

Verizon Northwest Inc.

Condensed Consolidated Financial Statements
Three Months Ended March 31, 2010 and 2009

Verizon Northwest Inc.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(dollars in millions) (unaudited)	<u>Three Months Ended March 31,</u>	
	<u>2010</u>	<u>2009</u>
Operating Revenues (including \$53 and \$54 from affiliates)	<u>\$ 217</u>	<u>\$ 231</u>
Operating Expenses (including \$63 and \$52 to affiliates)		
Cost of services and sales (exclusive of items shown below)	89	65
Selling, general and administrative expense	55	54
Depreciation and amortization expense	50	52
Total Operating Expenses	<u>194</u>	<u>171</u>
Operating Income	23	60
Interest expense (including \$(1) and \$(2) to affiliates)	<u>(4)</u>	<u>(4)</u>
Income Before Provision for Income Taxes	19	56
Provision for income taxes	<u>(15)</u>	<u>(17)</u>
Net Income	<u>\$ 4</u>	<u>\$ 39</u>

See Notes to Condensed Consolidated Financial Statements

Verizon Northwest Inc.

CONDENSED CONSOLIDATED BALANCE SHEETS

(dollars in millions) (unaudited)	At March 31, 2010	At December 31, 2009
Assets		
Current assets		
Accounts receivable:		
Trade and other, net of allowances for uncollectibles of \$6 and \$6	\$ 102	\$ 95
Affiliates	17	21
Prepaid expenses	5	9
Deferred income taxes	4	4
Deferred charges and other	15	20
Total current assets	<u>143</u>	<u>149</u>
Plant, property and equipment	5,210	5,177
Less accumulated depreciation	<u>3,468</u>	<u>3,425</u>
	<u>1,742</u>	<u>1,752</u>
Prepaid pension assets	213	228
Other assets	28	24
Total assets	<u>\$ 2,126</u>	<u>\$ 2,153</u>
Liabilities and Shareowner's Investment		
Current liabilities		
Debt maturing within one year:		
Notes payable to affiliates	\$ 641	\$ 678
Other	175	175
Accounts payable and accrued liabilities:		
Affiliates	36	41
Other	67	58
Other current liabilities	50	53
Total current liabilities	<u>969</u>	<u>1,005</u>
Employee benefit obligations	186	187
Deferred credits and other liabilities		
Deferred income taxes	298	296
Other	43	39
	<u>341</u>	<u>335</u>
Shareowner's investment		
Common stock (one share, without par value)	448	448
Contributed capital	107	107
Reinvested earnings	75	71
Total shareowner's investment	<u>630</u>	<u>626</u>
Total liabilities and shareowner's investment	<u>\$ 2,126</u>	<u>\$ 2,153</u>

See Notes to Condensed Consolidated Financial Statements

Verizon Northwest Inc.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in millions) (unaudited)	Three Months Ended March 31,	
	2010	2009
Net Cash Provided by Operating Activities	\$ 75	\$ 114
Cash Flows from Investing Activities		
Capital expenditures (including capitalized software)	(36)	(59)
Net change in short-term investments	---	5
Other, net	(2)	---
Net cash used in investing activities	(38)	(54)
Cash Flows from Financing Activities		
Net change in short-term notes payable to affiliate	(37)	(3)
Dividends paid	---	(58)
Net change in outstanding checks drawn on controlled disbursement accounts	---	1
Net cash used in financing activities	(37)	(60)
Net change in cash	---	---
Cash, beginning of period	---	---
Cash, end of period	\$ ---	\$ ---

See Notes to Condensed Consolidated Financial Statements

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. Basis of Presentation and Recent Accounting Standard Updates

Verizon Northwest Inc. (Verizon Northwest or the Company) is a wholly owned subsidiary of GTE Corporation (GTE), which is a wholly owned subsidiary of Verizon Communications Inc. (Verizon). The unaudited condensed consolidated financial statements include the accounts of Verizon Northwest Inc. and its wholly owned subsidiary, Verizon West Coast Inc. The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim periods. These condensed consolidated financial statements reflect all adjustments that are necessary for a fair presentation of results of operations and financial position for the interim periods shown including normal recurring accruals and other items. All significant intercompany accounts and transactions have been eliminated. We have evaluated subsequent events through May 28, 2010, the date these condensed consolidated financial statements were issued. The results for the interim periods are not necessarily indicative of results for the full year. The balance sheet at December 31, 2009 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. For a more complete discussion of significant accounting policies and certain other information, you should refer to our December 31, 2009 audited financial statements.

Recent Accounting Standards

In September 2009, the accounting standard update regarding revenue recognition for multiple deliverable arrangements was issued. This update requires the use of the relative selling price method when allocating revenue in these types of arrangements. This method allows a vendor to use its best estimate of selling price if neither vendor specific objective evidence nor third party evidence of selling price exists when evaluating multiple deliverable arrangements. This standard update is effective January 1, 2011 and may be adopted prospectively for revenue arrangements entered into or materially modified after the date of adoption or retrospectively for all revenue arrangements for all periods presented. We are currently evaluating the impact that this standard update will have on our consolidated financial statements.

