Verizon Northwest Inc.

Consolidated Financial Statements
As of December 31, 2009 and 2008
and for the years then ended

Verizon Northwest Inc.

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Verizon Northwest Inc.

REPORT OF INDEPENDENT AUDITORS

To The Board of Directors and Shareowner of Verizon Northwest Inc.

We have audited the accompanying consolidated balance sheets of Verizon Northwest Inc. ("the Company"), a subsidiary of Verizon Communications Inc., as of December 31, 2009 and 2008, and the related consolidated statements of income, changes in shareowner's investment, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Verizon Northwest Inc. at December 31, 2009 and 2008, and the consolidated results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

New York, New York
March 29, 2010

Verizon Northwest Inc.

CONSOLIDATED STATEMENTS OF INCOME

(dollars in millions)

Years Ended December 31,	2009	2008
Operating Revenues	**$ 914**	$ 955
Operating Expenses		
Cost of services and sales (exclusive of items shown below)	**285**	272
Selling, general and administrative expense	**283**	235
Depreciation expense	**212**	198
Total Operating Expenses	**780**	705
Operating Income	**134**	250
Other income (expense), net	**---**	1
Interest expense	**(15)**	(29)
Income Before Provision for Income Taxes	**119**	222
Provision for income taxes	**(43)**	(80)
Net Income	**$ 76**	$ 142

See Notes to Consolidated Financial Statements.

Verizon Northwest Inc.

CONSOLIDATED BALANCE SHEETS

(dollars in millions)

At December 31,	2009	2008
Assets		
Current assets		
Short-term investments	**$ ---**	$ 6
Accounts receivable:		
Trade and other, net of allowances for uncollectibles of $6 and $8	**95**	110
Affiliates	**21**	7
Material and supplies	**4**	7
Prepaid expenses	**9**	8
Deferred income taxes	**4**	2
Deferred charges and other	**16**	22
Total current assets	**149**	162
Plant, property and equipment	**5,177**	5,041
Less accumulated depreciation	**3,425**	3,300
	1,752	1,741
Prepaid pension assets	**228**	284
Other assets	**24**	15
Total assets	**$ 2,153**	$ 2,202
Liabilities and Shareowner's Investment		
Current liabilities		
Debt maturing within one year:		
Notes payable to affiliate	**$ 678**	$ 489
Other	**175**	---
Accounts payable and accrued liabilities:		
Affiliates	**41**	56
Other	**58**	74
Other current liabilities	**53**	69
Total current liabilities	**1,005**	688
Long-term debt	**---**	175
Employee benefit obligations	**187**	182
Deferred credits and other liabilities		
Deferred income taxes	**296**	250
Other	**39**	34
	335	284
Shareowner's investment		
Common stock - one share, without par value	**448**	448
Contributed capital	**107**	107
Reinvested earnings	**71**	318
Total shareowner's investment	**626**	873
Total liabilities and shareowner's investment	**$ 2,153**	$ 2,202

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREOWNER'S INVESTMENT

(dollars in millions)

Years Ended December 31,	2009	2008
Common Stock		
Balance at beginning of year	**$ 448**	$ 448
Balance at end of year	**448**	448
Contributed Capital		
Balance at beginning of year	**107**	107
Balance at end of year	**107**	107
Reinvested Earnings		
Balance at beginning of year	**318**	232
Net income	**76**	142
Dividends declared	**(324)**	(55)
Other	**1**	(1)
Balance at end of year	**71**	318
Total Shareowner's Investment	**$ 626**	$ 873

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in millions)

Years Ended December 31,	2009	2008
Cash Flow from Operating Activities		
Net income	**$ 76**	$ 142
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	**212**	198
Deferred income taxes, net	**44**	28
Employee retirement benefits	**84**	27
Provision for uncollectible accounts	**6**	6
Changes in current assets and liabilities:		
Accounts receivable	**(4)**	10
Material and supplies	**15**	(2)
Other current assets	**4**	1
Accounts payable and accrued liabilities	**(31)**	23
Other current liabilities	**(15)**	(7)
Other, net	**(25)**	(35)
Net cash provided by operating activities	**366**	391
Cash Flows from Investing Activities		
Capital expenditures (including capitalized network software)	**(217)**	(330)
Purchases of short-term investments	**---**	(3)
Proceeds from sale of short-term investments	**6**	34
Proceeds from sale of assets	**1**	(1)
Other, net	**(20)**	---
Net cash used in investing activities	**(230)**	(300)
Cash Flows from Financing Activities		
Principal repayments of borrowings and capital lease obligations	**---**	(200)
Net change in current notes payable to affiliate	**189**	160
Dividends paid	**(324)**	(55)
Net change in outstanding checks drawn on controlled disbursement accounts	**---**	4
Other, net	**(1)**	---
Net cash used in financing activities	**(136)**	(91)
Net change in cash	**---**	---
Cash, beginning of year	**---**	---
Cash, end of year	**$ ---**	$ ---

