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

FORM 10-Q

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

For the quarterly period ended September 30, 2006

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)

N/A
(Former name, former address and former fiscal year, if changed since last report)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☒

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

On October 30, 2006, one share of Qwest Corporation common stock was outstanding.

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GLOSSARY OF TERMS

Our industry uses many terms and acronyms that may not be familiar to you. To assist you in reading this document, 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. When we refer to our access lines we mean all our mass markets, wholesale and business access lines, including those used by us and our affiliates.
- *Asynchronous Transfer Mode (ATM)*. A broadband, network transport service utilizing data switches that provides a fast, efficient way to move large quantities of information.
- *Competitive Local Exchange Carriers (CLECs)*. Telecommunications providers that compete with us in providing local voice services in our local service area.
- *Data Integration*. Voice and data telecommunications customer premises equipment (CPE) and associated professional services, including network management, the installation and maintenance of data equipment and the building of proprietary fiber-optic broadband networks, for our governmental and business customers.
- *Frame Relay*. A high speed data switching technology primarily used to interconnect multiple local networks.
- *Incumbent Local Exchange Carrier (ILEC)*. A traditional telecommunications provider, such as Qwest Corporation, that, prior to the Telecommunications Act of 1996, had the exclusive right and responsibility for providing local telecommunications services in its local service area.
- *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.
- *Interexchange Carriers (IXCs)*. Telecommunications providers that provide long-distance services to end-users by handling calls that extend beyond a customer's local exchange service area.
- *InterLATA long-distance services*. Telecommunications services, including "800" services, that cross LATA boundaries.
- *Internet Dial Access*. Provides ISPs and business customers with a comprehensive, reliable and cost-effective dial-up network infrastructure.
- *Internet Protocol (IP)*. Those protocols that facilitate transferring information in packets of data and that enable each packet in a transmission to "tell" the data switches it encounters where it is headed and enables the computers on each end to confirm that message has been accurately transmitted and received.
- *Internet Service Providers (ISPs)*. Businesses that provide Internet access to retail customers.
- *IntraLATA long-distance services*. These services include calls that terminate outside a caller's local calling area but within their LATA, including wide area telecommunications service or "800" services for customers with geographically highly concentrated demand.
- *Local Access Transport Area (LATA)*. A geographical area associated with the provision of telecommunications services by local exchange and long distance carriers. There are 163 LATAs in the United States, of which 27 are in our 14 state local service area.
- *Local Calling Area*. A geographical area, usually smaller than a LATA, within which a customer can make telephone calls without incurring long-distance charges. Multiple local calling areas generally make up a LATA.
- *Private Lines*. Direct circuits or channels specifically dedicated to the use of an end-user organization for the purpose of directly connecting two or more sites.

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- *Public Switched Telephone Network (PSTN)*. The worldwide voice telephone network that is accessible to every person with a telephone equipped with dial tone.
- *Unbundled Network Elements (UNEs)*. Discrete elements of our network that are sold or leased to competitive telecommunications providers and that may be combined to provide their retail telecommunications services.
- *Virtual Private Network (VPN)*. A private network that operates securely within a public network (such as the Internet) by means of encrypting transmissions.
- *Voice over Internet Protocol (VoIP)*. An application that provides real-time, two-way voice capability originating in the Internet protocol over a broadband connection.
- *Web Hosting*. The providing of space, power and bandwidth in data centers for hosting of customers' Internet equipment as well as related services.
- *Wide Area Network (WAN)*. A communications network that covers a wide geographic area, such as a state or country. A WAN typically extends a local area network outside the building, over telephone common carrier lines to link to other local area networks in remote locations, such as branch offices or at-home workers and telecommuters.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

QWEST CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
	(Dollars in millions)			
Operating revenue:				
Operating revenue	\$ 2,220	\$ 2,219	\$ 6,682	\$ 6,749
Operating revenue—affiliates	256	251	732	814
Total operating revenue	<u>2,476</u>	<u>2,470</u>	<u>7,414</u>	<u>7,563</u>
Operating expenses:				
Cost of sales (exclusive of depreciation and amortization)	535	554	1,578	1,611
Cost of sales—affiliates	60	56	169	174
Selling, general and administrative	447	433	1,333	1,309
Selling, general and administrative—affiliates	257	274	796	829
Depreciation	525	587	1,573	1,744
Capitalized software amortization	64	79	204	255
Total operating expenses	<u>1,888</u>	<u>1,983</u>	<u>5,653</u>	<u>5,922</u>
Other expense (income)—net:				
Interest expense—net	154	155	463	455
Loss on early retirement of debt—net	9	—	9	37
Other—net	(4)	(8)	(8)	(15)
Total other expense (income)—net	<u>159</u>	<u>147</u>	<u>464</u>	<u>477</u>
Income before income taxes	429	340	1,297	1,164
Income tax expense	<u>(152)</u>	<u>(130)</u>	<u>(473)</u>	<u>(442)</u>
Net income	<u>\$ 277</u>	<u>\$ 210</u>	<u>\$ 824</u>	<u>\$ 722</u>

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

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QWEST CORPORATION CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	September 30,	December 31,
	2006	2005
	(Dollars in millions)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 235	\$ 160
Short-term investments	42	8
Accounts receivable (less allowance of \$56 and \$66, respectively)	1,007	1,019
Accounts receivable—affiliates	165	127
Deferred income taxes	115	98
Prepaid expenses and other current assets	219	218
Total current assets	1,783	1,630
Property, plant and equipment—net	13,270	14,037
Capitalized software—net	456	594
Prepaid pension asset	977	1,013
Other assets	267	297
Total assets	\$ 16,753	\$ 17,571
LIABILITIES AND STOCKHOLDER'S EQUITY		
Current liabilities:		
Current borrowings	\$ 71	\$ 1
Accounts payable	446	454
Accounts payable-affiliates	541	609
Dividends payable—QSC	205	126
Accrued expenses and other current liabilities	669	685
Deferred revenue and advance billings	470	492
Total current liabilities	2,402	2,367
Long-term borrowings (net of unamortized debt discount of \$127 and \$129, respectively)	7,610	7,664
Post-retirement and other post-employment benefit obligations	2,827	2,851
Deferred revenue	182	193
Deferred income taxes	1,661	1,881
Other long-term liabilities	270	279
Total liabilities	14,952	15,235
Commitments and contingencies (Note 5)		
Stockholder's equity:		
Common stock—one share without par value, owned by QSC	10,197	10,157
Accumulated deficit	(8,396)	(7,821)
Total stockholder's equity	1,801	2,336
Total liabilities and stockholder's equity	\$ 16,753	\$ 17,571

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

QWEST CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Nine Months Ended September 30,	
	2006	2005
	(Dollars in millions)	
Operating activities:		
Net income	\$ 824	\$ 722
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,777	1,999
Provision for bad debts—net	50	53
Deferred income taxes	(241)	(159)
Loss on early retirement of debt—net	9	37
Other non-cash charges—net	12	15
Changes in operating assets and liabilities:		
Accounts receivable	(38)	(56)
Accounts receivable—affiliates	(38)	28
Prepaid expenses and other current assets	30	35
Accounts payable and accrued expenses and other current liabilities	4	(64)
Accounts payable—affiliates	(70)	(79)
Deferred revenue and advance billings	(33)	(52)
Other non-current assets and liabilities	44	33
Cash provided by operating activities	<u>2,330</u>	<u>2,512</u>
Investing activities:		
Expenditures for property and equipment and intangible assets (net of tax refund of \$33 million in 2005)	(916)	(854)
Interest in net proceeds from investments managed by QSC	(34)	148
Proceeds from sale of property and equipment	43	—
Other	5	16
Cash used for investing activities	<u>(902)</u>	<u>(690)</u>
Financing activities:		
Proceeds from long-term borrowings	600	1,150
Repayments of long-term borrowings, including current maturities	(590)	(1,134)
Dividends paid to QSC	(1,321)	(1,820)
Other	(42)	(43)
Cash used for financing activities	<u>(1,353)</u>	<u>(1,847)</u>
Cash and cash equivalents:		
Increase (decrease) in cash and cash equivalents	75	(25)
Beginning balance	160	342
Ending balance	<u>\$ 235</u>	<u>\$ 317</u>

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

QWEST CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2006
(UNAUDITED)

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

Note 1: Basis of Presentation

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

In the opinion of management, these statements include all the adjustments necessary to fairly present our condensed consolidated results of operations, financial position and cash flows as of September 30, 2006 and for all periods presented. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in our annual report on Form 10-K for the year ended December 31, 2005 (the “2005 Form 10-K”). The condensed consolidated results of operations for the three and nine months ended September 30, 2006 and the condensed consolidated statement of cash flows for the nine months ended September 30, 2006 are not necessarily indicative of the results or cash flows expected for the full year or of the results we would have incurred had we operated as a stand-alone entity during the periods presented.

Certain prior period balances have been reclassified to conform to the current presentation.

Use of Estimates

Our condensed consolidated financial statements are prepared in accordance with GAAP. These accounting principles require us to make certain estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions made when accounting for items and matters such as, but not limited to, long-term contracts, customer retention patterns, allowance for bad debts, depreciation, amortization, asset valuations, internal labor capitalization rates, recoverability of assets, impairment assessments, employee benefits, taxes, reserves and other provisions and contingencies are reasonable, based on information available at the time they are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the condensed consolidated financial statements, as well as the reported amounts of revenue and expenses during the periods presented. We also assess potential losses in relation to threatened or pending legal matters and, if a loss is considered probable and the amount can be reasonably estimated, we recognize an expense for the estimated loss. Actual results could differ from these estimates. See Note 5—Commitments and Contingencies.

Allocations from Affiliates

We purchase services from our affiliates. These services include marketing and advertising, information technology, product and technical services as well as general support services. Our affiliates charge us for these services based on market price or fully distributed cost (“FDC”). Most services are priced by applying an FDC methodology. FDC rates are determined using salary rates, which include factors for payroll taxes, employee benefits, facilities and overhead costs. Whenever possible, costs are directly assigned to us for the services we

QWEST CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2006
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use. If costs cannot be directly assigned, they are allocated among all affiliates, including QC, based upon cost usage measures; or if no cost usage measure is available, these costs are allocated based on a general allocator. From time to time, QCII adjusts the basis for allocating the costs of a shared service among affiliates. Such changes in allocation methodologies are generally billed prospectively.

Depreciation and Amortization

Property, plant and equipment are shown net of accumulated depreciation on our condensed consolidated balance sheets. As of September 30, 2006 and December 31, 2005, accumulated depreciation was \$30.4 billion and \$29.3 billion, respectively.

Capitalized software is shown net of accumulated amortization on our condensed consolidated balance sheets. Accumulated amortization was \$1.1 billion and \$861 million as of September 30, 2006 and December 31, 2005, respectively.

