments towards improving customer services, including responding to requests for installation and repair services, resulted in higher labor costs. Across-the-board wage increases also offset the decreases in employee-related expenses.

OTHER OPERATING EXPENSES. Other operating expenses include access charges paid to carriers for the routing of local and long-distance traffic through their facilities, taxes other than income taxes, and other selling, general and administrative costs. The increases in other operating expenses for the three and six months ended June 30, 2000, were primarily attributable to the following:

- o increased costs of product sales associated with our growth initiatives, including wireless handset costs,
- o increased provision for uncollectibles, primarily attributable to increased wireless revenues; and
- o increased rent expense.

Offsetting the increases in other operating expense for the three and six months ended June 30, 2000 was the reduction in access expense related to end-users dialing toll calls using IXCs.

A decrease in property taxes due to adjustments related to 1999 property taxes also partially offset the increase in other operating expenses for the three months ended June 30, 2000.

DEPRECIATION AND AMORTIZATION EXPENSE. The increase in depreciation and amortization expense for the quarter ended June 30, 2000, was primarily attributable to higher overall property, plant and equipment balances resulting from our continued investment in our network. The decline in depreciation and amortization expense for the six months ended June 30, 2000 was attributable to the cessation of depreciation, beginning in April 1999, associated with access lines that were approved to be sold in 1999.

MERGER-RELATED EXPENSES. In connection with the Merger, we incurred several one-time charges that were primarily employee-related. Included in the charges were severance and benefit payments to employees who left the Company upon consummation of the Merger. Additionally, retention bonus payments were made that were subject to consummation of the Merger. We anticipate additional merger-related expenses, including additional severance and retention bonuses, contract terminations and asset impairment charges will be recognized in future quarters. See "Special Note Regarding Forward-Looking Statements" on page 10.

OTHER EXPENSE-NET. Interest expense increased \$27 million and \$57 million for the three and six months ended June 30, 2000, respectively, over the comparable 1999 periods. The increases were due to higher average debt balances to fund growth initiatives.

SEGMENT RESULTS. Segment results represent margins which, for segment reporting purposes, exclude certain costs and expenses, including depreciation and amortization. See Note 2 to the consolidated financial statements.

| (in millions) | Three Months Ended June 30, | | Increase (Decrease) | | Six Months Ended June 30, | | Increase (Decrease) | |
|-------------------------|--------------------------------|-------|------------------------|--------|------------------------------|---------|------------------------|--------|
| | 2000 | 1999 | | | 2000 | 1999 | | |
| Segment margin results: | | | | | | | | |
| Retail services..... | 1,510 | 1,543 | (33) | (2.1)% | 2,978 | 3,047 | (69) | (2.3)% |
| Wholesale services..... | 578 | 526 | 52 | 9.9 | 1,160 | 1,055 | 105 | 10.0 |
| Network services..... | (672) | (699) | 27 | 3.9 | (1,333) | (1,384) | 51 | 3.7 |

Margins from the retail services segment decreased due to increased operating expenses. Revenue from the retail services segment increased 8.4% and 7.8% for the three and six months ended June 30, 2000, respectively over the comparable 1999 periods, primarily due to growth in local services revenues. The revenue increases were offset by higher operating expenses driven by growth initiatives and costs associated with enhancing customer service. Margins from the wholesale services segment increased as a result of greater demand for access and interconnection services, partially offset by price reductions as mandated by both federal and state regulatory

authorities and higher operating costs associated with access charge expenses. Margins from the network services segment increased due to reduced operating expenses.

| (in millions) | Three Months Ended June 30, | | Increase | | Six Months Ended June 30, | | Increase | |
|---------------------------------|--------------------------------|--------|----------|------|------------------------------|--------|----------|------|
| | 2000 | 1999 | | | 2000 | 1999 | | |
| Provision for income taxes..... | \$ 247 | \$ 246 | \$ 1 | 0.4% | \$ 505 | \$ 462 | \$ 43 | 9.3% |

PROVISION FOR INCOME TAXES. The effective tax rate for the three months ended June 30, 2000 of 37.9% decreased from the comparable 1999 rate of 38.9%. The decrease in the effective rate was primarily attributable to a lower composite state tax rate for 2000. The effective tax rate for the six months ended June 30, 2000 of 37.8% was consistent with the six months ended June 30, 1999 rate of 37.9%.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Over time, we are exposed to market risks arising from changes in interest rates. The objective of our interest rate risk management program is to manage the level and volatility of our interest expense. We may employ derivative financial instruments to manage our interest rate risk exposure. We have also employed financial derivatives to hedge interest rate and foreign currency exposures associated with particular debt issues to synthetically obtain below market interest rates. We do not use derivative financial instruments for trading purposes.