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business

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). We presently serve a territory consisting of Local Access and Transport Areas (LATA) located in California, Idaho, Oregon and Washington. We have one reportable segment which provides domestic wireline telecommunications services. We currently provide three basic types of telecommunications services:

- *Exchange telecommunication service* is the transmission of telecommunications among customers located within a local calling area within a LATA. Examples of exchange telecommunications services include switched local residential and business services, local private line voice and data services and Centrex services. We also provide toll services within a LATA (intraLATA long distance).

- *Exchange access service* links a customer's premises and the transmission facilities of other telecommunications carriers, generally interLATA carriers. Examples of exchange access services include switched access and special access services.

- In addition, we also provide FiOS TV services for residential and small business subscribers in certain areas.

The communications services we provide are subject to regulation by the state regulatory commissions of California, Idaho, Oregon and Washington with respect to intrastate rates and services and other matters. The Federal Communications Commission regulates rates that we charge long distance carriers and end-user subscribers for interstate access services.

On May 13, 2009, Verizon announced a definitive agreement with Frontier Communications Corporation (Frontier) that will result in Verizon establishing a separate entity, known as New Communications Holdings Inc. (Spinco), for its local exchange and related business assets in 13 states and parts of California. At the closing 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 satisfaction of certain conditions, including receipt of state and federal telecommunications regulatory approvals. We anticipate the Frontier Merger will close during the second quarter of 2010. It is anticipated that if the Frontier Merger occurs after June 1, 2010, all outstanding long-term debt of Verizon Northwest will have been repaid.

During 2009, Verizon recorded pretax charges of $220 million for costs incurred related to the separation of the Wireline network, non-network and other activities to enable the markets to be divested to operate on a standalone basis subsequent to the closing of the transaction with Frontier, as well as for professional advisory and legal fees in connection with this transaction. Of this amount, we recorded $2 million.

Basis of Presentation

We prepare our financial statements using generally accepted accounting principles in the United States (U.S.) which require management to make estimates and assumptions that affect reported amounts and disclosures. Actual results could differ from those estimates. Examples of significant estimates include the allowance for doubtful accounts, the recoverability of long-lived assets, unrealized tax benefits, and pension and postretirement benefit assumptions.

The consolidated financial statements include the accounts of Verizon Northwest Inc. and its wholly owned subsidiary, Verizon West Coast Inc.

All significant intercompany accounts and transactions have been eliminated.

We have evaluated subsequent events through March 29, 2010, the date these financial statements were issued.

We have reclassified certain amounts from prior periods to conform with our current presentation.

Revenue Recognition

We recognize revenues based upon usage of our local exchange network and facilities and contract fees. Fixed monthly fees for local telephone, long distance and certain other services are billed one month in advance and recognized when earned. Revenue from services that are not fixed in amount and are based on usage is generally billed in arrears and recognized when such services are provided. When we bundle the equipment with maintenance and monitoring services, we recognize equipment revenue when the equipment is installed in accordance with contractual specifications and ready for the customer's use. The maintenance and monitoring services are recognized monthly over the term of the contract as we provide the services. Long-term contracts are accounted for using the percentage of completion method. We use the completed contract method if we cannot estimate the costs with a reasonable degree of reliability.

Customer activation fees, along with the related costs up to but not exceeding the activation fees, are deferred and amortized over the customer relationship period.

We report taxes imposed by governmental authorities on revenue-producing transactions between us and our customers on a net basis.

Maintenance and Repairs

The cost of maintenance and repairs, including the cost of replacing minor items not constituting substantial betterments, is charged primarily to Cost of services and sales as these costs are incurred.