Recently Adopted Accounting Pronouncements

In May 2005, the Financial Accounting Standards Board (“FASB”), as part of an effort to conform to international accounting standards, issued Statement of Financial Accounting Standards (“SFAS”) No. 154, “Accounting Changes and Error Corrections” (“SFAS No. 154”), which was effective for us beginning on January 1, 2006. SFAS No. 154 requires that all voluntary changes in accounting principles be retrospectively applied to prior financial statements as if that principle had always been used, unless it is impracticable to do so. When it is impracticable to calculate the effects on all prior periods, SFAS No. 154 requires that the new principle be applied to the earliest period practicable. The adoption of SFAS No. 154 has not had a material effect on our financial position or results of operations.

Effective January 1, 2006, we adopted SFAS No. 123(R), “Share-Based Payment” (“SFAS No. 123(R)”), which revises SFAS No. 123, “Accounting for Stock-Based Compensation.” See Note 2 for additional information on this recently adopted accounting pronouncement.

Recently Issued Accounting Pronouncements

In July 2006, the FASB issued FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes” (“FIN 48”), which is effective for us beginning on January 1, 2007. The validity of any tax position is a matter of tax law, and generally there is no controversy about recognizing the benefit of a tax position in a company’s financial statements when the degree of confidence is high that the tax position will be sustained upon examination by a taxing authority. However, in some cases, the law is subject to varied interpretation, and whether a tax position will ultimately be sustained may be uncertain. For us, FIN 48 establishes a different process to measure the impact of uncertainty associated with the income tax provision than we are currently using. Under FIN 48, the impact of an uncertain income tax position on the income tax provision must be recognized at the largest amount that is more likely than not to be sustained upon audit by the relevant taxing authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained. FIN 48 also requires additional disclosures about unrecognized tax benefits associated with uncertain income tax positions and a reconciliation of the change in the unrecognized benefit. We currently recognize an uncertain income tax position related to the timing of recognition if we are more likely than not to prevail. For uncertain income tax positions not related to timing of recognition, we recognize the position if it is probable that

QWEST CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
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we will prevail. We are evaluating the impact of FIN 48 on our financial statements. The standard establishes a lower threshold for recognizing the benefit of some uncertain tax positions than we have historically used. Therefore, the adoption could have a significant impact on our financial statements.

In September 2006, the Securities and Exchange Commission (“SEC”) issued Staff Accounting Bulletin No. 108, “Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements” (“SAB 108”), which is effective for us beginning with our fiscal year ending on December 31, 2006. Additionally, in September 2006, the FASB issued SFAS No. 157, “Fair Value Measurements,” which is effective for us beginning January 1, 2008 and provides a definition of fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements for future transactions. We do not expect the adoption of these pronouncements to have an impact on our financial statements.

Also in September 2006, the FASB issued SFAS No. 158, “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans—An amendment of FASB Statements No. 87, 88, 106, and 132(R)” (“SFAS No. 158”). SFAS No. 158 represents the first phase of the FASB’s two phase project to reconsider defined benefit pension and other postretirement plan accounting. SFAS No. 158 requires recognition of the over-funded or under-funded status of a defined benefit postretirement plan as an asset or liability in a company’s statement of financial position and requires a company to recognize changes in that funded status in comprehensive income in the year in which the changes occur. SFAS No 158 also requires measurement of the funded status of a plan as of the date of its year-end statement of financial position. Phase two will be a comprehensive examination of accounting for defined benefit pension and other postretirement plans and may reconsider the guidance of SFAS No. 158.

The guidance of SFAS No. 158 is effective for us in two steps. Step one is effective for us beginning with our fiscal year ending on December 31, 2006 and requires us to recognize on our consolidated balance sheet the over-funded or under-funded amount of our defined benefit postretirement plans. This amount is defined as the difference between the fair value of plan assets and the benefit obligation. We are also required to recognize as a component of other comprehensive income, net of tax, the actuarial gains and losses and the prior service costs and credits that arise but are not currently required to be recognized as components of net periodic benefit cost. Other comprehensive income is then adjusted as these amounts are later recognized into income as components of net periodic benefit cost. The adoption of step one requires us to record on our consolidated balance sheet increases in post-retirement and other post-employment benefit obligations and increases in accumulated other comprehensive loss. The adoption of step one could have a significant impact on our financial statements. Step two is effective for us beginning with our fiscal year ending on December 31, 2008 and requires us to disclose in the notes to our financial statements additional information about the expected effects on net periodic benefit cost of delayed recognition of the actuarial gains and losses and the prior service costs and credits. It also requires disclosure of information about any transition asset or obligation remaining from the application of pre-existing rules and requires a year end measurement date. We currently use December 31 as the measurement date of the funded status of our plans, which is the same date as our year end consolidated balance sheet. We do not expect the adoption of step two to have an impact on our financial statements.

Note 2: Stock-Based Compensation

Effective January 1, 2006, we adopted SFAS No. 123(R). Prior to 2006, we accounted for awards of QCII stock granted to our employees under the intrinsic-value recognition and measurement principles of Accounting

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
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Principles Board Opinion No. 25, “Accounting for Stock Issued to Employees” (“APB No. 25”). However, SFAS No. 123(R) requires that compensation expense be measured using estimates of the fair value of all stock-based awards and applies to new awards and to awards modified, repurchased, or cancelled after December 31, 2005, as well as to the unvested portion of awards outstanding as of January 1, 2006.

We are applying the “modified prospective method” for recognizing the expense over the remaining vesting period for awards that were outstanding but unvested at January 1, 2006. Under the modified prospective method, we have not adjusted the financial statements for periods ended prior to December 31, 2005. Compensation cost arising from stock-based awards granted to our employees is recognized as expense using the straight-line method over the vesting period and is included in the cost of sales and selling, general and administrative expense in our condensed consolidated statements of operations. The total compensation cost for awards of QCII stock granted to our employees was less than \$1 million for the three and nine months ended September 30, 2006. Because we purchase a significant amount of services from our parent, the direct stock-based compensation costs recorded by us for stock-based awards granted to our employees are not necessarily indicative of the costs we would have incurred had we operated as a stand-alone entity during the periods presented.

The following table illustrates the effect on net income for the three and nine months ended September 30, 2005 as if compensation costs arising from stock-based awards of QCII stock granted to our employees had been determined based on the fair value at the grant dates:

	September 30, 2005	
	Three Months	Nine Months
	Ended	Ended
	(Dollars in millions)	
Net income:		
As reported	\$ 210	\$ 722
Deduct: Total stock-based employee compensation expense determined under the fair-value-based method for all awards, net of related tax effects of \$26 and \$33, respectively	(42)	(54)
Pro forma net income	<u>\$ 168</u>	<u>\$ 668</u>

Our direct parent also adopted SFAS No. 123(R) on January 1, 2006, and as a result of its increased costs, it increased its billings to us during the three and nine months ended September 30, 2006 by approximately \$3 and \$10 million, respectively. These costs are not directly assigned, but are billed to us based on a general allocator and are included in the selling, general and administrative—affiliates expense line in our condensed consolidated statements of operations. As of September 30, 2006, QCII had \$56 million of total unrecognized compensation cost related to unvested stock-based awards, which it will recognize over the remaining weighted average vesting terms of 2.8 years, and because our direct parent will continue to record such stock-based compensation, it will continue to bill a portion of such costs to us. However, based on the many factors that affect the allocation, the amount that is ultimately billed to us as a result of stock-based compensation recorded at our direct parent may fluctuate.

QWEST CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2006
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Note 3: Borrowings

As of September 30, 2006 and December 31, 2005, our borrowings, net of discounts and premiums, consisted of the following:

	September 30, 2006	December 31, 2005
	(Dollars in millions)	
Current borrowings:		
Current portion of long-term borrowings	\$ 70	\$ —
Current portion of capital lease obligations	1	1
Total current borrowings	<u>\$ 71</u>	<u>\$ 1</u>
Long-term borrowings:		
Long-term notes	\$ 7,602	\$ 7,660
Long-term capital lease obligations	8	4
Total long-term borrowings	<u>\$ 7,610</u>	<u>\$ 7,664</u>

On August 8, 2006, we issued \$600 million aggregate principal amount of our 7.5% Notes due 2014. The notes are unsecured obligations and rank equally in right of payment with all of our other unsecured and unsubordinated indebtedness. The covenant and default terms are substantially the same as those associated with our other long-term debt. We plan to file an exchange offer registration statement with the SEC for a new issue of substantially identical notes registered under the Securities Act of 1933, as amended, within 315 calendar days of the date of issuance of the notes. If we fail to file this registration statement or fail to satisfy other obligations under the registration rights agreement relating to the notes, we will be required to pay additional interest on the notes at a rate of 25 basis points per year. The net proceeds of approximately \$592 million have been or will be used for general corporate purposes, including repayment of indebtedness and funding and refinancing investments in our telecommunications assets. Concurrent with the issuance of the notes, we called the remaining \$500 million aggregate principal amount of our floating rate term loan maturing in June 2007, plus accrued interest of \$3 million. The prepayment resulted in a loss on early retirement of debt of \$9 million.

On September 21, 2006, we also redeemed the remaining \$90 million aggregate principal amount of our 39-year 6.25% debentures due January 1, 2007 at face value plus accrued interest of \$1 million.

Note 4: Contribution to QCII Segments

Our operations are integrated into and are part of the segments of the QCII consolidated group. The chief operating decision maker (“CODM”) for us is the same as that for the consolidated group. The CODM makes resource allocation decisions and assessments of financial performance for the consolidated group based on wireline services, wireless services and other segmentation. Our business contributes to the segments reported by QCII, but the QCII 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.

QWEST CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2006
(UNAUDITED)

Revenue derived from external customers for the three and nine months ended September 30, 2006 and 2005 is summarized in the following table:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
	(Dollars in millions)			
Voice services	\$ 1,556	\$ 1,668	\$4,764	\$5,098
Data and Internet services	659	545	1,903	1,638
Other services	5	6	15	13
Total operating revenue	<u>\$ 2,220</u>	<u>\$ 2,219</u>	<u>\$6,682</u>	<u>\$6,749</u>

Voice services. Voice services revenue includes local voice, IntraLATA long-distance voice and access services. Local voice services revenue includes basic local exchange, switching, enhanced voice, operator and collocation services and custom calling features. Local voice services revenue also includes the provisioning of network transport, billing services and access to our local network on a wholesale basis. IntraLATA long-distance voice services revenue includes IntraLATA long-distance services within our local service area. Access services revenue includes fees charged to other data and telecommunications providers to connect their customers and their networks to our network.

Data and Internet services. Data and Internet services revenue includes data services (such as traditional private lines, wholesale private lines, and WAN) and Internet services (such as high-speed Internet and ISDN).

Other services. Other services revenue is predominantly derived from the sublease of some of our real estate, such as space in our office buildings, warehouses and other properties.

Affiliate services revenue is derived from telecommunications and other services provided to our affiliated entities. In addition to voice services, data and Internet services and other services, we provide to our affiliates sales and marketing services relating to our affiliates' products and services and other miscellaneous services, including billing and collection services.

Depending on the products or services purchased, a customer may pay an up-front or monthly fee, a usage charge or a combination of these.

While revenue from affiliates provided approximately ten percent of our total operating revenue, we do not have any single customer that provides more than ten percent of our total revenue derived from external customers.

