NEW APPLICATION

ORIGINAL

0000018888

BEFORE THE ARIZONA CORPORATION COMMISSION

RECEIVED
2005 APR 13 P 4:52
AZ CORP COMMISSION
DOCUMENT CONTROL

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
MARC SPITZER
WILLIAM A. MUNDELL
MIKE GLEASON
KRISTIN K. MAYES

T-01846B-05-0279
T-03258A-05-0279
T-03475A-05-0279
T-03289A-05-0279
T-03198A-05-0279
T-03574A-05-0279
T-02431A-05-0279
T-03197A-05-0279
T-02533A-05-0279
T-03394A-05-0279
T-03291A-05-0279

IN THE MATTER OF THE JOINT NOTICE OF INTENT VERIZON COMMUNICATIONS INC. AND MCI, INC.

DOCKET NO. _____

NOTICE OF INTENT

Verizon Communications Inc. ("Verizon") and MCI, Inc. ("MCI"), on behalf of their regulated subsidiaries, (collectively, the "Parties") hereby submit, pursuant to Ariz. Admin. Code R14-2-803, their Joint Notice of Intent to the Arizona Corporation Commission ("Commission").

I. INTRODUCTION

1. The Parties have entered into an Agreement and Plan of Merger (the "Agreement"), pursuant to which MCI will be merged with and into ELI Acquisition, LLC. ELI Acquisition will then be renamed MCI, LLC, and will continue as a wholly owned subsidiary of Verizon. Verizon is the corporate parent of the following named Verizon subsidiaries that provide telecommunications services in Arizona: Verizon California Inc.; Verizon Select Services Inc.; One Point Communications-Colorado, LLC d/b/a Verizon Avenue; Bell Atlantic Communications, Inc. d/b/a Verizon Long Distance; and NYNEX Long Distance Company d/b/a

Arizona Corporation Commission
DOCKETED
APR 13 2005
DOCKETED BY

Snell & Wilmer
L.L.P.
LAW OFFICES
One Arizona Center, 400 E. Van Buren
Phoenix, Arizona 85004-2202
(602) 382-6000

Snell & Wilmer
L.L.P.
LAW OFFICES
One Arizona Center, 400 E. Van Buren
Phoenix, Arizona 85004-2202
(602) 382-6000

Verizon Enterprise Solutions.[1] MCI is the parent corporation of MCImetro Access Transmission Services LLC; MCI WorldCom Network Services, Inc.; TTI National, Inc., Teleconnect Long Distance Services and Systems Co. d/b/a Telcom USA; MCI WorldCom Communications, Inc.; and Intermedia Communications, Inc. (collectively the "MCI subsidiaries"),[2] all of which provide telecommunications services in Arizona. Neither Verizon nor its affiliates are currently affiliated with MCI or its affiliates.

2. The Parties understand that the Commission staff intends to review the proposed transaction under the Affiliated Interest Rules, Ariz. Admin. Code R14-2-801 *et seq.* The Parties respectfully submit, however, that the rules should not be applied to the acquisition of MCI by Verizon. In *Arizona Corporation Commission v. State*, 171 Ariz. 286, 830 P.2d 807 (Ariz. 1992), the Arizona Supreme Court held that the rules "apply only to public utilities subject to the Commission's jurisdiction." 830 P.2d at 819. Accordingly, the rules should not apply to transactions that, like this one, do not directly involve utilities under the Commission's jurisdiction. The only two parties to the proposed acquisition — Verizon Communications Inc. and MCI, Inc. — are Delaware parent companies that do not provide telecommunications or other certificated services in Arizona. Neither the Verizon subsidiaries nor the MCI subsidiaries that provide regulated services in Arizona are parties to the transaction, and the acquisition of MCI's

---

[1] Verizon Avenue Corp.'s application to provide resold and facilities-based local exchange and interexchange telecommunications services is currently pending before the Commission. *See* Docket No. T-04231A-03-0937.

[2] Intermedia Communications, Inc.'s certificate of public convenience and necessity is pending cancellation at the company's request as part of MCI's CLEC consolidation. *See* Docket Nos. T-03291A-05-0038; T-03541A-05-0038.

Snell & Wilmer
L.L.P.
LAW OFFICES
One Arizona Center, 400 E. Van Buren
Phoenix, Arizona 85004-2202
(602) 382-6000

parent corporation will not affect the relationship that these entities have with the Commission.[3] As a result, approval of the transaction should not be required under the Affiliated Interest Rules.

3. That said, to the extent approval of the transaction is required under the Affiliated Interest Rules, it should be granted. The legal status of Verizon's and MCI's regulated subsidiaries in Arizona will remain unchanged following the transaction, and these companies will remain subject to the Commission's authority to the same extent following the acquisition as before it. As demonstrated herein, the proposed acquisition is in the public interest and will be beneficial to all relevant stakeholders. The transaction will have no adverse effect on the rates or the quality of service of the regulated Verizon and MCI subsidiaries. To the contrary, the greater resources of Verizon following the acquisition will enhance its ability to provide a full array of competitively-priced, facilities-based, high quality services and products in a dynamic telecommunications market in which wireless and broadband services are rapidly replacing the use of traditional wireline services.

II. THE PARTIES AND THEIR AFFILIATES

A. Verizon

4. Verizon Communications Inc. is a corporation created and existing under the laws of the State of Delaware. Its principal office is located at 1095 Avenue of the Americas, New York, New York 10036. Verizon's telephone operating company subsidiaries provide telecommunications services on a regulated and unregulated basis in 29 states, Puerto Rico, and

[3] Nor does the transaction satisfy the criteria that would require MCI to file a Notice of Intent despite its receipt of limited waivers of the Affiliated Interest Rules. *See* Decision No. 62702 (June 30, 2000) (requiring MCI to file a Notice of Intent only with respect to reorganizations that are likely to result in: (i) significant increased capital costs of its Arizona operations; (ii) significant additional costs allocated or charged directly to the Arizona jurisdiction; or (iii) significant reduction in net income of its Arizona operations).

Snell & Wilmer
L.L.P.
LAW OFFICES
One Arizona Center, 400 E. Van Buren
Phoenix, Arizona 85004-2202
(602) 382-6000

the District of Columbia, serving 53 million access lines. Although Verizon itself provides no services and is not a regulated telephone company within Arizona or elsewhere, Verizon's local telephone subsidiaries are subject to public utility regulation in the jurisdictions in which they operate, including Arizona. They are also subject to regulation by the FCC for the services they provide pursuant to federal tariffs and the federal Communications Act of 1934. Verizon's Arizona subsidiaries provide regulated telecommunications services in Arizona.

5. Verizon's domestic telecommunications services include the provision of exchange telecommunications services, encompassing switched local residential and business services, local private line, voice and data services, and Centrex services. Verizon also provides intraLATA and interLATA toll and interexchange services, as well as exchange access services, including switched access and special access services. Verizon provides these wireline services to consumers, small and enterprise businesses, and to other telecommunications carriers. Verizon's other domestic subsidiaries provide voice and data wireless services, information services including directory publishing, and electronic commerce. Verizon's international subsidiaries conduct wireline and wireless communications operations.

6. In 2004, Verizon had annual operating revenues of approximately $71 billion. Stressing diversity and a commitment to the communities in which it operates, Verizon has a highly diverse national workforce of 210,000 employees, including approximately 1450 employees in Arizona. Verizon has a strong balance sheet and investment-grade credit rating and is a stable, viable enterprise.