Trade and Other Accounts Receivable

Trade and other accounts receivable are stated at the amount we expect to collect. We maintain allowances for uncollectible accounts for estimated losses resulting from the inability of our customers to make required payments. In determining these estimates, we consider historical write-offs, the aging of the receivables and other factors, such as overall economic conditions.

Concentrations of Credit Risk

Financial instruments that subject us to concentrations of credit risk consist primarily of trade receivables. Concentrations of credit risk with respect to trade receivables, other than those from AT&T Inc. (AT&T) and Sprint Nextel Corporation (Sprint), are limited due to the large number of customers. We generated revenues from services provided to AT&T and Sprint (primarily network access and billing and collection) of $31 million and $20 million in 2009 and $49 million and $21 million in 2008, respectively.

While we may be exposed to credit losses due to the nonperformance of our counterparties, we consider this risk remote and do not expect the settlement of these transactions to have a material effect on our results of operations or financial position.

Material and Supplies

Material and supplies include new and reusable materials which are stated principally at average original cost, except that specific costs are used in the case of large individual items.

Plant and Depreciation

We record our plant, property and equipment at cost. Depreciation expense is principally based on the composite group remaining life method and straight-line composite rates. This method provides for the recognition of the cost of the remaining net investment in telephone plant, property and equipment less anticipated net salvage value, over the remaining asset lives. This method requires the periodic revision of depreciation rates.

The asset lives used by our operations are presented in the following table:

Average Useful Lives (in years)	
Buildings	45
Central office equipment	5-11
Outside communications plant	
Copper cable	15
Fiber cable	25
Poles and conduit	30-50
Furniture, vehicles and other	5-15

When we replace, retire or otherwise dispose of depreciable plant used in our local telephone network, we deduct the carrying amount of such plant from the respective accounts and charge it to accumulated depreciation.

We capitalize network software purchased or developed along with related plant assets. We also capitalize interest associated with the acquisition or construction of network-related assets. Capitalized interest is reported and depreciated as part of the cost of network-related assets and as a reduction in interest expense.

Annually, we review the estimated useful lives of plant, property and equipment along with the associated depreciation rates. We determined effective January 1, 2009 that the average useful lives of fiber cable would be increased to 25 years from 20 to 25 years and the average useful lives of copper cable was changed to 15 years from 14 to 18 years. As a result, 2009 depreciation expense increased by $5 million. Effective January 1, 2008, the average useful lives of fiber cable was increased from 20 years to 20 to 25 years. As a result, 2008 depreciation expense decreased by $6 million.

We believe that the current estimated useful asset lives are reasonable, although they are subject to continual review and analysis. In the evaluation of asset lives, multiple factors are considered, including, but not limited to, the ongoing plans to roll out the broadband network, technology upgrades and enhancements, planned retirements, and the adequacy of reserves.

Long-Lived Assets

Our plant, property and equipment are reviewed for impairment. These assets are tested for recoverability whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. If any indications were present, we would test for recoverability by comparing the carrying amount of the asset to the net undiscounted cash flows expected to be generated from the asset. If those net undiscounted cash flows do not exceed the carrying amount (i.e., the asset is not recoverable), we would perform the next step, which is to determine the fair value of the asset and record an impairment, if any. An impairment charge is recognized for the amount (if any) by which the carrying value of the asset exceeds its fair value.

Computer Software Costs

We capitalize the cost of internal-use network software, which has a useful life in excess of one year. Subsequent additions, modifications or upgrades to internal-use network software are capitalized only to the extent that they allow the software to perform a task it previously did not perform. Software maintenance and training costs are expensed in the period in which they are incurred. Also, we capitalize interest associated with the development of internal-use network software.

Advertising Costs

Costs for advertising products and services are charged to Selling, general and administrative expense in the period in which they are incurred.

Stock-Based Compensation

We participate in the Verizon Communications Long Term Incentive Plan (the Plan). The Plan permits the granting of stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares, performance stock units and other awards.

Restricted Stock Units

The Plan provides for grants of Restricted Stock Units (RSUs) that generally vest at the end of the third year after the grant. The RSUs are classified as liability awards because the RSUs will be paid in cash upon vesting. The RSU award liability is measured at its fair value at the end of each reporting period and, therefore, will fluctuate based on the price of Verizon's stock. Dividend equivalent units are also paid to participants at the time the RSU award is paid, and in the same proportion as the RSU award.