In September 2009, the accounting standard update regarding revenue recognition for arrangements that include software elements was issued. This update requires tangible products that contain software and non-software elements that work together to deliver the products' essential functionality to be evaluated under the accounting standard regarding multiple deliverable arrangements. This standard update is effective January 1, 2011 and may be adopted prospectively for revenue arrangements entered into or materially modified after the date of adoption or retrospectively for all revenue arrangements for all periods presented. We are currently evaluating the impact that this standard update will have on our consolidated financial statements.

2. Telephone Access Lines Spin-off

On May 13, 2009, Verizon announced a definitive agreement with Frontier Communications Corporation (Frontier) that has resulted in Verizon establishing a separate entity, known as New Communications Holdings Inc. (Spinco), for the purpose of holding defined assets and liabilities of Verizon's local exchange business and related landline activities in 13 states and portions of California. As part of this transaction, Verizon will distribute all of the outstanding shares of Spinco to Verizon's stockholders, and then Spinco will immediately merge with and into Frontier (the Frontier Merger).

Prior to the closing of the Frontier Merger, Verizon Northwest will become a wholly-owned subsidiary of Spinco, and Verizon Northwest will become a wholly owned subsidiary of Frontier at the closing of the Frontier Merger.

All outstanding long-term debt of Verizon Northwest will continue to remain the obligation of Verizon Northwest and be payable by Verizon Northwest in accordance with its terms both prior to and following the Frontier Merger. All intercompany debt between Verizon Northwest and Verizon or any of its subsidiaries will be eliminated prior to the closing of the Frontier Merger.

The Frontier Merger is subject to the continuing effectiveness of regulatory approvals and the satisfaction of certain other closing conditions. We expect that the Frontier Merger will close on July 1, 2010. We also expect that all outstanding long-term debt of Verizon Northwest will be repaid at maturity prior to the closing of the Frontier Merger.

Verizon Northwest Inc.

During the three months ended March 31, 2010, Verizon recorded pretax charges of \$145 million for costs incurred related to network, non-network software and other activities to enable the markets to be divested to operate on a stand-alone basis subsequent to the closing of the transaction with Frontier. Of this amount, we recorded \$2 million.

3. Shareowner's Investment

(dollars in millions)	Common Stock	Contributed Capital	Reinvested Earnings
Balance at December 31, 2009	\$ 448	\$ 107	\$ 71
Net income	---	---	4
Balance at March 31, 2010	<u>\$ 448</u>	<u>\$ 107</u>	<u>\$ 75</u>

Net income and comprehensive income were the same for the three months ended March 31, 2010 and 2009, respectively.

4. Debt

The fair value of our debt is determined based on market quotes for similar terms and maturities or future cash flows discounted at current rates. The fair value of our debt was approximately \$817 million and \$856 million at March 31, 2010 and December 31, 2009, respectively, as compared to the carrying value of approximately \$816 million and \$853 million at March 31, 2010 and December 31, 2009, respectively.

5. Commitments and Contingencies

Various legal actions and regulatory proceedings are pending to which we are a party and claims which, if asserted, may lead to other legal actions. We have established reserves for specific liabilities in connection with regulatory and legal matters, including environmental matters that we currently deem to be probable and estimable. We do not expect that the ultimate resolution of pending regulatory and legal matters in future periods will have a material effect on our financial condition, but it could have a material effect on our results of operations.

From time to time, state regulatory decisions require us to assure customers that we will provide a level of service performance that falls within prescribed parameters. There are penalties associated with failing to meet those service parameters and we, from time to time, pay such penalties. We do not expect these penalties to have a material effect on our financial condition, but they could have a material effect on our results of operations.

6. Other Items

Medicare Part D Subsidy

Under the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010, both of which became law in March 2010 (collectively the Health Care Act), beginning in 2013, Verizon and other companies that receive a subsidy under Medicare Part D to provide retiree prescription drug coverage will no longer receive a federal income tax deduction for the expenses incurred in connection with providing the subsidized coverage to the extent of the subsidy received. Because future anticipated retiree prescription drug plan liabilities and related subsidies are already reflected in our financial statements, this change requires us to reduce the value of the related tax benefits recognized in our financial statements in the period during which the Health Care Act was enacted. As a result, we recorded a one-time, non-cash income tax charge of \$9 million in the first quarter of 2010 to reflect the impact of this change.

Severance, Pension and Benefit Charges

During the three months ended March 31, 2010, we recorded non-cash pension settlement losses of \$15 million related to employees that received lump-sum distributions, primarily resulting from our previously announced separation plans in which prescribed payment thresholds were reached.