B. MCI

Snell & Wilmer
L.L.P.
LAW OFFICES
One Arizona Center, 400 E. Van Buren
Phoenix, Arizona 85004-2202
(602) 382-6000

7. MCI, Inc. is a corporation created and existing under the laws of the State of Delaware, with its principal office located at 22001 Loudoun County Parkway, Ashburn, Virginia 20147. MCI's subsidiaries provide telecommunications services on a regulated and unregulated basis throughout the United States and in several foreign countries.

8. MCI's subsidiaries provide services to business and government customers, including 75 federal government agencies. Among the enterprise services MCI provides through its subsidiaries are a comprehensive portfolio of local-to-global business data, Internet, and voice services, including IP network technology, Virtual Private Networking, SONET private line, frame relay, ATM, and a full range of dedicated, dial and value-added Internet services.

9. Although MCI, Inc. is not a regulated telephone company within Arizona or elsewhere, some of MCI's subsidiaries are subject to public utility regulation in the jurisdictions in which they operate. The MCI subsidiaries identified above provide consumer services, including interstate long distance services, intrastate toll services, competitive local exchange services, and other telecommunications services in Arizona. MCI's subsidiaries are also subject to regulation by the FCC for the interstate services they provide.

10. In 2004, MCI had annual operating revenues of approximately $21 billion. MCI has over 42,500 employees nationally and internationally, and provides jobs for approximately 1000 employees in Arizona.

II. DESCRIPTION OF THE TRANSACTIONS AND ITS ARIZONA EFFECTS

11. The details of the transaction are set forth in the Agreement and Plan of Merger (the "Agreement"), a copy of which is attached as Exhibit 1. The Agreement was amended on March 29, 2005, by an Amendment, which is attached as Exhibit 2. As described in the

Snell & Wilmer
L.L.P.
LAW OFFICES
One Arizona Center, 400 E. Van Buren
Phoenix, Arizona 85004-2202
(602) 382-6000

Agreement, MCI will merge into ELI Acquisition, LLC, a Delaware limited liability company, which is wholly owned by Verizon and was created solely to facilitate the transaction. ELI Acquisition, LLC will be the surviving company in the merger, and Verizon will be its parent corporation after the merger. Verizon intends to rename the company "MCI, LLC."

12. Under the Agreement as amended, MCI's shareholders will receive 0.4062 shares of Verizon common stock and $2.75 cash for every share owned of MCI (rather than 0.4062 shares of Verizon common stock and $1.50 cash for every share owned of MCI, as described in the Agreement). In addition to the Verizon shares and cash, MCI shareholders will receive a special dividend in the amount of $5.60 per share (rather than the $4.10 described in the Agreement), less any dividend paid by MCI between February 14, 2005, and the consummation of the transaction. *See* Amendment ¶1(a)-(d).

13. Until the transaction is completed, both corporations will continue to operate as independent entities. The acquisition will not occur until all necessary governmental and regulatory approvals and reviews have been obtained or completed. This process includes a review by the Department of Justice, the FCC, and some state commissions. At the time the transaction is completed, MCI's regulated subsidiaries in Arizona will remain as subsidiaries of MCI, LLC, and the authorizations and licenses currently held by MCI's regulated subsidiaries will continue to be held by the respective entities.

14. After the transaction is completed, MCI, LLC, will be a subsidiary of Verizon. The acquisition will not change the relationships of MCI subsidiaries with the Commission. The Agreement does not call for the merger of any assets, operations, lines, plants, franchises, or permits of MCI's regulated subsidiaries with the assets, operations, lines, plants, franchises, or

Snell & Wilmer
L.L.P.
LAW OFFICES
One Arizona Center, 400 E. Van Buren
Phoenix, Arizona 85004-2202
(602) 382-6000

permits of any Verizon entity. Nor does the Agreement call for the encumbrance of any such assets in Arizona. Similarly, the Agreement does not call for any change in the rates, terms, or conditions for the provision of any telecommunications services provided in Arizona.

15. The transaction will not affect the regulatory authority of the Commission over any of Verizon's or MCI's regulated subsidiaries, nor will it have any impact on the services that those subsidiaries provide in Arizona. Therefore, the acquisition will not interfere with the Commission's jurisdiction nor impede the satisfaction of its public policy goals. Verizon's and MCI's state-regulated subsidiaries will continue to meet all of their obligations and commitments under the Commission's rules, regulations, and orders.

16. The acquisition will have no anti-competitive effect in Arizona or nationally. As discussed below, Verizon does not currently address the upper end of the enterprise market with a wide array of services, nor has it been equipped to address customers with nationwide interests in that market. MCI, on the other hand, is an acknowledged leader in the market for enterprise telecommunications services. Verizon is a recognized leader in services to consumers and small businesses and is committed to building out a broadband network to improve those services. Competition, including increasingly important intermodal competition, will continue unimpaired.

III. BENEFITS OF THE PROPOSED TRANSACTION

17. The transaction is in the public interest because it will not adversely impact service in Arizona, but instead will result in benefits to residential and business customers by allowing the two companies to use their complementary strengths and resources to deliver a wider array of competitive products and services than either company could provide alone. Verizon has a long history of corporate responsibility and good citizenship in the communities it serves, and it will

continue that tradition in Arizona after this transaction is concluded. MCI has a practice of providing good jobs and cutting-edge network technology, and the acquisition will only enhance that capability. Thus, the Arizona communities served by the combined company will benefit from the transaction.

18. The proposed acquisition will have no adverse impact on rates or service quality of any regulated Arizona telephone utility or telephone corporation. As discussed below, the transaction will greatly enhance the abilities that Verizon and MCI independently possess to provide a comprehensive suite of services to consumers, businesses, and government customers. As a result of the transaction, Verizon and its MCI subsidiary will be able to provide a broader array of competitively priced services to business, government, and residential customers by improving the speed of delivery for wireline services, broadband services, wireless services, and IP-based services to that vital sector of the U.S. economy.

19. This transaction is the logical next step in the continuing evolution of the telecommunications industry, an evolution that is driven by customers and technology. The availability of wireline and wireless packages of "any time, any distance" minutes of use, Internet communication (including instant messaging), text messaging, and voice over Internet protocol ("VoIP") services has blurred the historical lines between local and long distance service. Today, customers rely on an array of communications platforms that include not only traditional and broadband wireline services (providing voice, DSL, Internet connectivity, and VoIP), but other platforms, such as wireless mobile (including cell phones, wireless data, wi-fi, wi-max, and PDAs) and cable platforms (providing voice, video, and data services). Wireline voice traffic no longer comprises a majority of the minutes used on the public switched network, and such traffic

Snell & Wilmer L.L.P.
LAW OFFICES
One Arizona Center, 400 E. Van Buren
Phoenix, Arizona 85004-2202
(602) 382-6000

Snell & Wilmer
L.L.P.
LAW OFFICES
One Arizona Center, 400 E. Van Buren
Phoenix, Arizona 85004-2202
(602) 382-6000

is declining as a percentage of overall communications traffic. In light of these changes, a company providing only traditional wireline POTS service would fast become obsolete. Consequently, the industry is rapidly restructuring itself so as to provide a full array of services using new and emerging technologies in the most economically efficient way.

20. This industry restructuring will continue irrespective of Verizon's proposed acquisition of MCI. MCI has recognized that — as a result of wireless competition, intense long distance competition from other carriers, restrictions on marketing resulting from "Do Not Call" legislation, competitors exploiting new, unregulated technologies, and applications that make possible such services as messaging on-the-go, high speed data connections, cable telephone, VoIP, e-mail, and instant messaging — its consumer business is in a continuing and irreversible decline, and has refocused its strategy accordingly. Verizon's acquisition of MCI positions a strong new competitor to provide a broader range of competitive services to customers.