Performance Stock Units

The Plan also provides for grants of Performance Stock Units (PSUs) that generally vest at the end of the third year after the grant. As defined by the Plan, the Human Resources Committee of the Board of Directors of Verizon determines the number of PSUs a participant earns based on the extent to which the corresponding goals have been achieved over the three-year performance cycle. All payments are subject to approval by Verizon's Human Resources Committee. The PSUs are classified as liability awards because the PSU awards are paid in cash upon vesting. The PSU award liability is measured at its fair value at the end of each reporting period and, therefore, will fluctuate based on the price of Verizon's stock as well as performance relative to the targets. Dividend equivalent units are also paid to participants at the time that the PSU award is determined and paid, and in the same proportion as the PSU award.

Stock Options

The Plan provides for grants of stock options to employees at an option price per share of 100% of the fair market value of Verizon common stock on the date of grant. Each grant has a 10 year life, vesting equally over a three year period, starting at the date of the grant. We have not granted new stock options since 2004.

The structure of Verizon's stock incentive plans does not provide for the separate determination of certain disclosures for our company. The required information is provided on a consolidated basis in Verizon's Annual Report on Form 10-K for the year ended December 31, 2009.

After-tax compensation expense for other stock-based compensation included in net income as reported for the years ended December 31, 2009 and 2008 was not material.

Employee Benefit Plans

We participate in Verizon's benefit plans and the structure of these plans does not provide for the separate disclosure of the related pension and postretirement assets and obligations at a company level. The annual income and expense related to our employees are allocated to the Company based on employee obligations and are included in the statements of income in Cost of services and sales and Selling, general and administrative expenses. The related pension and postretirement benefit asset/obligations have been accumulated over time based on accruals net of payments and termination/settlement charges and are included in Prepaid pension assets and Employee benefit obligations in the balance sheets (see Note 5).

We recognize a defined benefit postretirement plan's funded status as either an asset or liability on the consolidated balance sheets. Also, we measure any unrecognized actuarial gains and losses and prior service costs and credits that arise during the period as a component of Accumulated other comprehensive loss, net of applicable income tax. Because of the structure of the plans, the related adjustments recorded by Verizon to recognize the funded status are not reflected in the balance sheets as of December 31, 2009 or 2008.

We maintain ongoing severance plans for both management and associate employees, which provide benefits to employees that are terminated. The costs for these plans are accounted for under the accounting standards regarding employers' accounting for postemployment benefits. We accrue for severance benefits based on the terms of our severance plan over the estimated service periods of the employees. The accruals are also based on the historical run-rate of actual severances and expectations for future severances. Severance costs are included in Selling, general and administrative expense in our statements of income.

Fair Value Measurements

Fair Value of financial and non-financial assets and liabilities is defined as an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. The three-tier hierarchy for inputs used in measuring fair value, which prioritizes the inputs used in the methodologies of measuring fair value for assets and liabilities, is as follows:

Level 1 - Quoted prices in active markets for identical assets or liabilities
Level 2 - Observable inputs other than quoted prices in active markets for identical assets and liabilities
Level 3 - No observable pricing inputs in the market

Financial assets and financial liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurements. Our assessment of the significance of a particular input to the fair value measurements requires judgment, and may affect the valuation of the assets and liabilities being measured and their placement within the fair value hierarchy.

Income Taxes

Verizon and its domestic subsidiaries, including us, file a consolidated federal income tax return. We participate in a tax sharing agreement with Verizon and remit tax payments to Verizon based on the respective tax liability determined as if on a separate company basis. Current and deferred tax expense/(benefit) is determined by applying the accounting standard for accounting for income taxes to each subsidiary as if it were a separate taxpayer. At December 31, 2009 and December 31, 2008 we had an income tax receivable and payable from/due to Verizon Communications Inc. of $2 million and $15 million, respectively.

Our effective tax rate is based on pre-tax income, statutory tax rates, tax laws and regulations and tax planning strategies available to us in the various jurisdictions in which we operate.

Deferred income taxes are provided for temporary differences in the bases between financial statement and income tax assets and liabilities. Deferred income taxes are recalculated annually at rates then in effect. We record valuation allowances to reduce our deferred tax assets to the amount that is more likely than not to be realized.