As of June 30, 2000 and December 31, 1999, approximately \$692 million and \$218 million, respectively, of floating-rate debt was exposed to changes in interest rates. This exposure is primarily linked to commercial paper rates and changes in 3-month LIBOR. A hypothetical increase

of one percentage point in commercial paper rates would not have had a material effect on our earnings. As of June 30, 2000 and December 31, 1999, we also had \$300 million and \$522 million, respectively, of long-term fixed rate debt obligations maturing in the following 12 months. Any new debt obtained to refinance this debt would be exposed to changes in interest rates. A hypothetical 10% change in the interest rates on this debt would not have had a material effect on our earnings.

As of June 30, 2000 and December 31, 1999, we had also entered into cross-currency swaps with notional amounts of \$133 million. The cross-currency swaps synthetically transform \$92 million and \$94 million of Swiss Franc borrowings at June 30, 2000 and December 31, 1999, respectively, into U.S. dollar obligations. Any gains (losses) on the cross-currency swaps would be offset by losses (gains) on the Swiss Franc debt obligations.

Other assets at December 31, 1999 included marketable equity securities recorded at fair value of \$334 million including net unrealized gains of \$325 million. The securities have exposure

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to price risk. We transferred the marketable securities we held at December 31, 1999 to another wholly owned subsidiary of Qwest.

RECENT REGULATORY DEVELOPMENTS

ACCESS REFORM. In May 2000, the FCC adopted the access reform and universal service proposal developed by the Coalition for Affordable Local and Long Distance Service ("CALLS plan"). The five year plan significantly reduces switched access rates, eliminates the Presubscribed Interexchange Carrier Charge ("PICC") while raising current SLC caps, and establishes a new \$650 million universal fund to replace implicit subsidies in interstate access charges. The CALLS plan is mandatory for the 2000-01 annual price cap tariff filing and carriers that opt out of the voluntary provisions of the CALLS plan will be required to conduct a forward-looking cost study to set their rates. We have appealed the order and asked for a stay of certain provisions. The Federal Communications Commission ("FCC") denied the request for stay.

The access reform order also continued to allow information service providers to avoid access charges. This will continue to negatively impact results of in-region local exchange operations as the volume of information service-related usage continues to increase without an associated increase in revenues.

In 2000, the incumbent local exchange carriers ("ILECs") and WorldCom appealed the February 1999 FCC order declaring Internet traffic to be interstate. The FCC order required current agreements to remain intact for reciprocal compensation with CLECs until it rules on this matter. In March 2000, the U.S. Court of Appeals partially vacated and remanded the order back to the FCC. Until this is resolved, there will remain uncertainty regarding our local exchange business' payment obligation for Internet traffic.

COURT REMAND OF 6.5% PRODUCTIVITY FACTOR. In 1999, the District of Columbia U.S. Court of Appeals issued a ruling reversing and remanding back to the FCC its order requiring ILECs to retroactively increase the productivity offset to price caps to 6.5% in their annual price cap filings. The Court found that the FCC's order did not justify the increase. In December 1999, the FCC issued a notice of proposed rulemaking responding to the issues raised in the Court's remand. As part of adopting CALLS, the FCC noted that the CALLS participants have agreed to waive any right to recoupment they might be entitled to seek if the FCC could not justify the 6.5% productivity factor on remand. We are reviewing this issue and considering our options.

ADVANCED TELECOMMUNICATIONS SERVICES. In March 2000, the District of Columbia U.S. Court of Appeals partially vacated and remanded back to the FCC its order establishing expanded collocation requirements for both conventional voice and advanced services. We also appealed the December 1999 FCC order requiring that line sharing be provided as an unbundled network element ("UNE"). Line sharing allows a CLEC to provide advanced services over the same loop that the ILEC uses to provide analog voice service. Previously, CLECs purchased a separate loop to provision advanced services. In March 2000, we and GTE appealed the FCC's December 1999 order on remand concerning the application of the unbundling requirement to the provision of advanced services.