A. Benefits to Customers

(a) Consumers and Small Business Customers

21. The transaction continues Verizon's transformation into a national broadband company and will greatly enhance its advanced broadband and wireless networks. Ultimately, MCI's Internet backbone network, together with Verizon's ongoing deployment of fiber directly to customers, will create a platform that can support a broad array of multimedia communications services and applications for all customers.

22. American consumers and small businesses will benefit from the enhanced deployment of wireline and wireless broadband services that this transaction will promote. This transaction will ensure that Internet users in the United States will continue to have a robust,

Snell & Wilmer
L.L.P.
LAW OFFICES
One Arizona Center, 400 E. Van Buren
Phoenix, Arizona 85004-2202
(602) 382-6000

state-of-the-art backbone platform for their traffic; and the transaction will allow for higher quality of service and a greater investment in that backbone than MCI could achieve as a stand-alone company going forward. After the acquisition, consumers will continue to have a choice of competitive communications services, including wireline competitors, cable telephony providers, wireless services, and VoIP providers operating throughout the state. Similarly, small business customers will continue to be served by a host of telecommunications services providers including, in particular, cable companies that have recently stepped up their efforts to serve this segment of the business market.

(b) Enterprise and Government Customers

23. As a result of this transaction, Verizon will be able to provide better service to enterprise and government customers than either company could provide alone. For example, Verizon will be able to carry traffic over MCI's Internet backbone, improving efficiency and enhancing the ability to manage complex network assets and applications. Verizon will also be able to utilize MCI's ISP connectivity services (such as email, web hosting, and domain naming system services), again enhancing Verizon's capabilities in a market in which it currently is a small provider.

24. Although Verizon has been working to increase its enterprise business for several years, it still has a relatively small share of this business and does not serve a number of regions of the country at all. The acquisition provides Verizon with an opportunity to expand its small existing presence at a faster pace. In the process, the transaction will create a new competitor that is capable of providing enterprise customers across the nation with a wider array of services, including wireless services, than MCI is now providing. In the current environment, customers

demand a comprehensive solution to their communications needs; MCI's limited ability to offer a wireless product set will be solved by this transaction.

25. Even after the Verizon-MCI transaction is completed, AT&T will remain the largest single provider of services to enterprise customers, with or without its proposed merger with SBC. Enterprise customers are also served by a host of other competitors. These competitors include a number of global network service providers, as well as equipment providers, CLECs/DLECs, and systems integrators and IP applications providers.[4] With such a vast array of providers, competition for enterprise customers has long been considered intense and will remain intense after Verizon acquires MCI.

26. This transaction will ensure that MCI's enterprise and government customers will continue to be served by a strong provider of telecommunications services that can meet the customers' needs. The acquisition will also help Verizon become a strong competitor that will be able to challenge the larger incumbents that now serve enterprise and government customers. Verizon would require years to develop the capabilities to compete effectively for such customers without this transaction. Verizon must reach these customers expeditiously in light of the

[4] Some of the global network services providers are: BT (previously British Telecom), which has entered into an agreement to acquire Infonet Services Corp., a communications company that specializes in services to multinational corporations; Sprint (which is merging with wireless provider Nextel); and NTT Corporation (parent of Nippon Telephone and Telegraph), which through its various subsidiaries (such as NTT DoCoMo) provides broadband and wireless communications as well as IT services primarily in Asia but also to other global markets. Equipment providers serving enterprise customers include Cisco, Avaya, Nortel, Lucent, NEC, Alcatel, Fujitsu, Polycom, 3Com, Juniper Networks, Enterasys Networks, Foundry Networks, and Extreme Networks. CLECs and DLECs providing enterprise services include Time Warner, Cox Communications, PAETEC Communications, Equant, XO Communications, Wiltel, Infonet, McLeodUSA, Corvis/Broadwing Communications, ITC Deltacom, US LEC, ICG Communications, and FiberNet Telecom Group. Among the systems integrators and IP application providers serving enterprise customers are IBM, Hewlett-Packard, EDS, Accenture, Unisys, Northrup Grumman, Cap Gemini, Harris Corporation, EMC, Brocade, Network Appliance, and Savvis Communications.

Snell & Wilmer L.L.P.
LAW OFFICES
One Arizona Center, 400 E. Van Buren
Phoenix, Arizona 85004-2202
(602) 382-6000

Snell & Wilmer
L.L.P.
LAW OFFICES
One Arizona Center, 400 E. Van Buren
Phoenix, Arizona 85004-2202
(602) 382-6000

industry convergence and the growing intermodal competition among wireline and wireless and cable providers. Moreover, the bundled wireline, broadband, and wireless offering to MCI's and Verizon's current enterprise customers is an added benefit that both companies' customers will receive. Finally, the transaction will result in a more efficient operating structure, allowing for faster and more robust network deployment, and will strengthen MCI's national and international network, which is a critical component of government communications systems, including those used by national defense and homeland security.

B. Benefits to the American Economy

27. The transaction between Verizon and MCI will allow each to benefit from the strength of the other using complementary competencies and networks. It will thus ensure that key domestic communications networks are robust and technologically advanced, thereby enhancing the economic viability and security of America's homeland.

28. This acquisition will create a global industry leader by strengthening simultaneously America's premier telecommunications network builder and its leading service provider. Utilizing MCI's powerful networking assets, the transaction will give Verizon greater ability to lead the telecommunications industry's revitalization through new investment in world-class networks and services.

C. Benefits to Investors in Both Companies

29. This acquisition will provide MCI investors with a security that has the best prospect for long-term viability, stability, and prospect for growth. The transaction is expected to eliminate duplicative expenses and create operational efficiencies, thus enabling additional investment in and deployment of new services for all customers.

D. Benefits to Employees of Both Companies

30. The transaction between Verizon and MCI will create a far stronger company with the ability to thrive and grow in the intensely competitive telecommunications industry, both nationally and internationally, thus providing a higher degree of stability and certainty for employees and their dependents than either company could provide alone.

31. While it is anticipated that the transaction will lead to some reduction in the number of employees in duplicative jobs, the new Verizon and its subsidiary MCI will be stronger as a result and more likely to maintain higher levels of overall employment than either company would have been able to do on its own.

IV. R14-2-803 INFORMATION

A. Names and Business Addresses of the Proposed Officers and Directors of the Holding Company

32. The proposed officers and directors have not yet been determined, but the Parties will supplement this Notice when this information becomes available. The Merger Agreement does not require any change in the composition of the board of Directors of Verizon.

33. The names of Verizon's current officers are:

Ivan G. Seidenberg	Chairman and Chief Executive Officer
Lawrence T. Babbio, Jr.	Vice Chairman and President
Doreen A. Toben	Executive Vice President and Chief Financial Officer
William P. Barr	Executive Vice President and General Counsel
Thomas A. Bartlett	Senior Vice President and Treasurer
David H. Benson	Senior Vice President and Controller
Marc C. Reed	Executive Vice President - Human Resources

Snell & Wilmer L.L.P.
LAW OFFICES
One Arizona Center, 400 E. Van Buren
Phoenix, Arizona 85004-2202
(602) 382-6000

Dennis F. Strigl	Executive Vice President and President and CEO Verizon Wireless Joint Venture
Thomas J. Tauke	Executive Vice President Public Affairs, Policy and Communications
John W. Diercksen	Senior Vice President Strategy, Development and Planning
Marianne Drost	Senior Vice President Deputy General Counsel and Corporate Secretary
William F. Heitmann	Senior Vice President - Finance
Joleen D. Moden	Senior Vice President - Internal Auditing
Catherine T. Webster	Senior Vice President - Investor Relations

34. The business address for Verizon's current officers is 1095 Avenue of the Americas, New York, New York 10036.

35. Verizon's current Board of Directors consists of:

James R. Barker	Hugh B. Price
Richard L. Carrión	Ivan G. Seidenberg
Robert W. Lane	Walter V. Shipley
Sandra O. Moose	John R. Stafford
Joseph Neubauer	Robert D. Storey
Thomas H. O'Brien	

B. The Business Purposes for Reorganizing the Holding Company

36. The Parties agreed to the acquisition because it will greatly enhance the abilities that both Verizon and MCI currently possess to provide a comprehensive suite of services to their

Snell & Wilmer L.L.P.
LAW OFFICES
One Arizona Center, 400 E. Van Buren
Phoenix, Arizona 85004-2202
(602) 382-6000

customers. The business purposes for the reorganization are more fully described in paragraphs 16 through 31 above, and on pages 1 and 2 of the Agreement (*see* Exhibit 1).