We use a two-step approach for recognizing and measuring tax benefits taken or expected to be taken in a tax return. The first step is recognition: we determine whether it is more likely than not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. In evaluating whether a tax position has met the more-likely-than-not recognition threshold, we presume that the position will be examined by the appropriate taxing authority that has full knowledge of all relevant information. The second step is measurement: a tax position that meets the more-likely-than-not recognition threshold is measured to determine the amount of benefit to recognize in the financial statements. The tax position is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. Differences between tax positions taken in a tax return and amounts recognized in the financial statements will generally result in one or more of the following: an increase in a liability for income taxes payable, a reduction of an income tax refund receivable, a reduction in a deferred tax asset, or an increase in a deferred tax liability.

Significant management judgment is required in evaluating our tax positions and in determining our effective tax rate.

2. PLANT, PROPERTY AND EQUIPMENT

The following table displays the details of Plant, property and equipment, which is stated at cost:

		(dollars in millions)
At December 31,	**2009**	2008
Land	**$ 12**	$ 12
Buildings	**300**	292
Central office equipment	**1,925**	1,899
Outside communications plant	**2,823**	2,669
Furniture, vehicles and other work equipment	**77**	111
Construction-in-progress	**18**	32
Other	**22**	26
	5,177	5,041
Less accumulated depreciation	**3,425**	3,300
Total	**$ 1,752**	$ 1,741

3. LEASES

We lease certain facilities and equipment for use in our operations under operating leases. Total rent expense amounted to $31 million in 2009 and $42 million in 2008. Of these amounts, $25 million in 2009 and $32 million in 2008 were lease payments to affiliated companies.

This table displays the aggregate minimum rental commitments under noncancelable operating leases for the periods shown at December 31, 2009, excluding those with affiliated companies:

	(dollars in millions)
Years	**Operating Leases**
2010	$ 3
2011	2
2012	2
2013	1
2014	1
Thereafter	1
Total minimum rental commitments	$ 10

4. DEBT

Debt Maturing Within One Year

Debt maturing within one year as follows:

		(dollars in millions)
At December 31,	**2009**	2008
Notes payable to affiliate VNFC	**$ 678**	$ 489
Long-term debt maturing within one year	**175**	---
Total debt maturing within one year	**$ 853**	$ 489
Weighted average interest rate for notes payable outstanding at year-end	**0.73%**	2.93%

We have a contractual agreement with an affiliated company, Verizon Network Funding Corp. (VNFC), for the provision of financing and cash management services.

Long-Term Debt

At December 31, 2009, the Company did not have any outstanding long-term obligation. At December 31, 2008, the Company had $175 million of 6.3% twelve years debenture maturing in 2010.

During 2008, we redeemed $200 million of 5.55% notes.

The aggregate principal amount of bonds and debentures that may be issued is subject to the restrictions and provisions of our indentures.

We are in compliance with all of our debt covenants.

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 $856 million and $664 million at December 31, 2009 and 2008, respectively, as compared to the carrying value of $853 million and $664 million, respectively at December 31, 2009 and 2008.

5. EMPLOYEE BENEFITS

We participate in Verizon's benefit plans. Verizon maintains noncontributory defined benefit pension plans for many of our employees. The postretirement health care and life insurance plans for our retirees and their dependents are both contributory and noncontributory and include a limit on Verizon's share of cost for recent and future retirees. Verizon also sponsors defined contribution savings plans to provide opportunities for eligible employees to save for retirement on a tax-deferred basis. We use a measurement date of December 31 for our pension and postretirement health care and life insurance plans.

The structure of Verizon's benefit plans does not provide for the separate determination of certain disclosures for our company. The required information is provided on a consolidated basis in Verizon's Annual Report on Form 10-K for the year ended December 31, 2009.

Pension and Other Postretirement Benefits

Pension and other postretirement benefits for the majority of our employees are subject to collective bargaining agreements. Approximately 82% of our employees (associates) are covered by collective bargaining agreements. Modifications in benefits have been bargained from time to time, and Verizon may also periodically amend the benefits in the management plans.

The structure of Verizon's benefit plans does not provide for the separate determination of certain disclosures for our company. The required information is provided on a consolidated basis in Verizon's Annual Report on Form 10-K for the year ended December 31, 2009.