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INTERLATA LONG-DISTANCE ENTRY. We filed applications to enter the interLATA long-distance business in ten of the states in the U S WEST region and continue to work with the state PUCs in those states to gain approval. We are addressing operational support system issues and have agreed to participate in multistate testing where the states are agreeable. We intend to file entry applications with our remaining state PUCs by the end of the first quarter of 2001 with FCC filings following favorable state action. See "Special Note Regarding Forward-Looking Statements" on page 10.

NUMBER POOLING. In March 2000, the FCC issued an order substantially changing the way telephone numbers are allocated among carriers in order to avoid the premature exhaustion of telephone numbers in North America. This new approach must be in place by mid-2001 in our region and will require significant modifications to operational support systems and switch software with costs exceeding \$345 million. The FCC has issued a further notice of proposed rulemaking to determine how ILECs may recover these costs in a competitively neutral way.

CONTINGENCIES

We have pending regulatory actions in local regulatory jurisdictions. See Note 3 to the condensed consolidated financial statements.

NEW ACCOUNTING STANDARDS

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards ("FAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities." This statement establishes accounting and reporting standards for derivative instruments and for hedging activities. FAS No. 133 requires, among other things, that all derivative instruments be recognized at fair value as assets or liabilities in the consolidated balance sheets and changes in fair value generally be recognized currently in earnings unless specific hedge accounting criteria are met. This standard is effective for our 2001 fiscal year, although earlier adoption is permitted. Financial statement impacts of adopting the new standard depend upon the amount and nature of the future use of derivative instruments and their relative changes in valuation over time. Had we adopted FAS No. 133 in 2000, its impact on the consolidated financial statements would not have been material.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101 (the "Bulletin"), "Revenue Recognition in Financial Statements," which addresses revenue recognition issues. The Bulletin requires, in certain cases, nonrefundable up-front fees for services to be deferred and recognized over the expected period of performance. The Bulletin also requires that incremental direct costs incurred in obtaining the up-front fees be deferred and recognized over the same period as the up-front fees. The implementation of the Bulletin has been delayed until the fourth quarter of 2000 for fiscal years beginning after December 15, 1999. The application of this Bulletin will be retroactive to January 1, 2000. We are assessing the types of transactions that may be impacted by this pronouncement. The impact of the Bulletin on the consolidated financial statements is not yet known.

PART II - OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

The Company and its subsidiaries are subject to claims and proceedings arising in the ordinary course of business. For a discussion of these actions, see Note 3: "Commitments and Contingencies" - to the condensed consolidated financial statements.

Item 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) EXHIBITS

Exhibit No.

- | | |
|-------|--|
| (2.1) | Articles of Merger including the Plan of Merger between The Mountain States Telephone and Telegraph Company (renamed U S WEST Communications, Inc.) and Northwestern Bell Telephone Company (incorporated herein by this reference to Exhibit 2a to Form SE filed on January 8, 1991, File No. 1-3040). |
| (2.2) | Articles of Merger including the Plan of Merger between The Mountain States Telephone and Telegraph Company (renamed U S WEST Communications, Inc.) and Pacific Northwest Bell Telephone Company (incorporated herein by this reference to Exhibit 2b to Form SE filed on January 8, 1991, File No. 1-3040). |
| 3.1 | Amended Articles of Incorporation of the Registrant filed with the Secretary of State of Colorado on July 6, 2000, evidencing change of Registrant's name from U S WEST Communications, Inc. to Qwest Corporation. |
| (3.2) | Restated Articles of Incorporation of the Registrant (incorporated herein by this reference to Exhibit 3a to Form 10-K/A filed on April 13, 1998, File No. 1-3040). |
| (3.3) | Bylaws of the Registrant, as amended incorporated herein by this reference to Exhibit 3b to Form 10-K/A filed on April 13, 1998, File No. 1-3040). |
| 4.1 | No instrument which defines the rights of holders of long and intermediate term debt of the Registrant is filed herewith pursuant to Regulation S-K, Item 601(b) (4) (iii) (A). Pursuant to this regulation, the Registrant hereby agrees to furnish a copy of any such instrument to the SEC upon request. |
| (4.2) | Registration Rights Agreement, dated October 26, 1999, between U S WEST Communications, Inc. and the initial purchasers named |

Exhibit No.