C. Proposed Method of Financing the Holding Company and the Resultant Capital Structure

37. As discussed in paragraphs 11 and 12 above and in Sections 1.08 and 4.2 of the Agreement, MCI will merge into ELI Acquisition, LLC, a Delaware limited liability company that is wholly owned by Verizon and was created solely to facilitate the transaction. As of the date of the Agreement, Verizon owned all rights and title to all the outstanding membership interests in ELI Acquisition free of any liens, and Verizon's authorized capital stock consisted of 4,250,000,000 shares of Parent Common Stock and 250,000,000 shares of preferred stock, par value $0.10 per share.

38. Under the Agreement as amended, MCI's shareholders will receive 0.4062 shares of Verizon common stock and $2.75 cash for every share owned of MCI (rather than 0.4062 shares of Verizon common stock and $1.50 cash for every share owned of MCI as described in the Agreement); and in addition to the Verizon shares and cash, MCI shareholders will receive a special dividend in the amount of $5.60 per share (rather than the $4.10 described in the Agreement), less any dividend paid by MCI between February 14, 2005, and the consummation of the transaction. *See* Amendment ¶ 1(a)-(d). After the transaction closes, Verizon's capitalization and structure will remain as described above, and MCI will replace ELI Acquisition as a wholly owned Verizon subsidiary whose initial capitalization reflects the terms of the stock exchange described above.

D. Resultant Effect on the Capital Structure of the Public Utility

Snell & Wilmer L.L.P.
LAW OFFICES
One Arizona Center, 400 E. Van Buren
Phoenix, Arizona 85004-2202
(602) 382-6000

39. The acquisition as described in the Parties' Agreement will have no impact on the capital structure of the Arizona-regulated subsidiaries of Verizon.

E. Organization Chart of the Holding Company Identifying All Affiliates and Their Relationships Within the Holding Company

40. Organization charts for Verizon and MCI are attached as Exhibits 8 and 9.

F. Proposed Method for Allocating Federal and State Income Taxes to the Subsidiaries of the Holding Company

41. Allocations will comply with all applicable IRS and state guidelines and regulations and will be based on each member's contributions to taxable income.

G. Anticipated Changes in the Utility's Cost of Service and the Cost of Capital Attributable to the Reorganization

42. The Agreement will not affect the cost of services provided by the Arizona-regulated subsidiaries of Verizon and MCI. The transaction is expected to improve MCI's access to capital.

H. Diversification Plans of Affiliates

43. Verizon and MCI have no plans to diversify the businesses in which their Arizona-regulated subsidiaries are currently engaged.

I. Documents and Filings with the SEC and Other Federal or State Agencies

44. As discussed above, the proposed transaction will be reviewed by the SEC, the Department of Justice, the FCC, and some state agencies. Due to the substantial number of filings, the Parties have not attached them to this Notice, but will promptly provide copies of relevant documents upon request by the Commission.

J. Contemplated Investment in Affiliates.

Snell & Wilmer L.L.P.
LAW OFFICES
One Arizona Center, 400 E. Van Buren
Phoenix, Arizona 85004-2202
(602) 382-6000

45. The acquisition will not adversely affect investment in the Arizona subsidiaries and, as discussed in Paragraphs 17-31 above, should result in an entity with increased financial strength.

K. Manner in Which the Utility Can Assure Availability of Adequate Capital

46. The Arizona-regulated subsidiaries of Verizon and MCI will be able to attract capital on terms no less favorable than before the proposed transaction.

V. REQUEST FOR RELIEF

47. If approval of this transaction is warranted, *see supra* para. 2, the Parties respectfully request that the Commission expeditiously issue an order granting such approval. As explained above, the proposed acquisition will be beneficial to all relevant stakeholders and is clearly in the public interest of Arizona. The transaction will have no adverse effect on the rates or the quality of service of regulated Verizon or MCI subsidiaries. To the contrary, as a result of the transaction, both Verizon's and MCI's operating subsidiaries will be able to provide better services to their customers than either company could provide alone. Because the public benefits of the acquisition are clear, and because these benefits will be enhanced if they are realized quickly, the Parties respectfully request that, if Commission approval of the acquisition is required, the Commission issue such approval expeditiously based on this Notice and without a hearing. *See* Ariz. Admin. Code R14-2-803.B.

VI. CORRESPONDENCE AND COMMUNICATIONS

48. All communications and correspondence concerning this Notice should be addressed or directed to the following parties:

Snell & Wilmer L.L.P.
LAW OFFICES
One Arizona Center, 400 E. Van Buren
Phoenix, Arizona 85004-2202
(602) 382-6000

Snell & Wilmer
L.L.P.
LAW OFFICES
One Arizona Center, 400 E. Van Buren
Phoenix, Arizona 85004-2202
(602) 382-6000

FOR VERIZON:

Elaine M. Duncan
Vice President and General Counsel
Verizon California Inc.
700 Van Ness Avenue
San Francisco, CA 94102
(415) 474-0468 (phone)
(415) 474-6546 (fax)

Deborah R. Scott
Of Counsel
Snell & Wilmer
One Arizona Center
Phoenix, AZ 85004
602-382-6571 (phone: Phoenix)
520-882-1224 (phone: Tucson)
602-382-6070 (fax)
drscott@swlaw.com

Sherry F. Bellamy
Vice President and Associate General Counsel
Verizon Corporate Services Corp.
1515 North Courthouse Road, Ste. 500
Arlington, VA 22201
(703) 351-3011 (phone)
(703) 351-3655 (fax)

Robert P. Slevin
Associate General Counsel
Verizon Corporate Services Corp.
1095 Avenue of the Americas
Room 3824
New York, New York 10036
(212) 395-6390 (phone)
(212) 764-2739 (fax)

Andrew B. Clubok
Kirkland & Ellis LLP
655 Fifteenth Street, N.W., Suite 1200
Washington, DC 20005
(202) 879-5000 (phone)
(202 879-5200 (fax)

FOR MCI:

Thomas F. Dixon
Senior Attorney
MCI, Inc.
707 17th Street, #4200
Denver, CO 80202
(303) 390-6206 (phone)
(303) 390-6333 (fax)
thomas.f.dixon@mci.com

Thomas H. Campbell
Lewis and Roca LLP
40 North Central Avenue
Phoenix, AZ 85004-4429
(602) 262-5723 (phone)
(602) 734-3841(fax)
tcampbel@lrlaw.com

Richard B. Severy
MCI, Inc.
Director, State Regulatory
201 Spear Street, 9th Floor
San Francisco, CA 94105
(415) 228-1121 (phone)
(415) 228-1094 (fax)

Marsha A. Ward,
National Director – State Regulatory
Law & Public Policy
MCI, Inc.
6 Concourse Parkway, Suite 600
Atlanta, GA 30328
(770) 284-5490 (phone)
(770) 284-5488 (fax)

VII. CONCLUSION

49. For the foregoing reasons, Verizon and MCI respectfully request that, if Commission approval is required, the Commission expeditiously issue an order approving the transaction.