Benefit Cost

The following table displays the details of net periodic pension and other postretirement costs:

(dollars in millions)

	Pension		**Health Care and Life**	
Years Ended December 31,	**2009**	2008	**2009**	2008
Net periodic benefit (income) cost	**$ (7)**	$ (15)	**$ 25**	$ 30
Settlement loss	**61**	12	**---**	---
Curtailment loss	**2**	---	**3**	---
Subtotal	**63**	12	**3**	---
Total (income) cost	**$ 56**	$ (3)	**$ 28**	$ 30

In 2009, we recorded a pension settlement loss of $61 million related to employees that received lump-sum distributions, primarily resulting from our previous separation plans, as prescribed payment thresholds were reached. Additionally, we recorded pension and postretirement curtailment losses of $5 million as workforce reductions caused the elimination of a significant amount of future service requiring us to recognize a portion of the prior service cost and actuarial losses.

In 2008, we recorded a pension settlement loss of $12 million related to employees that received lump-sum distributions, primarily resulting from our previous separation plans, as prescribed payment thresholds were reached.

Amounts recognized in the consolidated balance sheets consist of:

(dollars in millions)

	Pension		Health Care and Life	
At December 31,	**2009**	2008	**2009**	2008
Prepaid pension asset	**$ 228**	$ 284	**$ ---**	$ ---
Employee benefit obligations	**1**	1	**172**	162

Changes in benefit obligations were caused by factors including changes in actuarial assumptions, settlements and curtailments.

Assumptions

The weighted-average assumptions used in determining benefit obligations follow:

	Pension		Health Care and Life	
At December 31,	**2009**	2008	**2009**	2008
Discount rate	**6.25%**	6.75%	**6.25%**	6.75%
Rate of compensation increases	**4.00**	4.00	**N/A**	N/A

The weighted-average assumptions used in determining net periodic cost follow:

	Pension		Health Care and Life	
Years Ended December 31,	**2009**	2008	**2009**	2008
Discount rate	**6.75%**	6.50%	**6.75%**	6.50%
Expected return on plan assets	**8.50**	8.50	**8.25**	8.25
Rate of compensation increases	**4.00**	4.00	**N/A**	4.00

In order to project the long-term target investment return for the total portfolio, estimates are prepared for the total return of each major asset class over the subsequent 10-year period, or longer. Those estimates are based on a combination of factors including the current market interest rates and valuation levels, consensus earnings expectations, historical long-term risk premiums and value-added. To determine the aggregate return for the pension trust, the projected return of each individual asset class is then weighted according to the allocation to that investment area in the trust's long-term asset allocation policy.

The assumed Health Care Cost Trend Rates follow:

	Health Care and Life	
At December 31,	**2009**	2008
Health care cost trend rate assumed for next year	**8.00%**	9.00%
Rate to which cost trend rate gradually declines	**5.00**	5.00
Year the rate reaches level it is assumed to remain thereafter	**2014**	2014

Savings Plans and Employee Stock Ownership Plans

Substantially all of our employees are eligible to participate in savings plans maintained by Verizon. Verizon maintains four leveraged employee stock ownership plans (ESOP). Only one plan currently has unallocated shares. Under this plan, a certain percentage of eligible employee contributions are matched with shares of Verizon's common stock. We recognize savings plan cost based on our matching obligation attributed to our participating management employees. In addition to the ESOP, Verizon also maintains a savings plan for associate employees. We recorded total savings plan costs of $4 million in 2009 and $5 million in 2008.

The following table provides an analysis of our severance liability recorded in accordance with the accounting standard regarding employers' accounting for postemployment benefits:

(dollars in millions)

Year	Beginning of Year	Charged to Expense (a)	Payments	End of Year (b)
2008	$ 17	$ 5	$ (9)	$ 13
2009	**$ 13**	**$ 1**	**$ (5)**	**$ 9**

(a) Includes accruals for ongoing employee severance costs and $5 million of charges in 2008 for the involuntary separation of employees.

(b) The remaining severance liability includes future contractual payments to employees separated as of the end of the year.