Note 5: Commitments and Contingencies

QCII is involved in several legal proceedings to which we are not a party that, if resolved against QCII, could have a material adverse effect on our business and financial condition. We have included below a discussion of these matters, together with a discussion of those matters to which we are a party (primarily the matter discussed below under the heading "Regulatory Matter" and the matter discussed below under the heading "DOJ Investigation and Remaining Securities Actions – Other"). Only those matters to which we are a party represent contingencies for which we have recorded, or could reasonably anticipate recording, an accrual if appropriate to do so.

QWEST CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
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Throughout this note, when we refer to a class action as “putative” it is because a class has been alleged, but not certified in that matter. Until and unless a class has been certified by the court, it has not been established that the named plaintiffs represent the class of plaintiffs they purport to represent.

Settlement of Consolidated Securities Action

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

On November 23, 2005, QCII, certain other defendants, and the putative class representatives entered into and filed with the federal district court in Colorado a Stipulation of Partial Settlement that, if implemented, will settle the consolidated securities action against QCII and certain other defendants. In September 2006, the federal district court in Colorado issued an order approving the proposed settlement on behalf of purchasers of QCII’s publicly traded securities between May 24, 1999 and July 28, 2002. The order is subject to appeal.

Under the settlement, QCII will pay a total of \$400 million in cash—\$100 million of which was deposited into an escrow account in the first quarter of 2006, \$100 million of which was deposited on October 27, 2006, and \$200 million of which will be deposited on January 15, 2007, plus interest on the \$200 million at 3.75% per year for the period from October 29, 2006 through January 14, 2007.

The settlement resolves and releases the individual claims of the class representatives and the claims of the class they represent against QCII and all defendants except Joseph Nacchio, QCII’s former chief executive officer, and Robert Woodruff, QCII’s former chief financial officer. As part of the settlement, QCII received \$10 million from Arthur Andersen LLP, which is also being released by the class representatives and the class they represent. If the settlement is not ultimately effected, QCII will repay the \$10 million to Arthur Andersen. No parties admit any wrongdoing as part of the settlement.

As noted below under “Remaining Securities Actions,” a number of persons, including large pension funds, were excluded from the settlement class at their request. Some of these pension funds have filed individual suits against QCII. QCII will vigorously defend against such claims.

Settlement of Consolidated ERISA Action

Seven putative class actions purportedly brought against QCII on behalf of all participants and beneficiaries of the Qwest Savings and Investment Plan and predecessor plans, or the Plan, from March 7, 1999 until January 12, 2004 have been consolidated into a consolidated action in federal district court in Colorado. Other defendants in this action include current and former directors of QCII, former officers and employees of QCII and Deutsche Bank Trust Company Americas, or Deutsche Bank (formerly doing business as Bankers Trust Company). These suits also purport to seek relief on behalf of the Plan. The first of these actions was filed in March 2002. Plaintiffs assert breach of fiduciary duty claims against QCII and others under the Employee

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Retirement Income Security Act of 1974, as amended, alleging, among other things, various improprieties in managing holdings of QCII stock in the Plan. Plaintiffs seek damages, equitable and declaratory relief, along with attorneys' fees and costs and restitution. Counsel for plaintiffs indicated that the putative class would seek billions of dollars of damages.

On April 26, 2006, QCII, the other defendants, and the putative class representatives entered into a Stipulation of Settlement that, if implemented, will settle the consolidated ERISA action. QCII has deposited \$33 million in cash into a settlement fund for the benefit of the Plan in connection with the proposed settlement. Deutsche Bank has deposited \$4.5 million in cash into a settlement fund for the benefit of the Plan to settle the claims against it in connection with the proposed settlement. No parties admit any wrongdoing as part of the proposed settlement. QCII received certain insurance proceeds as a contribution by individual defendants to this settlement, which offset \$10 million of QCII's \$33 million payment. If the settlement is not ultimately effected, QCII will repay these insurance proceeds. In addition to the \$33 million cash settlement, QCII has also agreed to pay, subject to certain contingencies, the amount (if any) by which the Plan's recovery from the settlement of the consolidated securities action is less than \$20 million. If approved by the district court, the proposed settlement will settle and release the claims of the class against QCII and all other defendants in the consolidated ERISA action. The federal district court in Colorado has issued orders (1) preliminarily approving the proposed settlement, (2) setting a hearing for November 17, 2006 to consider final approval of the proposed settlement, and (3) certifying a settlement class on behalf of participants in and beneficiaries of the Plan who owned, bought, sold or held shares or units of the Qwest Shares Fund, U S WEST Shares Fund or QCII common stock in their Plan accounts from March 7, 1999 until January 12, 2004. The proposed settlement is subject to review on appeal if the district court were finally to approve it.

DOJ Investigation and Remaining Securities Actions

The Department of Justice, or DOJ, investigation and the securities actions described below present material and significant risks to QCII. The size, scope and nature of the restatements of QCII's consolidated financial statements for 2001 and 2000, which are described in QCII's previously issued consolidated financial statements for the year ended December 31, 2002, or QCII's 2002 Financial Statements, affect the risks presented by this investigation and these actions, as these matters involve, among other things, QCII's prior accounting practices and related disclosures. Plaintiffs in certain of the securities actions have alleged QCII's restatement of items in support of their claims. We can give no assurance as to the impacts on our or QCII's financial results or financial condition that may ultimately result from these matters.

QCII has a reserve recorded in its financial statements for the minimum estimated amount of loss QCII believes is probable with respect to the remaining securities actions described below as well as any additional actions that may be brought by parties that, as described below under "Remaining Securities Actions," have opted out of the settlement of the consolidated securities action. QCII has recorded its estimate of the minimum liability for these matters because no estimate of probable loss for these matters is a better estimate than any other amount. If the recorded reserve is insufficient to cover these matters, QCII will need to record additional charges to its consolidated statement of operations in future periods. The amount QCII has reserved for these matters is its estimate of the lowest end of the possible range of loss. The ultimate outcomes of these matters are still uncertain and the amount of loss QCII may ultimately incur could be substantially more than the reserve it has provided.

QCII continues to defend against the remaining securities actions described below vigorously and is currently unable to provide any estimate as to the timing of the resolution of these actions. Any settlement of or

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judgment in one or more of these actions substantially in excess of QCII's recorded reserves could have a significant impact on QCII, and QCII can give no assurance that it will have the resources available to pay any such judgment. The magnitude of any settlement or judgment resulting from these actions 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 settlement or judgment may cause QCII to draw down significantly on its cash balances, which might force QCII 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 would be similarly affected.

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

DOJ Investigation

On July 9, 2002, QCII was informed by the U.S. Attorney's Office for the District of Colorado of a criminal investigation of QCII's business. QCII believes the U.S. Attorney's Office has investigated various matters that include transactions related to the various adjustments and restatements described in QCII's 2002 Financial Statements, transactions between QCII and certain of its vendors and certain investments in the securities of those vendors by individuals associated with QCII, and certain prior disclosures made by QCII. QCII is continuing in its efforts to cooperate fully with the U.S. Attorney's Office in its investigation. However, QCII cannot predict the outcome of this investigation or the timing of its resolution.

Remaining Securities Actions

QCII is a defendant in the securities actions described below. At their request, plaintiffs in these actions were excluded from the settlement class of the consolidated securities action. As a result, their claims were not released by the district court's order approving the settlement of the consolidated securities action. These plaintiffs have variously alleged, among other things, that QCII and others violated federal and state securities laws, engaged in fraud, civil conspiracy and negligent misrepresentation, and breached fiduciary duties owed to investors by issuing false and misleading financial reports and statements, falsely inflating revenue and decreasing expenses, creating false perceptions of revenue and growth prospects and/or employing improper accounting practices. Other defendants in one or more of these actions include current and former directors of QCII, former officers and employees of QCII, Arthur Andersen LLP, certain investment banks and others. Plaintiffs variously seek, among other things, compensatory and punitive damages, restitution, equitable and declaratory relief, pre-judgment interest, costs and attorneys' fees.

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Together, the parties to these lawsuits contend that they have incurred losses resulting from their investments in QCII's securities in excess of \$1.51 billion; they have also asserted claims for punitive damages and interest, in addition to claims to recover their alleged losses.

Plaintiff(s)	Date Filed	Court Where Action Is Pending
State of New Jersey (Treasury Department, Division of Investment)	November 27, 2002	New Jersey Superior Court, Mercer County
California State Teachers' Retirement System	December 10, 2002	Superior Court, State of California, County of San Francisco
State Universities Retirement System of Illinois	January 10, 2003	Circuit Court of Cook County, Illinois
Stichting Pensioenfonds ABP (SPA)	February 9, 2004	Federal District Court in Colorado
Shriners Hospital for Children	March 22, 2004	Federal District Court in Colorado
Teachers' Retirement System of Louisiana	March 30, 2004	Federal District Court in Colorado
A number of New York City pension and retirement funds	September 22, 2004	Federal District Court in Colorado
New York State Common Retirement Fund	April 18, 2006	Federal District Court in Colorado
San Francisco Employees Retirement System	April 18, 2006	Federal District Court in Colorado
Fire and Police Pension Association of Colorado	April 18, 2006	Federal District Court in Colorado
Commonwealth of Pennsylvania Public School Employees' Retirement System	May 1, 2006	Federal District Court in Colorado
Merrill Lynch Investment Master Basic Value Trust Fund, et al.	June 21, 2006	Federal District Court in Colorado
Denver Employees Retirement Plan	August 7, 2006	Federal District Court in Colorado
FTWF Franklin Mutual Beacon Fund, et al.	October 17, 2006	Superior Court, State of California, County of San Francisco

At their request, other persons (including large pension funds) who have not yet filed suit were also excluded from the settlement class. As a result, their claims were not released by the order approving the settlement of the consolidated securities action. QCII expects that some of these other persons will file actions against it if it is unable to resolve those matters amicably. In the aggregate, the persons who have requested exclusion from the settlement class, excluding those listed in the table above, contend that they have incurred losses resulting from their investments in QCII's securities of approximately \$1.19 billion, which does not include any claims for punitive damages or interest. Due to the fact that many of the persons who requested exclusion from the settlement class have not filed lawsuits, it is difficult to evaluate the claims that they may assert. Regardless, QCII will vigorously defend against any such claims.

Other

A putative class action purportedly brought on behalf of purchasers of QCII's stock between June 28, 2000 and June 27, 2002 and owners of U S WEST, Inc. stock on June 28, 2000 is pending in Colorado in the District

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Court for the County of Boulder. We are also a defendant in this action. This action was filed on June 27, 2002. Plaintiffs allege, among other things, that QCII and other defendants issued false and misleading statements and engaged in improper accounting practices in order to accomplish the U S WEST/Qwest merger, to make QCII appear successful and to inflate the value of QCII's stock. Plaintiffs seek unspecified monetary damages, disgorgement of illegal gains and other relief.

