GTE Southwest Incorporated

Condensed Financial Statements
Three and Nine Months Ended September 30, 2008 and 2007

GTE Southwest Incorporated

CONDENSED STATEMENTS OF INCOME

(dollars in millions) (unaudited)	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Operating Revenues				
(including $70, $72, $202 and $209 from affiliates)	$ 325	$ 338	$ 982	$ 1,008
Operating Expenses				
(including $78, $82, $239 and $239 to affiliates)				
Cost of services and sales (exclusive of items shown below)	116	132	355	360
Selling, general and administrative expense	99	97	268	256
Depreciation expense	74	75	221	222
Total Operating Expenses	289	304	844	838
Operating Income	36	34	138	170
Other income and (expense), net	---	1	2	3
(including $---, $1, $--- and $1 from affiliates)				
Interest expense				
(including $6, $14, $21 and $43 to affiliates)	(8)	(19)	(28)	(53)
Income Before Provision for Income Taxes	28	16	112	120
Provision for income taxes	(11)	(7)	(41)	(46)
Net Income	$ 17	$ 9	$ 71	$ 74

See Notes to Condensed Financial Statements

GTE Southwest Incorporated

CONDENSED BALANCE SHEETS

(dollars in millions) (unaudited)	At September 30, 2008	At December 31, 2007
Assets		
Current assets		
Short-term investments	$ 29	$ 78
Accounts receivable:		
Trade and other, net of allowances for uncollectibles of $15 and $14	155	165
Affiliates	27	38
Materials and supplies	19	19
Prepaid expenses	1	1
Deferred charges and other	31	32
Total current assets	262	333
Plant, property and equipment	6,123	6,004
Less accumulated depreciation	3,890	3,747
	2,233	2,257
Prepaid pension asset	576	565
Other assets	23	26
Total assets	$ 3,094	$ 3,181
Liabilities and Shareowner's Investment		
Current liabilities		
Debt maturing within one year:		
Notes payable to affiliates	$ 886	$ 1,061
Other	1	1
Accounts payable and accrued liabilities:		
Affiliates	69	62
Other	90	101
Deferred income taxes	10	12
Other current liabilities	84	96
Total current liabilities	1,140	1,333
Long-term debt	102	102
Employee benefit obligations	489	482
Deferred credits and other liabilities		
Deferred income taxes	252	229
Other	55	50
	307	279
Shareowner's investment		
Common stock (one share, without par value)	650	650
Contributed capital	391	391
Accumulated earnings/(deficit)	15	(56)
Total shareowner's investment	1,056	985
Total liabilities and shareowner's investment	$ 3,094	$ 3,181

See Notes to Condensed Financial Statements

GTE Southwest Incorporated

CONDENSED STATEMENTS OF CASH FLOWS

(dollars in millions) (unaudited)	Nine Months Ended September 30, 2008	2007
Net Cash Provided by Operating Activities	$ 321	$ 218
Cash Flows from Investing Activities		
Capital expenditures (including capitalized software)	(198)	(272)
Net change in short-term investments	49	49
Other, net	(2)	12
Net cash used in investing activities	(151)	(211)
Cash Flows from Financing Activities		
Repayment of borrowings and capital lease obligations	---	(150)
Net change in notes payable to affiliates	(175)	147
Net change in outstanding checks drawn on controlled disbursement accounts	5	(4)
Net cash used in financing activities	(170)	(7)
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 Pronouncements

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. The results for the interim periods are not necessarily indicative of results for the full year. The condensed balance sheet at December 31, 2007 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, 2007 audited financial statements.