- (4.3) Indenture, dated as of October 15, 1999, by and between U S WEST Communications, Inc. and Bank One Trust Company, NA as Trustee (Exhibit 4b to Form 10-K for the period ended December 31, 1999, File No. 1-3040). The form or forms of debt securities with respect to each particular series of debt securities registered hereunder will be filed as an exhibit to a Current Report on Form 8-K of U S WEST Communications, Inc. and incorporated herein by reference.
- (10.1) Reorganization and Divestiture Agreement, dated as of November 1, 1983, between American Telephone and Telegraph Company, U S WEST, Inc., and certain of their affiliated companies, including The Mountain States Telephone and Telegraph Company, Northwestern Bell Telephone Company, Pacific Northwest Bell Telephone Company and NewVector Communications, Inc. (Exhibit 10a to Form 10-K for the period ended December 31, 1983, File No. 1-3040).
- (10.2) Shared Network Facilities Agreement, dated as of January 1, 1984, between American Telephone and Telegraph Company, AT&T Communications of the Midwest, Inc. and The Mountain States Telephone and Telegraph Company. (Exhibit 10b to Form 10-K for the period ended December 31, 1983, File No. 1-3040).
- (10.3) Agreement Concerning Termination of the Standard Supply Contract, effective December 31, 1983, between American Telephone and Telegraph Company, Western Electric Company, Incorporated, The Mountain States Telephone and Telegraph Company and Central Services Organization (Exhibit 10d to Form 10-K for the period ended December 31, 1983, File No. 1-3040).
- (10.4) Agreement Concerning Certain Centrally Developed Computer Systems, effective December 31, 1983, between American Telephone and Telegraph Company, Western Electric Company, Incorporated, The Mountain States Telephone and Telegraph Company and Central Services Organization (Exhibit 10e to Form 10-K for the period ended December 31, 1983, File No. 1-3040).
- (10.5) Agreement Concerning Patents, Technical Information and Copy-rights, effective December 31, 1983, between American Telephone and Telegraph Company and U S WEST, Inc. (Exhibit 10f to Form 10-K for the period ended December 31, 1983, File No. 1-3040).

Exhibit No.

- (10.6) Agreement Concerning Liabilities, Tax Matters and Termination of Certain Agreements, dated as of November 1, 1983, between American Telephone and Telegraph Company, U S WEST, Inc., The Mountain States Telephone and Telegraph Company and certain of their affiliates (Exhibit 10g to Form 10-K for the period ended December 31, 1983, File No. 1-3040).
- (10.7) Agreement Concerning Trademarks, Trade Names and Service Marks, effective December 31, 1983, between American Telephone and Telegraph Company, American Information Technologies Corporation, Bell Atlantic Corporation, BellSouth Corporation, Cincinnati Bell, Inc., NYNEX Corporation, Pacific Telesis Group, The Southern New England Telephone Company, Southwestern Bell Corporation and U S WEST, Inc. (Exhibit 10i to Form 10-K for the period ended December 31, 1984, File No. 1-3040).
- (10.8) Shareholders' Agreement, dated as of January 1, 1988, between Ameritech Services, Inc., Bell Atlantic Management Services, Inc., BellSouth Services, Incorporated, NYNEX Service Company, Pacific Bell, Southwestern Bell Telephone Company, The Mountain States Telephone and Telegraph Company, Northwestern Bell Telephone Company and Pacific Northwest Bell Telephone Company (Exhibit 10h to Form SE dated March 5, 1992, File No. 1-3040).
- (10.9) Form of Agreement for Purchase and Sale of Telephone Exchanges,

dated as of June 16, 1999, between Citizens Utilities Company and U S WEST Communications, Inc. (Exhibit 99-B to Form 8-K dated June 17, 1999, File No. 1-3040).

- (10.10) 364-Day \$800 Million Credit Agreement dated May 19, 1999, with the banks listed therein and Morgan Guaranty Trust Company of New York, as administrative agent. (Exhibit 10-J to Form 10-Q for the period ended June 30, 1999, File No. 1-3040).
- (10.11) Amendment No. 1 to Credit Agreement, dated as of June 11, 1999, to the 364-Day \$800 Million Credit Agreement, dated as of May 19, 1999, among the Company, U S WEST, Inc., the banks listed therein and Morgan Guaranty Trust Company of New York, as administrative agent. (Exhibit 10-K to Form 10-Q for the period ended June 30, 1999, File No. 1-3040).
- (10.12) 364-Day \$4.0 Billion Credit Agreement dated as of May 5, 2000, among U S WEST Capital Funding, Inc., the Company and U S WEST, Inc., the banks listed therein, and Morgan Guaranty Trust Company of New York, as administrative agent (Exhibit 10-L to Form 10-Q for the period ended March 31, 2000, File No. 1-3040).