KPNQwest Litigation/Investigation

Settlement of Putative Securities Class Action

A putative class action is pending in the federal district court for the Southern District of New York against QCII, certain of its former executives who were also on the supervisory board of KPNQwest, N.V. (of which QCII was a major shareholder), and others. This lawsuit was initially filed on October 4, 2002. The current complaint alleges, on behalf of certain purchasers of KPNQwest securities, that, among other things, defendants engaged in a fraudulent scheme and deceptive course of business in order to inflate KPNQwest's revenue and the value of KPNQwest securities. Plaintiffs seek compensatory damages and/or rescission as appropriate against defendants, as well as an award of plaintiffs' attorneys' fees and costs. On February 3, 2006, QCII, certain other defendants and the putative class representative in this action executed an agreement to settle the case against QCII and certain other defendants. Under the settlement agreement, QCII has deposited \$5.5 million in cash into a settlement fund on behalf of the settlement class, and no later than 30 days following final approval by the court, QCII will issue shares of its stock to the settlement fund then valued at \$5.5 million as additional consideration for the settlement. The settlement agreement would settle the individual claims of the putative class representative and the claims of the class he purports to represent against QCII and all defendants except Koninklijke KPN N.V. a/k/a Royal KPN N.V., Willem Ackermans, Eelco Blok, Joop Drechsel, Martin Pieters, and Rhett Williams. Those defendants are parties to a separate proposed settlement agreement with the putative class representative. The federal district court for the Southern District of New York has issued orders (1) preliminarily approving the proposed settlements, (2) setting a hearing for January 4, 2007 to consider final approval of the proposed settlements, and (3) certifying a settlement class on behalf of purchasers of KPNQwest's publicly traded securities from November 9, 1999 through May 31, 2002.

QCII's settlement agreement with the putative class representative is subject to a number of conditions and future contingencies. Among others, it (i) requires final court approval; (ii) provides QCII with the right to terminate the settlement if class members representing more than a specified amount of alleged securities losses elect to opt out of the settlement; (iii) provides QCII with the right to terminate the settlement if it does not receive adequate protections for claims relating to substantive liabilities of non-settling defendants; and (iv) is subject to review on appeal even if the district court were finally to approve it. Any lawsuits that may be brought by parties opting out of the settlement will be vigorously defended regardless of whether the proposed settlement is consummated. No parties admit any wrongdoing as part of the proposed settlement.

Certain individuals and entities have opted out of the KPNQwest securities settlement class. As a result, their claims will not be released even if the settlement is finally approved by the district court. Some of these individuals and entities have already filed actions against QCII, as described below. QCII expects that at least some of the others who opted out will also pursue actions against it if it is unable to resolve their claims amicably. In the aggregate, those who have requested exclusion from the settlement class currently contend that they have incurred losses resulting from their investments in KPNQwest securities during the settlement class period of at least \$76 million, which does not include any claims for punitive damages or interest. The amount of these alleged losses may increase or decrease in the future as QCII learns more about the potential claims of

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those who opted out of the settlement class. Due to the fact that many of those who requested exclusion from the settlement class have not filed lawsuits based on the losses they claim to have incurred from their investments in KPNQwest securities during the settlement class period, it is difficult to evaluate the claims that they may assert. Regardless, QCII will vigorously defend against any such claims.

Other KPNQwest-Related Proceedings

On October 31, 2002, Richard and Marcia Grand, co-trustees of the R.M. Grand Revocable Living Trust, dated January 25, 1991, filed a lawsuit in Arizona Superior Court which, as amended, alleges, among other things, that the defendants violated state and federal securities laws and breached their fiduciary duty in connection with investments by plaintiffs in securities of KPNQwest. QCII was a defendant in this lawsuit along with Qwest B.V. (one of QCII's subsidiaries), Joseph Nacchio and John McMaster, the former President and Chief Executive Officer of KPNQwest. Plaintiffs claim to have lost approximately \$10 million in their investments in KPNQwest. The superior court granted defendants' motion for partial summary judgment with respect to a substantial portion of plaintiffs' claims and the remainder of plaintiffs' claims were dismissed without prejudice. Plaintiffs have appealed the summary judgment order to the Arizona Court of Appeals.

On June 25, 2004, J.C. van Apeldoorn and E.T. Meijer, in their capacities as trustees in the Dutch bankruptcy proceeding for KPNQwest, filed a lawsuit in the federal district court for the District of New Jersey alleging violations of the Racketeer Influenced and Corrupt Organizations Act, and breach of fiduciary duty and mismanagement under Dutch law. QCII was a defendant in this lawsuit along with Joseph Nacchio, Robert S. Woodruff and John McMaster. Plaintiffs allege, among other things, that defendants' actions were a cause of the bankruptcy of KPNQwest and they sought damages for the bankruptcy deficit of KPNQwest of approximately \$2.4 billion. Plaintiffs also sought treble damages as well as an award of plaintiffs' attorneys' fees and costs. On October 17, 2006, the court issued an order granting defendants' motion to dismiss the lawsuit, concluding that the dispute should not be adjudicated in the United States. That decision is subject to appeal.

On June 17, 2005, Appaloosa Investment Limited Partnership I, Palomino Fund Ltd., and Appaloosa Management L.P. filed a lawsuit in the federal district court for the Southern District of New York against QCII, Joseph Nacchio, John McMaster and Koninklijke KPN N.V., or KPN. The complaint alleges that defendants violated federal securities laws in connection with the purchase by plaintiffs of certain KPNQwest debt securities. Plaintiffs seek compensatory damages, as well as an award of plaintiffs' attorneys' fees and costs.

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 Telecom B.V., Koninklijke KPN N.V., Joseph Nacchio, John McMaster, and other former employees or supervisory board members of QCII, KPNQwest, or KPN. The lawsuit alleges that defendants misrepresented KPNQwest's financial and business condition in connection with the origination of a credit facility and wrongfully allowed KPNQwest to borrow funds under that facility. The plaintiffs allege damages of approximately €219million (or \$278 million based on the exchange rate on September 30, 2006).

On August 23, 2005, the Dutch Shareholders Association (Vereniging van Effectenbezitters, or VEB) filed a petition for inquiry with the Enterprise Chamber of the Amsterdam Court of Appeals, located in the Netherlands, with regard to KPNQwest. VEB seeks 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.

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Other than the putative class action in which QCII has entered into a proposed settlement (and for which it has a remaining reserve of \$5.5 million in connection with the proposed settlement), QCII will continue to defend against the pending KPNQwest litigation matters vigorously.

Regulatory Matter

On July 15, 2004, the New Mexico state regulatory commission opened a proceeding to investigate whether we were in compliance with or were likely to meet a commitment that we made in 2001 to invest \$788 million in communications infrastructure in New Mexico through March 2006 pursuant to an Alternative Form of Regulation plan, or AFOR. Multiple parties filed comments in that proceeding and variously argued that we should be subject to a range of requirements including an escrow account for capital spending, new investment obligations, and customer credits or price reductions.

On April 14, 2005, the Commission issued its Final Order in connection with this investigation. The Commission concluded in this Final Order that we had an unconditional commitment to invest \$788 million over the life of the AFOR. The Commission also ruled that if we failed to satisfy this investment commitment, any shortfall must be credited or refunded to our New Mexico customers. The Commission also opened an enforcement and implementation docket to review our investments and consider the structure and size of any refunds or credits to be issued to customers. On May 12 and 13, 2005, we filed appeals in federal district court and in the New Mexico State Supreme Court, respectively, challenging the lawfulness of the Commission's Final Order. On February 24, 2006, the federal district court granted the defendants' motion to dismiss and on June 29, 2006, the New Mexico Supreme Court issued its opinion affirming the Commission's Final Order. The opinion concluded that the Commission had the authority to add to the AFOR the incentive requiring Qwest to issue credits or refunds in the amount of the shortfall between the investment commitment and the amount invested during the term of the AFOR.

On July 26, 2006, we entered into a settlement with the New Mexico General Services Department and the New Mexico Attorney General that would resolve the disputes described above. This settlement must be approved by the Commission, and the hearing to consider the settlement is set for November 2006. Under the settlement, we would contribute \$15 million, for which we have established a liability, to the Students and Teachers Reaching Optimal New Goals Project, a program established and operated under the auspices of the New Mexico Department of Education. In addition, we would invest in our New Mexico network a total of \$250 million over 42 months in specific categories of telecommunications infrastructure projects. Our obligation to make these expenditures and investments will arise only upon approval of the settlement by the Commission. In the unlikely event that we do not achieve the required investment level over the 42 month period, we would be required under the settlement to refund any deficiency to our New Mexico customers.

Other Matters

Several putative class actions relating to the installation of fiber optic cable in certain rights-of-way were filed against QCII on behalf of landowners on various dates and in various courts in California, Colorado, Georgia, Illinois, Indiana, Kansas, Mississippi, Missouri, Oregon, South Carolina, Tennessee and Texas. For the most part, the complaints challenge QCII's right to install its fiber optic cable in railroad rights-of-way. Complaints in Colorado, Illinois and Texas, also challenge QCII's right to install fiber optic cable in utility and pipeline rights-of-way. The complaints allege that the railroads, utilities and pipeline companies own the right-of-way as an easement that did not include the right to permit QCII to install its fiber optic cable in the right-of-way without the plaintiffs' consent. Most actions (California, Colorado, Georgia, Kansas, Mississippi, Missouri, Oregon, South Carolina, Tennessee and Texas) purport to be brought on behalf of state-wide classes in

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the named plaintiffs' respective states. Several actions purport to be brought on behalf of multi-state classes. The Illinois state court action purports to be on behalf of landowners in Illinois, Iowa, Kentucky, Michigan, Minnesota, Nebraska, Ohio and Wisconsin. The Illinois federal court action purports to be on behalf of landowners in Arkansas, California, Florida, Illinois, Indiana, Missouri, Nevada, New Mexico, Montana and Oregon. The Indiana action purports to be on behalf of a national class of landowners adjacent to railroad rights-of-way over which QCII's network passes. The complaints seek damages on theories of trespass and unjust enrichment, as well as punitive damages.

On September 1, 2006, Ronald A. Katz Technology Licensing, L.P. ("Katz") filed a lawsuit in Federal District Court in Delaware against QCII (including a number of its subsidiaries). The lawsuit alleges infringement by QCII of 24 patents. The lawsuit also names as defendants a number of other entities that are unrelated to QCII. Katz is also involved in approximately 24 other cases against numerous other unrelated entities both in Delaware and in the Eastern District of Texas. Although the complaint against QCII is vague, it generally alleges infringement based on QCII's use of interactive voice response systems to automate processing of customer calls to it. Katz seeks unspecified damages, trebling of the damages based on alleged willful infringement, attorney's fees and injunctive relief.

The Internal Revenue Service ("IRS") proposed a tax adjustment for tax years 1994 through 1996. The principal issue involves the allocation of costs between long-term contracts with customers for the installation of conduit or fiber optic cable and additional conduit or fiber optic cable retained by QCII. The IRS disputes the allocation of the costs between QCII and third parties. Similar claims have been asserted against QCII with respect to the 1997 to 1998 and the 1998 to 2001 audit periods. On March 13, 2006, the Tax Court issued a decision for the tax years 1994 to 1996, which was favorable to QCII. The IRS may appeal the decision to the 10th Circuit Court of Appeals. The trial for the 1997-1998 tax years has been scheduled for April 2007. If QCII ultimately were to lose this issue for the tax years 1994 through 1998, QCII estimates it would have to pay approximately \$57 million in tax plus approximately \$51 million in interest pursuant to tax sharing agreements with the Anschutz Company relating to those time periods.