In April 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. FAS 142-3, *Determination of the Useful Life of Intangible Assets* (FSP 142-3). FSP 142-3 removes the requirement under Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets* to consider whether an intangible asset can be renewed without substantial cost or material modifications to the existing terms and conditions, and replaces it with a requirement that an entity consider its own historical experience in renewing similar arrangements, or a consideration of market participant assumptions in the absence of historical experience. FSP 142-3 also requires entities to disclose information that enables users of financial statements to assess the extent to which the expected future cash flows associated with the asset are affected by the entity's intent and/or ability to renew or extend the arrangement. We are required to adopt FSP 142-3 effective January 1, 2009 on a prospective basis. The adoption of this statement will not have any impact on our financial statements.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133*, (SFAS No. 161). This statement requires additional disclosures for derivative instruments and hedging activities that include how and why an entity uses derivatives, how these instruments and the related hedged items are accounted for under SFAS No. 133 and related interpretations, and how derivative instruments and related hedged items affect the entity's financial position, results of operations and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations (Revised)*, (SFAS No. 141(R)), to replace SFAS No. 141, *Business Combinations*. SFAS No. 141(R) requires the use of the acquisition method of accounting, defines the acquirer, establishes the acquisition date and broadens the scope to all transactions and other events in which one entity obtains control over one or more other businesses. This statement is effective for business combinations or transactions entered into for fiscal years beginning on or after December 15, 2008. The adoption of this statement will not have any impact on our financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51*, (SFAS No. 160). SFAS No. 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the retained interest and gain or loss when a subsidiary is deconsolidated. This statement is effective for financial statements issued for fiscal years beginning on or after December 15, 2008. The adoption of this statement will not have any impact on our financial statements.

2. Shareowner's Investment

(dollars in millions)	**Common Stock**	**Contributed Capital**	**Accumulated Earnings**
Balance at December 31, 2007	$ 650	$ 391	$ (56)
Net income	---	---	71
Balance at September 30, 2008	$ 650	$ 391	$ 15

Net income and comprehensive income were the same for the three and nine months ended September 30, 2008 and 2007, respectively.

3. Fair Value Measurements

SFAS No. 157

SFAS No. 157, *Fair Value Measurements* (SFAS No. 157) defines fair value, establishes a framework for measuring fair value and establishes a hierarchy that categorizes and prioritizes the sources to be used to estimate fair value. SFAS No. 157 also expands financial statement disclosures about fair value measurements. On February 12, 2008, the FASB issued FSP No. FAS 157-2 (FSP 157-2), *Effective Date of FASB Statement No. 157 (FSP 157-2),* which delays the effective date of SFAS No. 157 for one year for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. We elected a partial deferral of SFAS No. 157 under the provisions of FSP 157-2 related to the measurement of fair value used when evaluating intangible assets and other long-lived assets for impairment and valuing asset retirement obligations and liabilities for exit or disposal activities. Furthermore, the impact of implementing FSP 157-2 is not expected to be material on our financial statements. The impact of partially adopting SFAS No. 157 effective January 1, 2008 was not material on our financial statements.

On October 10, 2008, the FASB issued FSP 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*, (FSP 157-3), which clarifies application of SFAS No. 157 in a market that is not active. FSP 157-3 was effective upon issuance, including prior periods for which financial statements have not been issued. The adoption of this FSP had no impact on our financial statements.

Fair Value Measurements on a Recurring Basis

Financial assets and 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.

The following table presents the asset balances measured at fair value on a recurring basis as of September 30, 2008:

(dollars in millions)	**Level 1** [(1)]	**Level 2** [(2)]	**Level 3** [(3)]	**Total**
Assets:				
Short-term investments	$ –	$ 29	$ –	$ 29

[(1)] – quoted prices in active markets for identical assets or liabilities
[(2)] – observable inputs other than quoted prices in active markets for identical assets and liabilities
[(3)] – no observable pricing inputs in the market

Short-term investments primarily include a fund comprised of cash equivalents held in trust for the payment of certain employee benefits and are classified as Level 2 as they are not actively traded in an established market. The decrease in our short-term investments during the nine months ended September 30, 2008 was due to the payment of these employee benefits.

Fair Value Measurements on a Nonrecurring Basis

As permitted by FSP 157-2, we elected to defer the fair value measurement disclosure of our (a) long-lived assets and finite-lived intangible assets in the determination of impairment under SFAS No. 142 or SFAS No. 144, (b) asset retirement obligations initially measured at fair value under SFAS No. 143 *Accounting for Asset Retirement Obligations*, and (c) nonfinancial liabilities for exit or disposal activities initially measured at fair value under SFAS No. 146 *Accounting for Costs Associated with Exit or Disposal Activities*.

SFAS No. 159

SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of SFAS No. 115* (SFAS No. 159), permits but does not require us to measure financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. As we did not elect to fair value any of our financial instruments under the provisions of SFAS No. 159, our adoption of this statement effective January 1, 2008 did not have an impact on our financial statements.

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, 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.