Respectfully submitted,

VERIZON COMMUNICATIONS INC.

By: _____

Deborah R. Scott
Snell & Wilmer
One Arizona Center
Phoenix, AZ 85004
602-382-6571 (phone: Phoenix)
520-882-1224 (phone: Tucson)
602-382-6070 (fax)
drscott@swlaw.com

MCI, INC.

By: _____

Thomas H. Campbell
Lewis and Roca LLP
40 North Central Avenue
Phoenix, AZ 85004-4429
(602) 262-5723 (phone)
(602) 734-3841(fax)
tcampbel@lrlaw.com

Dated: April 13, 2005

Snell & Wilmer
L.L.P.
LAW OFFICES
One Arizona Center, 400 E. Van Buren
Phoenix, Arizona 85004-2202
(602) 382-6000

Snell & Wilmer
L.L.P.
LAW OFFICES
One Arizona Center, 400 E. Van Buren
Phoenix, Arizona 85004-2202
(602) 382-6000

The ORIGINAL and thirteen (13) copies of the foregoing were filed this 13th day of April 2005.

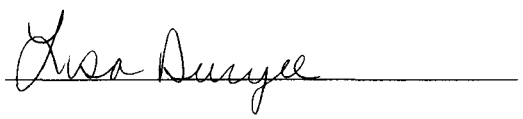
Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

A COPY of the foregoing was hand-delivered this 13th day of April, 2005, to:

Lyn Farmer
Chief Administrative Law Judge
Hearing Division
ARIZONA CORPORATION COMMISSION
1200 West Washington
Phoenix, Arizona 85007

Christopher C. Kempley, Chief Counsel
Legal Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

Ernest G. Johnson, Director
Utilities Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007



Snell & Wilmer
L.L.P.
LAW OFFICES
One Arizona Center, 400 E. Van Buren
Phoenix, Arizona 85004-2202
(602) 382-6000

LIST OF EXHIBITS

Exhibit No.	Description
1	Agreement and Plan of Merger, Dated as of February 14, 2005, by and among Verizon Communications Inc., ELI Acquisition, LLC and MCI, Inc. (without schedules)
2	March 29, 2005 Amendment
3	MCI 2004 Form 10K
4	MCI 2004 3rd Quarter Form 10Q
5	Verizon 2004 Form 10K
6	Verizon 2004 3rd Quarter Form 10Q
7	Verizon 2003 Annual Report
8	Organization Chart for Verizon
9	Organization Chart for MCI

EXHIBIT 1

EXECUTION COPY

AGREEMENT AND PLAN OF MERGER

DATED AS OF FEBRUARY 14, 2005

AMONG

VERIZON COMMUNICATIONS INC.,

ELI ACQUISITION, LLC

AND

MCI, INC.

LIST OF EXHIBITS

Exhibit	Title
A	Form of Affiliate Agreement

AGREEMENT AND PLAN OF MERGER

This AGREEMENT AND PLAN OF MERGER, dated as of February 14, 2005 (this "Agreement"), is among VERIZON COMMUNICATIONS INC., a Delaware corporation ("Parent"), ELI ACQUISITION, LLC, a Delaware limited liability company and a direct, wholly owned subsidiary of Parent ("Merger Sub"), and MCI, INC., a Delaware corporation (the "Company" and, collectively with Parent and Merger Sub, the "parties").

RECITALS

WHEREAS, the respective Boards of Directors of the Company, Parent and Merger Sub have deemed it advisable and in the best interests of their respective companies and stockholders that the Company and Parent engage in a business combination;

WHEREAS, in furtherance thereof, the respective Boards of Directors of the Company, Parent and Merger Sub have approved and declared advisable this Agreement and the merger of the Company with and into Merger Sub (the "Merger") in accordance with the applicable provisions of the Delaware General Corporation Law (the "DGCL"), and the Delaware Limited Liability Company Act (the "LLC Act") and upon the terms and subject to the conditions set forth in this Agreement; and

WHEREAS, it is intended that, for U.S. federal income tax purposes, the Merger (to the extent effected as a merger of the Company with and into Merger Sub and not pursuant to the alternative merger structure set forth in Section 1.9) shall qualify as a reorganization under Section 368(a) of the Code;

NOW, THEREFORE, in consideration of the foregoing and their respective representations, warranties, covenants and agreements set forth in this Agreement, and intending to be legally bound hereby, the parties agree as follows:

ARTICLE I

THE MERGER; CERTAIN RELATED MATTERS

Section 1.1 The Merger. Upon the terms and subject to the conditions set forth in this Agreement, at the Effective Time, the Company shall be merged with and into Merger Sub and the separate corporate existence of the Company shall thereupon cease. Merger Sub shall be the surviving entity in the Merger (with respect to all post-Closing periods, the "Surviving Entity"). At the Effective Time, the effect of the Merger shall be as provided in this Agreement, the Certificate of Merger and the applicable provisions of the DGCL and the LLC Act. Without limiting the generality of the foregoing, and

subject thereto, at the Effective Time, all the property, rights, privileges, powers and franchises of the Company and Merger Sub shall vest in the Surviving Entity, and all debts, liabilities and duties of the Company and Merger Sub shall become the debts, liabilities and duties of the Surviving Entity.

Section 1.2 Closing. The closing of the Merger (the "Closing") shall, subject to the fulfillment or waiver of the conditions set forth in Article VII, take place at the offices of Debevoise & Plimpton LLP, 919 Third Avenue, New York, New York, at 9:00 a.m., New York City time, on the third Business Day after all of the conditions set forth in Article VII have been fulfilled or waived (other than those conditions that by their nature are to be satisfied at the Closing) in accordance with this Agreement or at such other place and time and/or on such other date as the Company and Parent may agree in writing (the "Closing Date").

Section 1.3 Effective Time. Subject to the provisions of this Agreement, as soon as practicable on the Closing Date, the parties hereto shall file a certificate of merger as contemplated by the DGCL and the LLC Act (the "Certificate of Merger"), together with any required related certificates, with the Secretary of State of the State of Delaware, in such form as required by, and executed in accordance with, the DGCL and the LLC Act. The Merger shall become effective at such time as the Certificate of Merger is duly filed with such Secretary of State on the Closing Date, or at such later time as Parent and the Company shall agree and specify in the Certificate of Merger. As used herein, the "Effective Time" shall mean the time at which the Merger shall become effective.

Section 1.4 Certificate of Formation. The certificate of formation of Merger Sub, as in effect immediately prior to the Effective Time, shall be the certificate of formation of the Surviving Entity until thereafter changed or amended as provided therein or by the LLC Act or applicable Law (the "Certificate of Formation"), except that the Certificate of Formation shall be amended to provide that the name of the Surviving Entity shall become MCI, LLC.

Section 1.5 By-Laws. The by-laws (if any) of Merger Sub in effect immediately prior to the Effective Time shall be the by-laws of the Surviving Entity (the "By-Laws") until thereafter amended as provided therein or by applicable Law.

Section 1.6 Directors. The directors of Merger Sub immediately prior to the Effective Time shall, from and after the Effective Time, be the directors of the Surviving Entity until their successors have been duly elected or appointed and qualified or until their earlier death, resignation or removal in accordance with the Certificate of Incorporation and the By-Laws.