QCII has tax related matters pending against it, certain of which are before the Appeals Office of the IRS. In addition, 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. Generally, QCII has not provided for liabilities of former affiliated members or for claims they have asserted or may assert against QCII. QCII believes it has adequately provided for these tax-related matters. If the recorded reserves for these tax-related matters are insufficient, QCII may need to record additional amounts in future periods.

Note 6: Severance Accruals

We continue to manage our cost structure and reflect the impact of productivity gains achieved. For the three and nine months ended September 30, 2006, we recorded \$32 million and \$33 million of severance costs, respectively. These costs were included in our condensed consolidated statements of operations in selling, general and administrative expenses. We expect to substantially complete these payments in 2007.

Note 7: Dividends

During the three and nine months ended September 30, 2006, we declared dividends to our parent of \$400 million and \$1.4 billion, respectively. On October 16, 2006 we declared a dividend of \$600 million to our parent.

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

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

Certain statements set forth below under this caption constitute forward-looking statements. See "Special Note Regarding Forward-Looking Statements" at the end of this Item 2 for additional factors relating to such statements, and see "Risk Factors" in Item 1A of Part II of this report for a discussion of certain risk factors applicable to our business, financial condition and results of operations.

Business Overview and Presentation

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

- InterLATA long-distance services;
- Dedicated Internet access;
- Virtual private network;
- Web hosting; and
- Data Integration.

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

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

Our operations are integrated into and are part of the segments of the QCII consolidated group. The chief operating decision maker, or CODM, for us is the same as that for the consolidated group. The CODM makes resource allocation decisions and assessments of financial performance for the consolidated group based on wireline services, wireless services and other services segments. For more information about QCII's reporting segments, see QCII's Annual Report on Form 10-K for the year ended December 31, 2005. Our business contributes to the segments reported by QCII, but the QCII CODM reviews our financial information only in connection with our quarterly and annual reports that we file with the Securities and Exchange Commission, or SEC. Consequently, we do not provide our discrete financial information to the CODM on a regular basis. See further discussion in Note 4—Contribution to QCII Segments to our condensed consolidated financial statements in Item 1 of Part I of this report. Certain prior year revenue, expense and access line amounts have been reclassified to conform to the current year presentations.

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Business Trends

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

- *Access line losses.* Our revenue has been, and we expect it to continue to be, adversely affected by access line losses. Increased competition, including product substitution, continues to be the primary reason for our access line losses. For example, consumers are increasingly substituting other telephony services for traditional telecommunications services, which has increased the number and type of competitors within our industry and decreased our market share. Product bundling, as described more fully below, has been one of our responses to our declining revenue due to access line losses.
- *Data and Internet growth.* Data and Internet revenue and subscribers continue to grow as customers continue to migrate Internet service to higher speed connections. We have expanded our availability of these services. In addition, we continue to increase the available connection speeds in order to meet customer demand and expect this trend will continue into the future. We also expect to face continuing competition for these subscribers.
- *Product bundling.* We believe consumers increasingly value the convenience of receiving multiple services from a single provider. As such, we increased our marketing and advertising spending levels in 2005 and 2006 focusing on product bundling and packaging. Product bundles and packages represent combinations of products and services (such as local voice, long-distance, high-speed Internet, video and wireless) and features and services (such as three-way calling and call forwarding) related to an access line. To do so, we rely on joint marketing relationships with our affiliates, which allow us to bundle our services with wireless, long distance, video and other services. As a result of these offerings, our sales of bundled products have increased.
- *Operational efficiencies.* We have continued to evaluate our operating structure and focus, and we continue to right-size our workforce in response to changes in the telecommunications industry and productivity improvements. Through targeted restructuring plans in prior years, focused improvements in operational efficiency, process improvements through automation and normal employee attrition, we have reduced our workforce and employee-related costs while achieving operational goals.

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

Results of Operations

Overview

We generate revenue from the provision of voice services, data and Internet services and other services, as well as from the provision of services to our affiliates.

- *Voice services .* Voice services revenue includes local voice, IntraLATA long-distance voice and access services. Local voice services revenue includes basic local exchange, switching, enhanced voice, operator and collocation services and custom calling features. Local voice services revenue also includes the provisioning of network transport, billing services and access to our local network on a wholesale basis. IntraLATA long-distance voice services revenue includes IntraLATA long-distance services within our local service area. Access services revenue includes fees charged to other data and telecommunications providers to connect their customers and their networks to our network.
- *Data and Internet services .* Data and Internet services revenue includes data services (such as traditional private lines, wholesale private lines and WAN) and Internet services (such as high-speed Internet and ISDN).
- *Other services.* Other services revenue is predominantly derived from the sublease of some of our real estate, such as space in our office buildings, warehouses and other properties.

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- *Affiliate services.* Affiliate services revenue is derived from telecommunications and other services provided to our affiliated entities. In addition to voice services, data and Internet services and other services, we provide to our affiliates sales and marketing services relating to our affiliates' products and services and other miscellaneous services, including billing and collection services.

Depending on the products or services purchased, a customer may pay an up-front or monthly fee, a usage charge or a combination of these.

The following table summarizes our results of operations for the three and nine months ended September 30, 2006 and 2005:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2006	2005	Increase/ (Decrease)	% Change (Dollars in millions)	2006	2005	Increase/ (Decrease)	% Change
Operating revenue	\$2,476	\$2,470	\$ 6	0%	\$7,414	\$7,563	\$ (149)	(2)%
Operating expenses	1,888	1,983	(95)	(5)%	5,653	5,922	(269)	(5)%
Other expense—net	159	147	12	8%	464	477	(13)	(3)%
Income before income taxes	429	340	89	26%	1,297	1,164	133	11%
Income tax expense	152	130	22	17%	473	442	31	7%
Net income	<u>\$ 277</u>	<u>\$ 210</u>	<u>\$ 67</u>	32%	<u>\$ 824</u>	<u>\$ 722</u>	<u>\$ 102</u>	14%

Operating Revenue

The following table compares operating revenue for the three and nine months ended September 30, 2006 and 2005:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2006	2005	Increase/ (Decrease)	% Change (Dollars in millions)	2006	2005	Increase/ (Decrease)	% Change
Voice services	\$1,556	\$1,668	\$ (112)	(7)%	\$4,764	\$5,098	\$ (334)	(7)%
Data and Internet services	659	545	114	21%	1,903	1,638	265	16%
Affiliate services	256	251	5	2%	732	814	(82)	(10)%
Other services	5	6	(1)	(17)%	15	13	2	15%
Total operating revenue	<u>\$2,476</u>	<u>\$2,470</u>	<u>\$ 6</u>	0%	<u>\$7,414</u>	<u>\$7,563</u>	<u>\$ (149)</u>	(2)%

Voice Services

The decrease in voice services revenue for the three and nine months ended September 30, 2006 was primarily due to mass markets and business access line losses from competitive pressures, including wireless and cable substitution. In addition, we are seeing a decline in local voice services revenue related to our bundle discounts. Access services revenue also decreased primarily due to a \$23 million favorable settlement of a customer billing dispute in the second quarter of 2005 and the recognition of a non-recurring benefit due to favorable regulatory rulings during the nine months ended September 30, 2005. Additionally, for the three and nine months ended September 30, 2006, regulated access rates decreased due to legislative action in certain states and wholesale volumes decreased. We continue to see declines in wholesale access lines as demand for UNEs decreases.

The following table summarizes our access lines by channel as of September 30, 2006 and 2005:

	As of September 30,			
	2006	2005	Increase/ (Decrease) (in thousands)	% Change
Mass markets	9,601	10,145	(544)	(5)%
Business	2,872	3,032	(160)	(5)%
Wholesale	1,564	1,756	(192)	(11)%
Total access lines	<u>14,037</u>	<u>14,933</u>	<u>(896)</u>	(6)%

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Data and Internet Services

The increase in data and Internet services revenue for the three and nine months ended September 30, 2006 compared to the same periods of 2005 was primarily due to the transfer of a new Internet service to us from an affiliate and to a 46.1% increase in high-speed Internet subscribers. To a lesser extent, the increase was also due to an increase in satellite subscribers. The growth in high-speed Internet revenue resulted from increased penetration and expanded service availability and from customers migrating from dial-up connections to higher speed plans.

Affiliate Services

The decrease in affiliate services revenue for the nine months ended September 30, 2006 compared to the same period of 2005 was primarily due to a price reduction for billing and collection services provided. Additionally, in connection with our affiliate's transition to a third party wireless provider, we no longer provide certain services to that affiliate. This transition was completed in 2005. These decreases were partially offset by increased Private Line and other services primarily in support of our affiliates' data and Internet businesses.

Operating Expenses

The following table provides further detail regarding our operating expenses for the three and nine months ended September 30, 2006 and 2005:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2006	2005	Increase/ (Decrease)	% Change (Dollars in millions)	2006	2005	Increase/ (Decrease)	% Change
Cost of sales:								
Employee-related costs	\$ 351	\$ 353	\$ (2)	(1)%	\$1,036	\$1,049	\$ (13)	(1)%
Network expenses	55	56	(1)	(2)%	143	160	(17)	(11)%
Other non-employee related costs	129	145	(16)	(11)%	399	402	(3)	(1)%
Affiliate costs	60	56	4	7%	169	174	(5)	(3)%
Total cost of sales	595	610	(15)	(2)%	1,747	1,785	(38)	(2)%
Selling, general and administrative:								
Employee-related costs	148	148	—	0%	438	466	(28)	(6)%
Bad debt	15	13	2	15%	50	53	(3)	(6)%
Property and other taxes	82	82	—	0%	242	269	(27)	(10)%
Restructuring, realignment and severance related costs	36	4	32	nm	41	6	35	nm
Other non-employee related costs	166	186	(20)	(11)%	562	515	47	9%
Affiliate costs	257	274	(17)	(6)%	796	829	(33)	(4)%
Total selling, general and administrative	704	707	(3)	(0)%	2,129	2,138	(9)	(0)%
Depreciation	525	587	(62)	(11)%	1,573	1,744	(171)	(10)%
Capitalized software amortization	64	79	(15)	(19)%	204	255	(51)	(20)%
Total operating expenses	<u>\$1,888</u>	<u>\$1,983</u>	<u>\$ (95)</u>	(5)%	<u>\$5,653</u>	<u>\$5,922</u>	<u>\$ (269)</u>	(5)%

nm—percentages greater than 200% and comparisons from positive to negative values or to zero values are not considered meaningful

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Cost of Sales

Cost of sales includes employee-related costs (such as salaries, wages and benefits directly attributable to products or services), network expenses and other non-employee related costs (such as real estate, Universal Service Fund charges, call termination fees, materials and supplies, contracted engineering services and computer system support), which are incurred by us or on our behalf by our affiliates. Cost of sales as a percentage of revenue remained flat at 24% of revenue for the three and nine months ended September 30, 2006 and 2005.

