

GTE Southwest Incorporated

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

GTE Southwest Incorporated
CONDENSED STATEMENTS OF INCOME

(dollars in millions) (unaudited)	Three Months Ended March 31,	
	2010	2009
Operating Revenues (including \$75 and \$71 from affiliates)	\$ 307	\$ 316
Operating Expenses (including \$103 and \$89 to affiliates)		
Cost of services and sales (exclusive of items shown below)	121	101
Selling, general and administrative expense	70	80
Depreciation and amortization expense	67	74
Total Operating Expenses	258	255
Operating Income	49	61
Interest expense (including \$(2) and \$(3) to affiliates)	(4)	(5)
Income Before Provision for Income Taxes	45	56
Provision for income taxes	(29)	(15)
Net Income	\$ 16	\$ 41

See Notes to Condensed Financial Statements

GTE Southwest Incorporated
CONDENSED 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 \$13 and \$13

\$ 136 \$ 143

Affiliates

24 27

Prepaid expenses

94 1

Deferred income taxes

8 8

Deferred charges and other

20 31

Total current assets

282 210

Plant, property and equipment

6,271 6,228

Less accumulated depreciation

4,165 4,096

2,106 2,132

Intangible assets, net

4 4

Prepaid pension asset

506 502

Other assets

23 22

Total assets

\$ 2,921 \$ 2,870

Liabilities and Shareowner's Investment

Current liabilities

Debt maturing within one year:

Notes payable to affiliates

\$ 801 \$ 870

Other

1 1

Accounts payable and accrued liabilities:

Affiliates

70 65

Other

67 86

Other current liabilities

62 63

Total current liabilities

1,001 1,085

Long-term debt

101 102

Employee benefit obligations

586 588

Deferred credits and other liabilities:

Deferred income taxes

388 274

Other

53 45

441 319

Shareowner's investment

Common stock (one share, without par value)

650 650

Contributed capital

200 200

Accumulated deficit

(58) (74)

Total shareowner's investment

792 776

Total liabilities and shareowner's investment

\$ 2,921 \$ 2,870

See Notes to Condensed Financial Statements

GTE Southwest Incorporated

CONDENSED STATEMENTS OF CASH FLOWS

(dollars in millions) (unaudited)	Three Months Ended March 31,	
	2010	2009
Net Cash Provided by Operating Activities	\$ 102	\$ 105
Cash Flows from Investing Activities		
Capital expenditures (including capitalized software)	(30)	(52)
Net change in short-term investments	---	11
Net cash used in investing activities	(30)	(41)
Cash Flows from Financing Activities		
Net change in short-term notes payable to affiliate	(69)	(22)
Dividends paid	---	(5)
Net change in outstanding checks drawn on controlled disbursement accounts	(3)	(2)
Return of capital to parent	---	(35)
Net cash used in financing activities	(72)	(64)
Net change in cash	---	---
Cash, beginning of period	---	---
Cash, end of period	\$ ---	\$ ---

See Notes to Condensed Financial Statements

GTE Southwest Incorporated

NOTES TO CONDENSED FINANCIAL STATEMENTS (Unaudited)

1. Basis of Presentation and Recent Accounting Standard Updates

GTE Southwest Inc. (GTE Southwest or the Company) is a wholly owned subsidiary of GTE Corporation (GTE), which is a wholly owned subsidiary of Verizon Communications Inc. (Verizon). The accompanying unaudited condensed financial statements have been prepared in accordance with generally accepted accounting principles for interim periods. These condensed 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. We have evaluated subsequent events through May 28, 2010, the date these 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 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 financial statements.

2. Shareowner's Investment

(dollars in millions)	Common Stock	Contributed Capital	Accumulated Deficit
Balance at December 31, 2009	\$ 650	\$ 200	\$ (74)
Net income	---	---	16
Balance at March 31, 2010	\$ 650	\$ 200	\$ (58)

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

3. Debt

The fair value of our short-term and long-term debt, excluding capital leases, is determined based on market quotes for similar terms and maturities or future cash flows discounted at current rates. The fair value of our long-term and short-term debt, excluding capital leases, was approximately \$919 million and \$985 million at March 31, 2010 and December 31, 2009, respectively, as compared to the carrying value of approximately \$900 million and \$969 million at March 31, 2010 and December 31, 2009, respectively.

GTE Southwest Incorporated

4. 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.

5. 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 \$11 million in the first quarter of 2010 to reflect the impact of this change.