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Exhibit No.

27 Financial Data Schedule

() Previously filed.

(b) Reports on Form 8-K filed during the second quarter of 2000 and through the filing of this Form 10-Q.

(i) Form 8-K, dated April 28, 2000, providing notification of the release of the first quarter 2000 earnings of the Company.

(ii) Form 8-K, dated April 28, 2000, providing notification of a press release announcing that the Company had extended its exchange offer for \$750 billion of 7.20% Notes due November 1, 2004.

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SIGNATURES

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

Qwest Corporation

/s/ ROBERT S. WOODRUFF
By: _____
Robert S. Woodruff
Executive Vice President - Finance and
Chief Financial Officer

August 11, 2000

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Mail to: Secretary of State

For office use only

Corporations Section
1560 Broadway, Suite 200
Denver, CO 80202
(303) 894-2251
Fax (303) 894-2242

MUST BE TYPED
FILING FEE: \$25.00
MUST SUBMIT TWO COPIES

ARTICLES OF AMENDMENT
TO THE

Please include a typed

self-addressed envelope ARTICLES OF INCORPORATION

Pursuant to the provisions of the Colorado Business Corporation Act, the undersigned corporation adopts the following Articles of Amendment to its Articles of Incorporation:

FIRST: The name of the corporation is U S WEST Communications, Inc.

SECOND: The following amendment to the Articles of Incorporation was adopted on June 30, 2000, as prescribed by the Colorado Business Corporation Act, in the manner marked with an X below:

No shares have been issued or Directors Elected - Action by Incorporators

No shares have been issued but Directors Elected - Action by Directors

Such amendment was adopted by the board of directors where shares have been issued and shareholder action was not required.

X Such amendment was adopted by a vote of the shareholders. The number of shares voted for the amendment was sufficient for approval.

THIRD: If changing corporate name, the new name of the corporation is Qwest Corporation

FOURTH: The manner, if not set forth in such amendment, in which any exchange, reclassification, or cancellation of issued shares provided for in the amendment shall be effected, is as follows:

If these amendments are to have a delayed effective date, please list that date:
June 30, 2000 (Not to exceed ninety (90) days from the date of filing)

U S WEST Communications, Inc.

/s/ Yash A. Rana
Signature -----
Title Yash A. Rana, Assistant Secretary

ARTICLE 5

Financial Data Schedule

CIK: 0000068622

NAME: QWEST CORPORATION

MULTIPLIER: 1,000,000

| PERIOD TYPE | 6 MOS | 3 MOS |
|----------------------------|-------------|-------------|
| FISCAL YEAR END | DEC 31 2000 | DEC 31 2000 |
| PERIOD START | JAN 01 2000 | APR 01 2000 |
| PERIOD END | JUN 30 2000 | JUN 30 2000 |
| CASH | 241 | 241 |
| SECURITIES | 0 | 0 |
| RECEIVABLES | 1,902 | 1,902 |
| ALLOWANCES | 0 | 0 |
| INVENTORY | 210 | 210 |
| CURRENT ASSETS | 2,661 | 2,661 |
| PP&E | 38,823 | 38,823 |
| DEPRECIATION | 21,595 | 21,595 |
| TOTAL ASSETS | 21,618 | 21,618 |
| CURRENT LIABILITIES | 6,040 | 6,040 |
| BONDS | 0 | 0 |
| PREFERRED MANDATORY | 0 | 0 |
| PREFERRED | 0 | 0 |
| COMMON | 8,139 | 8,139 |
| OTHER SE | (3,632) | (3,632) |
| TOTAL LIABILITY AND EQUITY | 4,507 | 4,507 |
| SALES | 5,973 | 3,022 |
| TOTAL REVENUES | 5,973 | 3,022 |
| CGS | 0 | 0 |
| TOTAL COSTS | 0 | 0 |
| OTHER EXPENSES | 4,375 | 2,232 |
| LOSS PROVISION | 0 | 0 |
| INTEREST EXPENSE | 244 | 125 |
| INCOME PRETAX | 1,335 | 652 |
| INCOME TAX | 505 | 247 |
| INCOME CONTINUING | 830 | 405 |
| DISCONTINUED | 0 | 0 |
| EXTRAORDINARY | 0 | 0 |
| CHANGES | 0 | 0 |
| NET INCOME | 830 | 405 |
| EPS BASIC | 0 | 0 |
| EPS DILUTED | 0 | 0 |

End of Filing

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