Section 1.7 Officers. The officers of the Company immediately prior to the Effective Time shall, from and after the Effective Time, be the officers of the Surviving Entity until their successors have been duly elected or appointed and qualified or until their earlier death, resignation or removal in accordance with the Certificate of Incorporation and the By-Laws.

Section 1.8 Effect on Capital Stock.

(a) At the Effective Time, by virtue of the Merger and without any action on the part of the holder thereof, each share of Company Common Stock issued and outstanding immediately prior to the Effective Time (excluding any Company Restricted Shares and Excluded Shares) shall be converted into the right to receive (i) 0.4062 (the "Exchange Ratio") validly issued, fully paid and non-assessable shares of Parent Common Stock (the "Stock Consideration") and (ii) $1.50 in cash (the "Per Share Cash Amount"), without interest, together with any cash in lieu of fractional shares of Parent Common Stock to be paid pursuant to Section 2.5 (such shares and cash, the "Base Merger Consideration"). The Exchange Ratio and Base Merger Consideration shall be subject to adjustment pursuant to Section 1.10 (as so adjusted, the "Merger Consideration").

(b) As a result of the Merger and without any action on the part of the holders thereof, at the Effective Time, all shares of Company Common Stock (other than Company Restricted Shares and Excluded Shares) shall cease to be outstanding and shall be canceled and retired, and each certificate that immediately prior to the Effective Time represented any such shares of Company Common Stock (the "Certificates") shall thereafter represent only the right to receive the Merger Consideration with respect to the shares of Company Common Stock (other than Company Restricted Shares and Excluded Shares) formerly represented thereby, and any dividends or other distributions to which the holders thereof are entitled pursuant to Section 2.3.

(c) Each Excluded Share at the Effective Time shall, by virtue of the Merger and without any action on the part of the holder thereof, cease to be outstanding and shall be canceled and retired and no stock of Parent or other consideration shall be delivered in exchange therefor.

(d) At the Effective Time, each limited liability company interest of Merger Sub issued and outstanding immediately prior to the Effective Time shall continue to be issued and outstanding and shall constitute the only issued and outstanding interests of the Surviving Entity.

Section 1.9 Alternative Merger Structure. Notwithstanding any other provision of this Agreement, if (i) either of the conditions specified in Section 7.4 fails to be duly satisfied or waived or (ii) at any time prior to the Effective Time, Parent

reasonably determines in good faith that effecting the Merger as a merger of the Company into Merger Sub with Merger Sub surviving would result in a material risk of materially adverse regulatory or other materially adverse consequences, the transactions contemplated herein shall be effected (subject to other conditions contained herein) by merging the Company with a Delaware corporation wholly owned by Parent, with the Company as the surviving corporation (the "Alternative Merger"). In such event, the conversion of the outstanding Company securities will occur as provided in this Article, and following the Effective Time all outstanding stock of the surviving corporation will be owned by Parent. The other provisions of this Agreement will continue to apply in the event of the Alternative Merger, *mutatis mutandis*.

Section 1.10 Adjustment for Specified Included Liabilities at Closing.

(a) Determination of Remaining Specified Included Liabilities Amount. At such time as either Company or Parent reasonably believes in good faith that the Closing Date will occur within 120 days, such party may deliver notice (a "Trigger Notice") to the other party requesting commencement of the procedure set forth in this Section 1.10 to determine the best estimate of the amount of cash in U.S. dollars (the "Remaining Specified Included Liabilities Amount") that will actually be required, from and after the Closing Date, to satisfy in full all remaining Specified Included Liabilities. Promptly after delivery of the Trigger Notice, (i) the Company shall deliver to Parent a schedule setting forth all Specified Included Liabilities and the status thereof and (ii) the parties will agree on and jointly engage an independent valuation firm reasonably satisfactory to Parent and the Company to act as arbitrator with respect to the Bankruptcy Claims (other than any claims relating to Taxes) (the "Bankruptcy Claims Valuation Firm"), and PricewaterhouseCoopers LLP to act as arbitrator with respect to any claims related to Taxes (the "Specified Tax Liabilities Valuation Firm" and, together with the Bankruptcy Claims Valuation Firm, the "Neutral Valuation Firms"), pursuant to Section 1.10(c) and 1.10(d) in the event the parties are unable to agree on the Remaining Specified Included Liabilities Amount; provided that if the parties are unable to agree on a Bankruptcy Claims Valuation Firm within 30 days of delivery of the Trigger Notice, then either party may request that the American Arbitration Association select an independent valuation firm to act as arbitrator and the firm so selected shall be the Bankruptcy Claims Valuation Firm. If PricewaterhouseCoopers LLP is unavailable or declines to serve as the Specified Tax Liabilities Valuation Firm, then either party may request the American Arbitration Association to select an independent accounting firm to serve as the Specified Tax Liabilities Valuation Firm, and the firm so selected shall be the Specified Tax Liabilities Valuation Firm.

(b) Best Efforts. Parent and the Company shall, during the period following the delivery of the Trigger Notice until such date as all conditions to Closing under Article VII (other than Section 7.1(f)) are satisfied or waived, use their best efforts to reach agreement on the Remaining Specified Included Liabilities Amount, including

giving full access to all relevant information, with due consideration being given to privilege issues and techniques for resolving them. If Parent and the Company agree on the calculation of the Remaining Specified Included Liabilities Amount, then such Remaining Specified Included Liabilities Amount shall become final and binding on the parties.

(c) Submission to Neutral Valuation Firms. If Parent and the Company are unable to agree on the calculation of the Remaining Specified Included Liabilities Amount within 60 days of the date of the Trigger Notice, the parties will refer the matter to the Neutral Valuation Firms and will make submissions to the Neutral Valuation Firms so that the Neutral Valuation Firms are in a position to make a final determination of the Remaining Specified Included Liabilities Amount within the period set forth in Section 1.10(d). Parent and Company shall cooperate and assist the Neutral Valuation Firms in their review of the Remaining Specified Included Liabilities and the calculation of the Remaining Specified Included Liabilities Amount, including giving full access to all relevant information, with due consideration being given to privilege issues and techniques for resolving them.

(d) Determination by Neutral Valuation Firms. If Parent and the Company are unable to agree on the calculation of the Remaining Specified Included Liabilities Amount by such date as all conditions to Closing under Article VII (other than Section 7.1(f)) are satisfied or waived, each of Parent and the Company will, at a mutually agreed time within three Business Days following such date, simultaneously submit to the Neutral Valuation Firms its final proposal (which proposal shall specify the items as to which the parties have been able to agree pursuant to Section 1.10(b) and such party's proposal as to the items in dispute) as to (i) the Remaining Specified Included Liabilities Amount (to the extent relating to non-Tax Bankruptcy Claims) (the "Bankruptcy Claims Proposals") and (ii) the Remaining Specified Included Liabilities Amount (to the extent relating to Tax claims) (the "Specified Tax Liabilities Proposals"), provided, however, that the Specified Tax Liabilities Proposals shall not be translated into U.S. dollars. Within 10 Business Days of such final submissions, (x) the Bankruptcy Claims Valuation Firm will select one of the two Bankruptcy Claims Proposals as being most representative of the Remaining Specified Included Liabilities Amount (to the extent relating to Bankruptcy Claims) and (y) the Specified Tax Liabilities Valuation Firm will select one of the two Specified Tax Liabilities Proposals as being most representative of the Remaining Specified Included Liabilities Amount (to the extent relating to Tax claims), and the amounts so selected shall be final and binding on the parties. In making such determination, the Neutral Valuation Firms shall consider only those items or amounts as to which the parties have been unable to agree pursuant to Section 1.10(b).