Network expenses decreased primarily due to an exit from the wholesale modem services market during the second quarter of 2005, partially offset by higher contract labor costs in 2006. Other non-employee-related costs decreased for the third quarter of 2006 compared to the same period of 2005 primarily due to lower call termination fees.

The increase in affiliate costs for the three months ended September 30, 2006 was primarily due to the purchase of wholesale support for data and Internet services from an affiliate. The increase was partially offset by reductions in affiliate billing primarily for software development. The decrease in affiliate costs for the nine months ended September 30, 2006 was primarily due to employee reductions at our affiliates, reduced contract labor and purchases by our affiliates, and reductions in affiliate billing for software development. These cost reductions were partially offset by increased charges for the purchase of wholesale support for data and Internet services from an affiliate.

Selling, General and Administrative Expenses

Selling, general and administrative expenses, or SG&A, include employee-related costs (such as salaries, wages and benefits not directly attributable to products or services and sales commissions), severance related costs, bad debt charges, property and other taxes and other non-employee related costs such as real estate, marketing and advertising, professional service fees and computer systems support incurred by us or on our behalf by our affiliates.

SG&A was flat for the third quarter of 2006 compared to the same period of 2005. In the third quarter of 2006, we incurred \$32 million of severance related costs, primarily associated with the closing of two call centers and a planned reduction in network employees as we continue to right-size our workforce in response to changes in the telecommunications industry and productivity improvements. This increase was partially offset by decreased marketing and advertising costs, which are included in other non-employee related costs.

SG&A remained flat for the nine months ended September 30, 2006 compared to same period of 2005. Employee-related costs decreased due to lower salaries and wages as a result of reduced headcount. Property and other taxes decreased primarily due to a net taxable property tax base decrease and favorable property tax settlements. We do not expect property tax reductions to continue at this level. Increases in other non-employee-related costs were due to marketing and advertising costs, other professional services fees and loss contingency accruals.

SG&A affiliate costs include services for corporate administration, information technology, sales, marketing and advertising and technical support. Affiliate costs decreased primarily as a result of employee reductions at our affiliates and reduced contract labor and purchases by our affiliates. These decreases were partially offset by increases in marketing and advertising costs.

Combined Pension and Post-Retirement Benefits

Our employees participate in the QCII pension, non-qualified pension and post-retirement healthcare and life insurance benefit plans. The amounts contributed by us are not segregated or restricted to pay amounts due to our employees and may be used to provide benefits to other employees of QCII or its affiliates. QCII allocates the cost of pension, non-qualified pension, and post-retirement healthcare and life insurance benefits and the associated obligations and assets to us and determines our required contribution. The allocation is based upon demographics of our employees compared to all the remaining participants.

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Our results include expenses of \$40 million and \$120 million for the three and nine months ended September 30, 2006 compared to \$24 million and \$134 million for the three and nine months ended September 30, 2005, respectively. The expense is a function of the amount of pension, non-qualified pension and post-retirement benefits earned, interest on projected benefit obligations, amortization of costs and credits from prior benefit changes and the expected return on the assets held in the various plans. The expense is allocated to cost of sales and SG&A.

Depreciation

Depreciation expense for the three and nine months ended September 30, 2006 was \$525 million and \$1.573 billion, respectively, or 11% and 10% lower than the same periods in the prior year. The primary driver of this decrease was decreased capital expenditures since 2002 and the changing mix of our investment in property, plant and equipment over that period of time. If our capital investment program stays approximately the same and there are no significant decreases in our estimates of the useful lives of assets, we expect that our year-over-year depreciation expense will continue to decrease.

Capitalized Software Amortization

Amortization expense for the three and nine months ended September 30, 2006 was \$64 million and \$204 million, or 19% and 20% lower than the same periods in the prior year, respectively. This reduction reflects the lower capital spending on software related assets since 2001.

Other Expense (Income)—Net

Other expense (income)—net generally includes interest expense, net of capitalized interest, gains and losses on early retirement of debt and other—net, which includes interest income. The following table provides further detail regarding our other expense—net for the three and nine months ended September 30, 2006 and 2005:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2006	2005	Increase/ (Decrease)	% Change	2006	2005	Increase/ (Decrease)	% Change
	(Dollars in millions)							
Other expense (income)—net:								
Interest expense—net	\$154	\$155	\$ (1)	(1)%	\$463	\$455	\$ 8	2%
Loss on early retirement of debt—net	9	—	9	nm	9	37	(28)	(76)%
Other—net	(4)	(8)	4	50%	(8)	(15)	7	47%
Total other expense (income)—net	<u>\$159</u>	<u>\$147</u>	<u>\$ 12</u>	8%	<u>\$464</u>	<u>\$477</u>	<u>\$ (13)</u>	(3)%

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

The increase in other expense (income)—net for the third quarter of 2006 was primarily due to a loss of \$9 million from the early retirement of debt. The decrease in other expense (income)—net for the nine months ended September 30, 2006 was primarily due to a loss of \$37 million from the early retirement of debt in June 2005.

Income Taxes

The effective income tax rate is the provision for income taxes as a percentage of income before income taxes. The effective income tax rate declined for the three months ended September 30, 2006 to 35.4% as compared to 38.2% for the three months ended September 30, 2005. The rate declined to 36.5% for the nine

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months ended September 30, 2006 as compared to 38.0% for the nine months ended September 30, 2005. The decrease was primarily due to an increase in the non-taxable income associated with the federal subsidy under the Medicare Prescription Drug, Improvement and Modernization Act of 2003 and lower state taxes, partially offset by an increase in expense associated with our uncertain tax positions.

Liquidity and Capital Resources

We are a wholly owned subsidiary of Qwest Services Corporation, or QSC, which is wholly owned by QCII. As such, factors relating to or affecting QCII's liquidity and capital resources could have material impacts on us, including changes in the market's perception of us and impacts on our credit ratings and on our access to capital markets. QCII and its consolidated subsidiaries had total borrowings of \$14.9 billion at September 30, 2006 and \$15.5 billion at December 31, 2005.

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

Near-Term View

We had \$235 million in cash and cash equivalents and \$42 million of short-term investments available at September 30, 2006. For the nine months ended September 30, 2006, our primary source of funds was cash provided by operating activities. For the next twelve months, we expect to use our available excess cash primarily to pay dividends to our parent and make additional investment in our network. For the nine months ended September 30, 2006, we declared dividends of \$1.4 billion to our parent.

Our working capital deficit, or the amount by which our current liabilities exceed our current assets, was \$619 million and \$737 million as of September 30, 2006 and December 31, 2005, respectively. Our working capital increased \$118 million primarily due to cash generated by operating activities partially offset by the reclassification to current of \$70 million of debt obligations maturing within twelve months, capital expenditures of \$916 million and dividends declared of \$1.4 billion.

We continue to pursue our strategy to improve our near-term liquidity and our capital structure in order to reduce financial risk. During the quarter ended September 30, 2006, we took the following measures to improve our near-term financial position:

- On August 8, 2006, we issued \$600 million aggregate principal amount of our 7.5% Notes due 2014. The net proceeds from the issuance have been or will be used for general corporate purposes, including repayment of indebtedness and funding and refinancing investments in our telecommunications assets;
- Concurrent with the issuance of these notes, we called the remaining \$500 million aggregate principal amount of our floating rate term loan maturing in June 2007, plus accrued interest of \$3 million; and
- On September 21, 2006, we redeemed the remaining \$90 million aggregate principal amount of our 39-year 6.25% debentures due January 1, 2007 at face value plus accrued interest of \$1 million.

Our working capital deficit is primarily caused by dividends that we pay to QSC. The timing of cash payments for declared dividends to QSC is at our discretion in consultation with QSC. We continue to produce significant cash from operating activities, and we believe that our cash on hand together with our cash flows from operations should be sufficient to meet our cash needs through the next twelve months. However, if we or QCII become subject to significant judgments, settlements and/or tax payments, as further discussed in Note 5—Commitments and Contingencies to our condensed consolidated financial statements in Item 1 of Part I of this report, we or QCII could be required to make significant payments that we or QCII may not have the resources to

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make. The magnitude of any settlements or judgments resulting from these actions 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 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.

To the extent that QCII's EBITDA (as defined in QCII's debt covenants) is reduced by cash judgments, settlements and/or tax payments, its debt to consolidated EBITDA ratios under certain debt agreements will be adversely affected. This could reduce QCII's liquidity and flexibility due to potential restrictions on drawing on its line of credit 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.

QCII has \$850 million available to it under a revolving credit facility (referred to as the Credit Facility), which is currently undrawn and which expires in October 2010. Until July 2006, QSC was the potential borrower under the Credit Facility. The Credit Facility contains various limitations, including a restriction on using any proceeds from the facility to pay settlements or judgments relating to the investigation and securities actions discussed in Note 5—Commitments and Contingencies to our condensed consolidated financial statements in Item 1 of Part I of this report. The Credit Facility is guaranteed by QSC and is secured by a senior lien on our stock.

We expect our 2006 capital expenditures to approximate our 2005 level.

On October 4, 2006, QCII's Board of Directors approved a stock repurchase program for up to \$2 billion of QCII's common stock over the next two years. It is QCII's intention to fully achieve this plan over the next two years, while reviewing, on a regular basis, opportunities to enhance shareholder returns.

Long-Term View

We have historically operated with a working capital deficit due to our practice of declaring and paying regular cash dividends 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 cash provided by operations, combined with our current cash position and continued access to capital markets to refinance our current portion of debt, should allow us to meet our cash requirements for the foreseeable future.

We may periodically need to obtain financing in order to meet our debt obligations as they come due. We may also need to obtain additional financing or investigate other methods to generate cash (such as further cost reductions or the sale of assets) if revenue and cash provided by operations decline, if economic conditions weaken, if competitive pressures increase or if we or QCII become subject to significant judgments, settlements and/or tax payments as further discussed in Note 5—Commitments and Contingencies to our condensed consolidated financial statements in Item 1 of Part I of this report. In the event of an adverse outcome in one or more of these matters, we or QCII could be required to make significant payments that we do not have the resources to make. The magnitude of any settlements or judgments resulting from these actions 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 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, potentially impacting our credit ratings and access to the capital markets.

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The Credit Facility makes available to QCII \$850 million of additional credit subject to certain restrictions as described below and is currently undrawn. This facility has a cross payment default provision and this facility and certain other debt issues of QCII and its other subsidiaries also have cross acceleration provisions. When present, such provisions could have a wider impact on liquidity than might otherwise arise from a default or acceleration of a single debt instrument. These provisions generally provide that a cross default under these debt instruments could occur if:

- QCII fails to pay any indebtedness when due in an aggregate principal amount greater than \$100 million,
- any indebtedness is accelerated in an aggregate principal amount greater than \$100 million (\$25 million in the case of one of the debt instruments), or
- judicial proceedings are commenced to foreclose on any of QCII's assets that secure indebtedness in an aggregate principal amount greater than \$100 million.