Recent Developments

On March 23, 2010, President Obama signed into law the Patient Protection and Affordable Care Act (PPACA), which includes provisions that, when fully phased in, limit the federal income tax deduction an employer can claim for retiree health care costs for providing retiree prescription drug benefits that are equivalent to Medicare D coverage, and also imposes a 40% excise tax on coverage providers to the extent the value of employer-sponsored health plans exceeds certain prescribed dollar thresholds. Verizon is currently evaluating the impacts that the PPACA will have on Verizon's financial position and results of operations, including its effective tax rate, which may be material.

6. INCOME TAXES

The components of the provision for income taxes are presented in the following table:

(dollars in millions)

Years Ended December 31,	2009	2008
Current:		
Federal	**$ (4)**	$ 48
State and local	**3**	4
	(1)	52
Deferred:		
Federal	**39**	26
State and local	**5**	2
	44	28
Total income tax expense	**$ 43**	$ 80

Included within the 2009 deferred tax expense of $44 million is $1.5 million net of federal income tax related to a statutory rate change within the state of Oregon.

The following table shows the primary reasons for the difference between the effective income tax rate and the statutory federal income tax rate:

Years Ended December 31,	2009	2008
Statutory federal income tax rate	**35.0%**	35.0%
State income taxes, net of federal tax benefits	**4.4**	1.9
Unrecognized tax benefit	**(2.2)**	(2.0)
Other, net	**(1.1)**	1.1
Effective income tax rate	**36.1%**	36.0%

Deferred taxes arise because of differences in the book and tax bases of certain assets and liabilities. Significant components of our deferred tax assets and liabilities are shown in the following table:

	(dollars in millions)	
Years Ended December 31,	**2009**	2008
Deferred tax assets:		
Allowance for uncollectible accounts	**$ 1**	$ 2
Other - assets	**2**	1
Total deferred tax assets	**3**	3
Deferred tax liabilities:		
Employee benefits	**2**	29
Depreciation	**291**	218
Other - liabilities	**2**	4
Total deferred tax liabilities	**295**	251
Net deferred tax liability	**$ 292**	$ 248

Unrecognized Tax Benefits

A reconciliation of the beginning and ending balance of unrecognized tax benefits is as follows:

	(dollars in millions)	
	2009	2008
Balance at January 1,	**$ 12**	$ 21
Additions based on tax positions related to the current year	**1**	2
Additions for tax positions of prior years	**6**	1
Reductions for tax positions of prior years	**(7)**	(4)
Settlements	**---**	(8)
Balance at December 31,	**$ 12**	$ 12

Included in the total unrecognized tax benefits at December 31, 2009 and 2008 is $1 million and $1 million, respectively, that, if recognized, would favorably affect the effective income tax rate.

We recognize any interest and penalties accrued related to unrecognized tax benefits in income tax expense. During 2009 and 2008, we recognized a net after tax benefit in the income statement related to interest and penalties of approximately $3 million and $4 million, respectively. We had approximately $1 million (after-tax) and $4 million (after-tax) for the payment of interest and penalties accrued in the balance sheets at December 31, 2009 and December 31, 2008, respectively.

Verizon and/or its domestic subsidiaries file income tax returns in the U.S. federal jurisdiction and various state and local jurisdictions. The Internal Revenue Service (IRS) is currently examining Verizon's U.S. income tax returns for years 2004 through 2006. As a large taxpayer, we are under continual audit by the IRS and multiple state jurisdictions on numerous open tax positions. It is reasonably possible that the amount of the remaining liability for unrecognized tax benefits could change by a significant amount during the next twelve-month period. An estimate of the range of the possible change cannot be made until issues are further developed or examinations close.

7. TRANSACTIONS WITH AFFILIATES

Our consolidated financial statements include transactions with the following affiliates:

		(dollars in millions)
Years Ended December 31,	**2009**	2008
Operating revenues:		
Verizon Online	**$ 126**	$ 110
Verizon Business	**58**	57
Verizon Wireless Inc.	**19**	18
Verizon Long Distance	**11**	12
Verizon Operating Telephone Companies	**3**	4
Verizon Services	**1**	1
Other	**---**	1
	$ 218	$ 203
Operating expenses:		
Verizon Services	**$ 208**	$ 143
Verizon Data Services Inc.	**34**	31
Verizon Wireless Inc.	**2**	4
GTE Communication Systems Corporation	**---**	2
Verizon Business	**1**	1
	$ 245	$ 181
Other income (expense), net:		
Interest income from Verizon affiliate companies	**$ ---**	$ 1
Interest expense:		
Interest expense to Verizon Network Funding Corp.	**$ 5**	$ 11
Purchases from GTE Communication Systems Corporation	**$ ---**	$ 12
Dividends paid to GTE Corporation	**$ 324**	$ 55

Outstanding balances with affiliates are reported in the consolidated balance sheets at December 31, 2009 and 2008 as Accounts Receivable from Affiliates, Notes Payable to Affiliates, and Accounts Payable and Accrued Liabilities to Affiliates.