(e) Paid Specified Included Liabilities Amount. Five days prior to the anticipated Closing Date, the Company shall provide to Parent a schedule of the Paid

Specified Included Liabilities Amount and detailing each item comprising the Paid Specified Included Liabilities Amount, together with reasonable supporting documentation.

(f) Postponement of Closing. If applicable, the Closing Date shall be postponed to the Business Day following the final determination of the Remaining Specified Included Liabilities Amount pursuant to the procedures set forth in Section 1.10(d). In addition, if the Closing Date does not occur within a period of 90 days from the date on which the Final Remaining Specified Included Liabilities Amount was determined, the Specified Included Liabilities Amount shall be redetermined pursuant to the procedures set forth in this Section 1.10.

(g) Adjustments to the Merger Consideration. Upon determination of the Specified Included Liabilities Amount, the Base Merger Consideration shall be adjusted as follows: If the Specified Included Liabilities Amount is greater than $1,725,000,000, then the Per Share Cash Amount shall be reduced by an amount equal to the quotient obtained by dividing (x) the difference between the Specified Included Liabilities Amount and $1,725,000,000 by (y) the sum of (A) the number of shares of Company Common Stock issued and outstanding immediately prior to the Effective Time (excluding any Excluded Shares other than Dissenting Shares) and (B) the number of shares reserved for issuance pursuant to the Chapter 11 Plan that are unissued immediately prior to the Effective Time (which number shall not exceed 5,375,000 *minus* the number of shares so issued after the date hereof); provided that if, pursuant to the foregoing adjustment, the Per Share Cash Amount would otherwise be less than zero (the amount by which the Per Share Cash Amount would otherwise be less than zero, the "Incremental Amount"), the Per Share Cash Amount shall be reduced to zero, and there shall be a further adjustment made to the Exchange Ratio such that the Exchange Ratio shall be equal to the product of (x) 0.4062 and (y) the quotient obtained by dividing (1) the Aggregate Base Merger Consideration *minus* the Aggregate Incremental Amount by (2) the Aggregate Base Merger Consideration. For the avoidance of doubt, if the Specified Included Liabilities Amount is $1,725,000,000 or less, there shall be no adjustment made to the Base Merger Consideration.

For the purposes hereof, the "Aggregate Base Merger Consideration" shall equal $14.75 multiplied by the sum of (x) the number of shares of Company Common Stock issued and outstanding immediately prior to the Effective Time (excluding any Excluded Shares other than Dissenting Shares) and (y) the number of shares reserved for issuance pursuant to the Chapter 11 Plan that are unissued immediately prior to the Effective Time (which number shall not exceed 5,375,000 *minus* the number of shares so issued after the date hereof).

Section 1.11 Treatment of Company Restricted Shares and Other Equity-Based Awards.

(a) Restricted Shares. At the Effective Time, by virtue of the Merger and without any action on the part of the holder thereof, each then outstanding Company Restricted Share shall be converted into (i) that number of restricted shares of Parent Common Stock ("Parent Restricted Shares") equal to the Exchange Ratio, as adjusted pursuant to Section 1.10(g), *plus* (ii) a cash payment to the holder of any Company Restricted Share of an amount equal to the Per Share Cash Amount. Notwithstanding the fact that part of each holder's Company Restricted Shares will be settled in cash as provided in the immediately preceding sentence, each Parent Restricted Share issued pursuant to this Section 1.11(a) will have, and be subject to, the same terms and conditions as in effect immediately prior to the Effective Time with respect to the corresponding Company Restricted Shares (and shall bear a legend containing the same restrictions on transferability).

(b) Other Equity-Based Awards. As of the Effective Time, by virtue of the Merger and without any action on the part of the holder thereof, each then outstanding equity-based award (other than Company Restricted Shares or rights under the ESPP) providing for a cash or stock payment measured by the value of Company Common Stock (an "Other Company Equity-Based Award") shall be deemed to refer to (or be measured by) (i) the number of shares of Parent Common Stock equal to the result determined by multiplying such number of shares of Company Common Stock covered by the Other Company Equity-Based Award by the Exchange Ratio as adjusted pursuant to Section 1.10(g), *plus* (ii) a cash payment to the holder of any Other Company Equity-Based Award in an amount equal to the product of the Per Share Cash Amount and the number of shares of Company Common Stock covered by such Other Company Equity-Based Award. Notwithstanding the fact that part of each holder's Other Company Equity-Based Award will be settled in cash as provided in the immediately preceding sentence, the rights of any person with respect to Parent Common Stock under each Other Company Equity-Based Award shall be on the same terms, conditions and restrictions, if any, as were applicable to such Other Company Equity-Based Award immediately prior to the Effective Time.

(c) ESPP. The Company shall establish a date on or before December 31, 2005 as the final purchase date under the terms of the Company's Employee Stock Purchase Plan (the "ESPP"), and shall cause all accumulated cash balances standing to the credit of each participant under the ESPP on such final purchase date to be applied to purchase the number of shares of Company Common Stock that could be purchased with such amounts on such date pursuant to the ESPP. The Company shall take any and all actions necessary or appropriate to cause the ESPP to terminate on such final purchase date, after giving effect to the purchases of Company Common Stock contemplated by this Section 1.11(c), and shall not thereafter offer any plan, program or arrangement for

the purchase of shares of Company Common Stock. Each participant who would otherwise have been entitled to receive a fractional share of Company Common Stock, after giving effect to the purchase of Company Common Stock contemplated by this Section 1.11(c), shall receive, in lieu thereof, a cash disbursement (without interest) of such participant's contributions credited to his or her account and not applied to such purchase.

Section 1.12 Certain Adjustments. If, between the date of this Agreement and the Effective Time, the outstanding Parent Common Stock or Company Common Stock shall have been changed into a different number of shares or different class by reason of any reclassification, recapitalization, stock split, split-up, combination or exchange of shares, or a stock dividend or dividend payable in any other securities shall be declared with a record date within such period, or any similar event shall have occurred, the Exchange Ratio and the Per Share Cash Amount shall be appropriately adjusted to provide to the holders of Company Common Stock the same economic effect as contemplated by this Agreement prior to such event.

Section 1.13 Appraisal Rights. No holder of Dissenting Shares (a "Dissenting Stockholder") shall be entitled to any Merger Consideration or dividends or other distributions pursuant to Section 2.3 in respect of such Dissenting Shares unless and until such holder shall have failed to perfect or shall have effectively withdrawn or lost such holder's right to seek appraisal of its Dissenting Shares under the DGCL, and any Dissenting Stockholder shall be entitled to receive only the payment provided by Section 262 of the DGCL with respect to the Dissenting Shares owned by such Dissenting Stockholder. If any Person who otherwise would be deemed a Dissenting Stockholder shall have failed properly to perfect or shall have effectively withdrawn or lost the right to seek appraisal with respect to any Dissenting Shares, such Dissenting Shares shall thereupon be treated as though such Dissenting Shares had been converted into the Merger Consideration pursuant to Section 1.8. The Company shall give Parent (i) prompt notice of any written demands for appraisal, attempted withdrawals of such demands, and any other instruments served pursuant to applicable Law received by the Company relating to stockholders' rights of appraisal and (ii) the opportunity to direct all negotiations and proceedings with respect to demand for appraisal under the DGCL. The Company shall not, except with the prior written consent of Parent, voluntarily make any payment with respect to any demands for appraisals of Dissenting Shares, offer to settle or settle any such demands or approve any withdrawal of any such demands.