Upon such a cross default, the creditors of a material amount of QCII's debt may elect to declare that a default has occurred under their debt instruments and to accelerate the principal amounts due such creditors. Cross acceleration provisions are similar to cross default provisions, but permit a default in a second debt instrument to be declared only if in addition to a default occurring under the first debt instrument, the indebtedness due under the first debt instrument is actually accelerated. As a wholly owned subsidiary of QCII, in the event of such a cross-default or cross-acceleration, our business operations and financial condition could be affected, potentially impacting our credit ratings and access to the capital markets. In addition, the Credit Facility contains various limitations, including a restriction on using any proceeds from the facility to pay settlements or judgments relating to the investigation and securities actions discussed in Note 5—Commitments and Contingencies to our condensed consolidated financial statements in Item 1 of Part I of this report.

Historical View

The following table summarizes cash flow activities for the nine months ended September 30, 2006 and 2005:

	Nine Months Ended September 30,			% Change
	2006	2005	Increase/ (Decrease)	
			(Dollars in millions)	
Cash flows:				
Provided by operating activities	\$ 2,330	\$ 2,512	\$ (182)	(7)%
Used for investing activities	(902)	(690)	(212)	31%
Used for financing activities	(1,353)	(1,847)	494	(27)%
Increase (decrease) in cash and cash equivalents	<u>\$ 75</u>	<u>\$ (25)</u>	<u>\$ 100</u>	nm

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

Operating Activities

The decrease in cash provided by operating activities is primarily attributable to a decrease in revenue and an increase in income taxes paid to our parent of \$62 million during the nine months ended September 30, 2006 compared to the same period of 2005, partially offset by decreases in cost of goods sold and SG&A during the same period.

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Investing Activities

Our capital expenditures for the nine months ended September 30, 2006 and 2005 were \$916 million and \$854 million (net of tax refund of \$33 million), respectively. The increase in capital expenditures was due primarily to increased spending for strategic products and outside plant, which includes network assets, such as cables, poles, equipment and other components that are physically located outside of our company buildings. Although our capital expenditures for the nine months ended September 30, 2006 increased over the same period in 2005, we expect our 2006 capital expenditures to approximate our 2005 level. In addition, our investments in securities managed by our parent resulted in a \$34 million net use of cash in 2006 compared to a \$148 million net source of cash in 2005 primarily due to the changes in the balance of our parent's investments in auction rate securities.

Financing Activities

The decrease in cash used for financing activities was primarily attributable to decreased dividend payments made to QSC during the nine months ended September 30, 2006 compared to the same period of 2005.

Credit Ratings

The table below summarizes our long-term debt ratings at September 30, 2006:

Moody's	Ba2
S&P	BB
Fitch	BB+

These ratings are the same as they were at December 31, 2005, except that Moody's rating was Ba3 on that date.

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/or impaired ability to borrow. 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.

Given our current credit ratings, as noted above, our ability to raise additional capital under acceptable terms and conditions may be negatively impacted.

Risk Management

We are exposed to market risks arising from changes in interest rates. The objective of our interest rate risk management program is to manage the level and volatility of our interest expense. We may employ derivative financial instruments to manage our interest rate risk exposure.

Approximately \$750 million and \$1.25 billion of our floating-rate debt was exposed to changes in interest rates as of September 30, 2006 and December 31, 2005, respectively. This exposure is linked to LIBOR. A hypothetical increase of 100 basis points in LIBOR would not have had a material effect on interest expense for the nine months ended September 30, 2006. As of September 30, 2006 and December 31, 2005, we had approximately \$70 million and \$0 million, respectively, of long-term fixed rate debt obligations maturing in the subsequent 12 months. We are exposed to changes in interest rates at any time that we choose to refinance this debt. A hypothetical increase of 100 basis points in the interest rates on any refinancing of the current portion of long-term debt would not have a material effect on our earnings.

As of September 30, 2006, our proportionate share of QCII's investments was \$167 million of cash invested in money market instruments and \$42 million invested in short-term investments. Most cash investments are

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invested at floating rates. 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 not have a material effect on our earnings.

Off-Balance Sheet Arrangements

There were no substantial changes to our off-balance sheet arrangements or contractual commitments in the nine months ended September 30, 2006, when compared to the disclosures provided in our Annual Report on Form 10-K for the year ended December 31, 2005.

Special Note Regarding Forward Looking Statements

This Form 10-Q contains or incorporates by reference forward-looking statements about our financial condition, results of operations and business. These statements include, among others:

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

These statements may be made expressly in this document or may be incorporated by reference to other documents we have filed or will file with the Securities and Exchange Commission (“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 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 Part II of this report. These risk factors should be considered in connection with any subsequent written or oral forward-looking statements that we or persons acting on our behalf may issue. 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 intention as of the date of this document and is based upon, among other things, the existing regulatory environment, industry conditions, market conditions and prices, the economy in general and our assumptions as of such date. We may change our intentions, at any time and without notice, based upon any changes in such factors, in our assumptions or otherwise.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information under the caption “Risk Management” in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in Item 2 of Part I of this report is incorporated herein by reference.

ITEM 4. CONTROLS AND PROCEDURES

The effectiveness of our or any system of disclosure controls and procedures is subject to certain limitations, including the exercise of judgment in designing, implementing and evaluating the controls and procedures, the assumptions used in identifying the likelihood of future events, and the inability to eliminate misconduct

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completely. As a result, there can be no assurance that our disclosure controls and procedures will detect all errors or fraud. By their nature, our or any system of disclosure controls and procedures can provide only reasonable assurance regarding management's control objectives.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, or the "Exchange Act") as of September 30, 2006. On the basis of this review, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures are designed, and are effective, to give reasonable assurance that the information required to be disclosed by us in reports that we file under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and to ensure that information required to be disclosed in the reports filed or submitted under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, in a manner that allows timely decisions regarding required disclosure.

There were no changes in our internal control over financial reporting that occurred in the third quarter of 2006 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II—OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information contained in Note 5—Commitments and Contingencies to our condensed consolidated financial statements in Item 1 of Part I of this report is incorporated herein by reference.

ITEM 1A. RISK FACTORS

Risks Affecting Our Business

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

We compete in a rapidly evolving and highly competitive market, and we expect competition to continue to intensify. We are facing greater competition in our core local business from cable companies, wireless providers (including one of our affiliates), facilities-based providers using their own networks as well as those leasing parts of our network, and resellers. In addition, regulatory developments over the past few years have generally increased competitive pressures on our business. Due to these and other factors, we continue to lose access lines and are experiencing pressure on profit margins.

We seek to distinguish ourselves from our competitors by providing new or expanded services such as high-speed Internet, packaging of expanded feature-rich products and improving the quality of our customer service. In addition, through joint marketing relationships with our affiliates, we are able to bundle our services with wireless, long-distance, private line, and other services. However, we may not be successful in these efforts. We may not have sufficient resources to distinguish our service levels from those of our competitors, and we may not be successful in integrating our product offerings. Even if we are successful, these initiatives may not be sufficient to offset our continuing loss of access lines. If these initiatives are unsuccessful or insufficient and our revenue declines significantly without corresponding cost reductions, this will cause a significant deterioration to our results of operations and financial condition and adversely affect our ability to service debt and pay other obligations.

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

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

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

The telecommunications industry is experiencing significant technological changes, and our ability to execute our business plans and compete depends upon our ability to develop and deploy new products and services, such as broadband data and video services. The development and deployment of new products and services could 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 such 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 the trading price of our securities and our ability to service our debt.

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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 claiming we have or are infringing upon their intellectual property rights. We may receive similar notices in the future. Responding to these claims may require us to expend significant time and money defending our use of affected technology, may require us to enter into royalty or licensing agreements on less favorable terms than we could otherwise obtain 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 investigation of QCII's business currently being conducted by the DOJ or the material litigation pending against QCII and us, including the securities actions, 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.

The DOJ investigation and the remaining securities actions described in Note 5—Commitments and Contingencies to our condensed consolidated financial statements in Item 1 of Part I of this report present material and significant risks to QCII and us. In the aggregate, the plaintiffs in the remaining securities actions and persons who, at their request, were excluded from the settlement class in the consolidated securities action seek billions of dollars in damages, and the outcome of one or more of these matters or the DOJ investigation could have a negative impact on the outcomes of the other actions. Further, the size, scope and nature of the restatements of QCII's consolidated financial statements for 2001 and 2000, which are described in QCII's Annual Report on Form 10-K/A for the fiscal year ended December 31, 2002, affect the risks presented by these actions and the DOJ investigation, as these matters involve, among other things, QCII's prior accounting practices and related disclosures. Plaintiffs in certain of the securities actions have alleged QCII's restatement of items in support of their claims. QCII and we continue to defend against the remaining securities actions vigorously and are 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 all of these matters. QCII has a recorded reserve in its financial statements for the minimum estimated amount of loss it believes is probable with respect to the remaining securities actions described in Note 5—Commitments and Contingencies to our condensed consolidated financial statements in Item 1 of Part I of this report, as well as any additional actions that may be brought by parties who, at their request, were excluded from the settlement class in the consolidated securities action, but who have not yet filed suit. However, the ultimate outcomes of these matters are still uncertain and the amount of loss QCII ultimately incurs could be substantially more than the reserves it has provided. If the recorded reserves are insufficient, QCII will need to record additional charges to its consolidated statement of operations in future periods. In addition, any settlement or judgment in one or more of these actions substantially in excess of QCII's recorded reserves could have a significant impact on QCII and us, and we can give no assurance that QCII and we will have the resources available to pay any such judgment. The magnitude of any settlement or judgment 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 settlement or judgment 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 would be similarly affected.

Further, there exist other material proceedings pending against QCII and us as described in Note 5—Commitments and Contingencies to our condensed consolidated financial statements in Item 1 of Part I of this report that, depending on their outcome, may have a material adverse effect on QCII's and our financial position. Thus, we can give no assurances as to the impacts on QCII's and our financial results or financial condition as a result of these matters.

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Current or future civil or criminal actions against QCII's former officers and employees could reduce investor confidence in QCII and us and cause the trading price for our debt securities to decline.

As a result of QCII's past accounting issues, investor confidence in QCII and us has suffered and could suffer further. Although QCII has consummated a settlement with the SEC concerning its investigation of QCII, in March 2005, the SEC filed suit against QCII's former chief executive officer, Joseph Nacchio, two of QCII's former chief financial officers, Robert Woodruff and Robin Szeliga, and other former QCII officers and employees. In December 2005, a criminal indictment was filed against Mr. Nacchio charging him with 42 counts of insider trading.

Trials could take place in the pending SEC lawsuit against Mr. Nacchio and others or in connection with the criminal charges against Mr. Nacchio. Evidence introduced at such trials and in other matters may result in further scrutiny by governmental authorities and others. The existence of this heightened scrutiny could adversely affect investor confidence in QCII and us and cause the trading price for our debt securities to decline.