Verizon Online

Our operating revenues include transactions with Verizon Online LLC (Verizon Online) associated with the provision of network access and billing and collection services. These revenues are earned from Verizon Online, which utilizes our facilities to provide Internet access services to their customers. Revenues from Verizon Online include revenues from GTE.net LLC, which merged with and into Verizon Online on March 31, 2009.

Verizon Business

Our operating revenues include transactions with Verizon Business associated with the provision of network access services, wholesale interconnection service agreements and from billing and collection services.

Our operating expenses also include transactions with Verizon Business. We recognize costs associated with interconnection agreements and capacity services agreements.

Verizon Wireless Inc.

Our operating revenues include transactions with Verizon Wireless Inc. (Verizon Wireless) associated with the provision of local and network access services, billing and collection services and from interconnection agreements and commission fees. These revenues are earned from Verizon Wireless who provides wireless voice and data services, paging services and equipment sales to their customers.

Our operating expenses also include transactions with Verizon Wireless. We recognize costs associated with wireless voice and data services, paging services and for interconnection agreements.

Verizon Services

We have contractual arrangements with Verizon Services for the provision of various centralized services. These services are divided into two broad categories. The first category is comprised of network related services which generally benefit only Verizon's operating telephone subsidiaries. These services include marketing, sales, legal, accounting, finance, data processing, materials management, procurement, labor relations, and staff support for various network operations. The second category is comprised of overhead and support services which generally benefit all subsidiaries of Verizon. Such services include corporate governance, corporate finance, external affairs, legal, media relations, employee communications, corporate advertising, human resources, treasury, and rent expenses associated with the rental of facilities and equipment. Costs may be either directly assigned to one subsidiary or allocated to more than one subsidiary based on functional reviews of the work performed.

Verizon Long Distance

Our operating revenues include transactions with Verizon Long Distance associated with the provision of local and network access and billing and collection services. These revenues are earned from Verizon Long Distance who utilizes our facilities to provide long distance services to their customers.

Verizon Operating Telephone Companies

Our operating revenues include transactions with other Verizon operating telephone companies. Revenues associated with transactions with these affiliates are primarily earned from the rental of our facilities and equipment.

Verizon Data Services Inc.

Verizon Data Services Inc. provides data processing services, software application development and maintenance, which generally benefit Verizon's operating telephone subsidiaries, including us. We are charged for these affiliated transactions based on proportional cost allocation methodologies.

GTE Communication Systems Corporation

GTE Communication Systems Corporation (GTE Communication Systems) provides construction and maintenance equipment, supplies and electronic repair services to us. We record these purchases and services at cost, including a return realized by GTE Communication Systems.

Verizon Network Funding Corporation

We recognize interest expense in connection with a contractual agreement with an affiliated company, Verizon Network Funding Corp. (VNFC), for the provision of short-term financing, short-term investing and cash management services.

Other Affiliates

Other operating revenues include miscellaneous items of income resulting from transactions with other affiliates. These transactions include the provision of local and network access services, billing and collection services, rental of facilities and equipment, and sales of material and supplies. We also earn revenue from an agreement to provide subscriber lists to an affiliate and transactions with Verizon Services.

8. ADDITIONAL FINANCIAL INFORMATION

The tables below provide additional financial information related to our consolidated financial statements:

		(dollars in millions)
Years Ended December 31,	**2009**	2008
Cash Flows Information:		
Cash paid during the year for:		
Income taxes paid, net	**$ 20**	$ 53
Interest, net of amounts capitalized (excluding affiliates)	**10**	21
Statements of Income Information:		
Depreciation expense	**212**	198
Interest costs incurred	**16**	31
Capitalized interest	**(1)**	(2)
Advertising expense (allocated to us by Verizon Services)	**11**	16

9. 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 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.