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

Our operations are subject to significant federal regulation, including the Communications Act of 1934, as amended, and Federal Communications Commission, or FCC, regulations thereunder. We are also subject to the applicable laws and regulations of various states, including regulation by public utility commissions, or PUCs, and other state agencies. Federal laws and FCC regulations generally apply to regulated interstate telecommunications (including international telecommunications that originate or terminate in the United States), while state regulatory authorities generally have jurisdiction over regulated telecommunications services that are intrastate in nature. The local competition aspects of the Telecommunications Act of 1996 are subject to FCC rulemaking, but the state regulatory authorities play a significant role in implementing those FCC rules. Generally, we must obtain and maintain certificates of authority from regulatory bodies in most states where we offer regulated services and must obtain prior regulatory approval of rates, terms and conditions for our intrastate services, where required. Our businesses 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 their own perceptions of our conduct, or based on customer complaints.

Regulation of the telecommunications industry is changing rapidly, and the regulatory environment varies substantially from state to state. Recently a number of state legislatures and state PUCs adopted reduced or modified forms of regulation for retail services. This is generally beneficial to us because it reduces regulatory costs and regulatory filing and reporting requirements. These changes also generally allow more flexibility for new product introduction and enhance our ability to respond to competition. At the same time, some of the changes, occurring at both the state and federal level, may have the potential effect of reducing some regulatory protections, including having FCC-approved tariffs that include rates, terms and conditions. These changes may necessitate the need for customer-specific contracts to address matters previously covered in our tariffs. Despite these regulatory changes, a substantial portion of our local voice services revenue remains subject to FCC and state PUC pricing regulation, which could expose us to unanticipated price declines. There can be no assurance that future regulatory, judicial or legislative activities will not have a material adverse effect on our operations, or that regulators or third parties will not raise material issues with regard to our compliance or noncompliance with applicable regulations.

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

Risks Affecting Our Liquidity

QCII's high debt levels pose risks to our viability and may make us more vulnerable to adverse economic and competitive conditions, as well as other adverse developments.

Our ultimate parent, QCII, is highly leveraged on a consolidated basis. As of September 30, 2006, our consolidated debt was approximately \$7.7 billion, which was included in QCII's consolidated debt of \$14.9 billion as of that date. Approximately \$2.4 billion of QCII's debt, which includes approximately \$390 million of our debt obligations, comes due over the next three years. In addition, holders of QCII's \$1.265 billion 3.50% Convertible Senior Notes due 2025 may elect to convert the principal of their notes into cash during periods when specified, market-based conversion requirements are met. However, QCII does not anticipate holders will make such an election because QCII believes it would likely result in adverse economic consequences to such holders. While we currently believe QCII and we will have the financial resources to meet our obligations when they come due, we cannot anticipate what QCII's and our future condition will be. We may have unexpected costs and liabilities and we may have limited access to financing. In addition, on October 4, 2006, QCII's Board of Directors approved a stock repurchase program for up to \$2 billion of QCII's common stock over the next two years. Cash used by QCII in connection with purchases of its common stock would 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. 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 or if QCII or we become subject to significant judgments, settlements and/or tax payments as further discussed in Note 5—Commitments and Contingencies to our condensed consolidated financial statements in Item 1 of Part I of this report and in "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources" in Item 2 of Part I of this report. We can give no assurance that such additional financing will be available on terms that are acceptable. 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 \$850 million revolving 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, such provisions could have a wider impact on liquidity than might otherwise arise from a default or acceleration of a single debt instrument. As a wholly owned subsidiary of QCII and QSC, 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 DOJ investigation and securities actions discussed in Note 5—Commitments and Contingencies to our condensed consolidated financial statements in Item 1 of Part I of this report.

Our high debt levels could adversely impact our credit ratings. Additionally, 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.

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

The industry in which we operate is capital intensive, and as such we anticipate that our capital requirements will continue to be significant in the coming years. Although we have reduced our capital expenditures and operating expenses over the past few years, we may be unable to further significantly reduce these costs, even if revenue is decreasing. While we believe that our current 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.

Declines in the value of QCII's qualified pension plan assets, or unfavorable changes in laws or regulations that govern pension plan funding, could require it to provide significant amounts of funding for its qualified pension plan.

Our employees participate in a qualified defined benefit pension plan sponsored by QCII. While QCII does not expect to be required to make material cash contributions to its qualified defined benefit pension plan in the near term based upon current actuarial analyses and forecasts, a significant decline in the value of qualified pension plan assets in the future or unfavorable changes in laws or regulations that govern pension plan funding could materially change the timing and amount of required pension funding. As a result, QCII and we may be required to fund QCII's qualified defined benefit pension plan with cash from operations, perhaps by a material amount.

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

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

Our debt agreements and the debt agreements of QCII allow us and QCII to incur significantly more debt, which could exacerbate the other risks described herein.

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

Other Risks Relating to Qwest

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

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States, or GAAP, requires management to make judgments, assumptions and estimates that affect the amounts reported in our consolidated financial statements and accompanying notes. Our critical accounting policies, which are described in our Annual Report on Form 10-K for the year ended December 31, 2005, 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 differ significantly from the judgments, assumptions and estimates in our critical accounting policies, such events or assumptions could have a material impact on our consolidated financial statements and related disclosures.

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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 from the Internal Revenue Service, or IRS, as well as from state and local tax authorities. These audits could subject us to risks due to adverse positions that may be taken by these tax authorities. Please see Note 5—Commitments and Contingencies to our condensed consolidated financial statements in Item 1 of Part I of this report for examples of legal proceedings involving some of these adverse positions. In addition, for example, in the fourth quarter of 2004, QCII received notices of proposed adjustments on several significant issues for its 1998-2001 audit cycle. Certain of these proposed adjustments are before the Appeals Office of the IRS. And in June 2006 QCII received notices of proposed adjustments on several significant issues for its 2002-2003 audit cycle, including a proposed adjustment disallowing a loss recognized by QCII relating to the sale of its DEX directory publishing business. There is no assurance that QCII and the IRS will reach settlements on any of these issues or that, if QCII does reach settlements, the terms will be favorable to QCII.

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

While QCII believes its tax reserves adequately provide for the associated tax contingencies, QCII's tax audits and examinations may result in tax liabilities that differ materially from those QCII has recorded in its consolidated financial statements. Also, the ultimate outcomes of all of these matters are uncertain, and QCII can give no assurance as to whether an adverse result from one or more of them will have a material effect on its financial results or its net operating loss carryforwards, which could in turn affect our financial condition and operating results to the extent the matters affect us.

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. In August 2005, we reached agreements with the Communications Workers of America and the International Brotherhood of Electrical Workers on three-year labor agreements. Each of these agreements was ratified by union members and expires on August 16, 2008. Although we believe that our relations with our employees are satisfactory, no assurance can be given that we will be able to successfully extend or renegotiate our collective bargaining agreements as they expire from time to time. The impact of future negotiations, including changes in wages and benefit levels, could have a material impact on our financial results. Also, if we fail to extend or renegotiate our collective bargaining agreements, if disputes with our unions arise, or if our unionized workers engage in a strike or other work stoppage, we could incur higher ongoing labor costs or experience a significant disruption of operations, which could have a material adverse effect on our business.

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ITEM 6. EXHIBITS

Exhibits filed for Qwest through the filing of this Form 10-Q:

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

Exhibit Number	Description
(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).
(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 filing August 8, 2006, File No. 001-03040).
(10.1)	Registration Rights Agreement, dated November 23, 2004, by and among Qwest Corporation and the initial purchasers listed therein (incorporated by reference to Qwest Corporation's Current Report on Form 8-K dated November 18, 2004, File No. 001-03040).

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<u>Exhibit Number</u>	<u>Description</u>
(10.2)	Registration Rights Agreement, dated June 17, 2005, by and among Qwest Corporation and the initial purchasers listed therein (incorporated by reference to Qwest Corporation's Current Report on Form 8-K filed June 23, 2005, File No. 001-03040).
(10.3)	Registration Rights Agreement, dated August 8, 2006, by and among Qwest Corporation and the initial purchasers listed therein (incorporated by reference to Qwest Corporation's Current Report on Form 8-K filing August 8, 2006, File No. 001-03040).
12	Calculation of Ratio of Earnings to Fixed Charges.
31.1	Chief Executive Officer Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Chief Financial Officer Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

() Previously filed.

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

SIGNATURE

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

Q WEST C ORPORATION

By: /s/ John W. Richardson
 John W. Richardson
 Senior Vice President and Controller
 (Duly Authorized Officer and Chief Accounting Officer)

October 31, 2006

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

	Nine Months Ended September 30,	Years Ended December 31,				
	2006	2005	2004	2003	2002	2001
(Dollars in millions)						
Income from continuing operations before income taxes, discontinued operations and cumulative effect of change in accounting principle	\$ 1,297	\$1,530	\$1,742	\$1,758	\$2,435	\$2,833
Add: estimated fixed charges	503	668	647	643	634	588
Add: estimated amortization of capitalized interest	9	12	12	13	14	14
Less: interest capitalized	(6)	(7)	(9)	(13)	(24)	(44)
Total earnings available for fixed charges	<u>\$ 1,803</u>	<u>\$2,203</u>	<u>\$2,392</u>	<u>\$2,401</u>	<u>\$3,059</u>	<u>\$3,391</u>
Estimate of interest factor on rentals	\$ 34	\$ 54	\$ 54	\$ 57	\$ 69	\$ 79
Interest expense, including amortization of premiums, discounts and debt issuance costs	463	607	584	573	541	465
Interest capitalized	6	7	9	13	24	44
Total fixed charges	<u>\$ 503</u>	<u>\$ 668</u>	<u>\$ 647</u>	<u>\$ 643</u>	<u>\$ 634</u>	<u>\$ 588</u>
Ratio of earnings to fixed charges	3.6	3.3	3.7	3.7	4.8	5.8

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Richard C. Notebaert, certify that:

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

Date: October 31, 2006

/s/ Richard C. Notebaert

Richard C. Notebaert
Chief Executive Officer and President

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Oren G. Shaffer, certify that:

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

Date: October 31, 2006

/s/ Oren G. Shaffer

Oren G. Shaffer
Vice Chairman and Chief Financial Officer

CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER CERTIFICATION

Each of the undersigned hereby certifies, for the purposes of section 1350 of chapter 63 of title 18 of the United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, in his capacity as an officer of Qwest Corporation ("Qwest"), that, to his knowledge, the Quarterly Report of Qwest on Form 10-Q for the quarter ended September 30, 2006, fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and that the information contained in such report fairly presents, in all material respects, the financial condition and results of operation of Qwest. This written statement is being furnished to the Securities and Exchange Commission as an exhibit to such Form 10-Q. A signed original of this statement has been provided to Qwest and will be retained by Qwest and furnished to the Securities and Exchange Commission or its staff upon request.

Dated: October 31, 2006

By: /s/ Richard C. Notebaert
Richard C. Notebaert
Chief Executive Officer and President

Dated: October 31, 2006

By: /s/ Oren G. Shaffer
Oren G. Shaffer
Vice Chairman and Chief Financial Officer