Section 1.14 Associated Rights. References in Article I and Article II of this Agreement to Company Common Stock shall include, unless the context requires otherwise, the associated Company Rights.

ARTICLE II

EXCHANGE OF CERTIFICATES

Section 2.1 Exchange Fund. Prior to the Effective Time, Parent shall appoint a commercial bank or trust company reasonably acceptable to the Company to act as exchange agent hereunder for the purpose of exchanging Certificates for the Merger Consideration (the "Exchange Agent"). At or prior to the Effective Time, Parent shall deposit with the Exchange Agent, in trust for the benefit of holders of shares of Company Common Stock, certificates representing the Parent Common Stock issuable pursuant to Section 1.8 in exchange for outstanding shares of Company Common Stock and an amount of cash representing the aggregate cash consideration payable pursuant to Section 1.8. Parent agrees to make available, or to cause the Surviving Entity to make available, to the Exchange Agent from time to time as needed, cash sufficient to make cash payments for the cash consideration pursuant to Section 1.8, in lieu of fractional shares pursuant to Section 2.5 and any dividends and other distributions pursuant to Section 2.3. Any cash and certificates of Parent Common Stock deposited with the Exchange Agent shall hereinafter be referred to as the "Exchange Fund."

Section 2.2 Exchange Procedures. Promptly after the Effective Time, the Surviving Entity shall cause the Exchange Agent to mail to each holder of record of one or more Certificates (a) a letter of transmittal that shall specify that delivery shall be effected, and risk of loss and title to the Certificates shall pass, only upon proper delivery of the Certificates to the Exchange Agent, which letter shall be in customary form and have such other provisions as Parent may reasonably specify and which letter shall be reasonably acceptable to the Company prior to the Effective Time and (b) instructions for effecting the surrender of such Certificates in exchange for the Merger Consideration. Upon surrender of a Certificate to the Exchange Agent together with such letter of transmittal, duly executed and completed in accordance with the instructions thereto, and such other documents as may reasonably be required by the Exchange Agent, the holder of such Certificate shall be entitled to receive in exchange therefor (i) one or more shares of Parent Common Stock which shall be in uncertificated book-entry form unless a physical certificate is requested and which shall represent, in the aggregate, the whole number of shares that such holder has the right to receive pursuant to Section 1.8 (after taking into account all shares of Company Common Stock then held by such holder) and (ii) a check in the amount equal to any cash that such holder has the right to receive pursuant to the provisions of Section 1.8 and this Article II, consisting of the cash consideration pursuant to Section 1.8, cash in lieu of any fractional shares of Parent Common Stock, as the case may be, pursuant to Section 2.5 and dividends and other distributions pursuant to Section 2.3. No interest will be paid or will accrue on any cash payable pursuant to Section 1.8, Section 2.3 or Section 2.5. In the event of a transfer of ownership of Company Common Stock that is not registered in the transfer records of the Company, one or more shares of Parent Common Stock evidencing, in the aggregate, the

proper number of shares of Parent Common Stock and a check in the proper amount of any cash consideration pursuant to Section 1.8, cash in lieu of any fractional shares of Parent Common Stock pursuant to Section 2.5 and any dividends or other distributions to which such holder is entitled pursuant to Section 2.3, may be issued with respect to such Company Common Stock, as the case may be, to such a transferee if the Certificate representing such shares of Company Common Stock is presented to the Exchange Agent, accompanied by all documents required to evidence and effect such transfer and to evidence that any applicable stock transfer taxes have been paid.

Section 2.3 Distributions with Respect to Unexchanged Shares. All shares of Parent Common Stock to be issued pursuant to the Merger (which shall exclude shares issued pursuant to the Bankruptcy Court Order) shall be deemed issued and outstanding as of the Effective Time. No dividends or other distributions declared or made in respect of the Parent Common Stock shall be paid to the holder of any Certificate until the holder of such Certificate shall surrender such Certificate in accordance with this Article II. Subject to applicable Law, following surrender of any such Certificate, there shall be paid to such holder of shares of Parent Common Stock issuable in exchange therefor, without interest, (a) promptly after the time of surrender the number of whole shares of Parent Common Stock issuable in exchange therefor pursuant to this Article II, together with the cash consideration payable pursuant to Section 1.8, cash in lieu of a fractional share of Parent Common Stock to which such holder is entitled pursuant to Section 2.5 and the amount of dividends or other distributions with a record date after the Effective Time theretofore paid with respect to such whole shares of Parent Common Stock and (b) at the appropriate payment date the amount of dividends or other distributions with a record date after the Effective Time but prior to such surrender and a payment date subsequent to such surrender payable with respect to such shares of Parent Common Stock.

Section 2.4 No Further Ownership Rights in Company Common Stock. All shares of Parent Common Stock issued and cash paid upon conversion of shares of Company Common Stock in accordance with the terms of this Article II (including any cash paid pursuant to Section 2.3 or Section 2.5) shall be deemed to have been issued or paid in full satisfaction of all rights pertaining to the shares of Company Common Stock previously represented by such Certificates.

Section 2.5 No Fractional Shares of Parent Common Stock.

(a) No certificates or scrip or shares of Parent Common Stock representing fractional shares of Parent Common Stock or book-entry credit of the same shall be issued upon the surrender for exchange of Certificates and such fractional share interests will not entitle the owner thereof to vote or to have any rights of a stockholder of Parent.

(b) Notwithstanding any other provision of this Agreement, each holder of shares of Company Common Stock exchanged pursuant to the Merger who would otherwise have been entitled to receive a fractional share of Parent Common Stock (after taking into account all Certificates delivered by such holder) shall receive, in lieu thereof, cash (without interest) in an amount equal to the product of (i) such fractional part of a share of Parent Common Stock multiplied by (ii) the closing price for a share of Parent Common Stock on the New York Stock Exchange, Inc. ("NYSE") Composite Transactions Tape on the Closing Date.

(c) As promptly as practicable after the determination of the amount of cash, if any, to be paid to holders of fractional interests, the Exchange Agent shall so notify Parent, and Parent shall deposit or cause the Surviving Entity to deposit such amount with the Exchange Agent and shall cause the Exchange Agent to forward payments to such holders of fractional interests subject to and in accordance with the terms hereof.

Section 2.6 Termination of Exchange Fund. Any portion of the Exchange Fund that remains undistributed to the holders of Certificates for six months after the Effective Time shall be delivered to Parent or otherwise on the instruction of Parent, and any holders of the Certificates who have not theretofore complied with this Article II shall thereafter look only to Parent for the Merger Consideration with respect to the shares of Company Common Stock formerly represented thereby to which such holders are entitled pursuant to Section 1.8 and Section 2.3, cash in lieu of fractional shares of Parent Common Stock to which such holders are entitled pursuant to Section 2.5 and any dividends or distributions with respect to shares of Parent Common Stock to which such holders are entitled pursuant to Section 2.3, the cash consideration to which such holders are entitled pursuant to Section 1.8. Any such portion of the Exchange Fund remaining unclaimed by holders of shares of Company Common Stock five years after the Effective Time (or such earlier date immediately prior to such time as such amounts would otherwise escheat to or become property of any Governmental Entity) shall, to the extent permitted by applicable Law, become the property of the Surviving Entity free and clear of any claims or interest of any Person previously entitled thereto.

Section 2.7 No Liability. None of Parent, Merger Sub, the Company, the Surviving Entity or the Exchange Agent shall be liable to any Person in respect of any Merger Consideration from the Exchange Fund delivered to a public official or Governmental Entity pursuant to any applicable abandoned property, escheat or similar Law.

Section 2.8 Investment of the Exchange Fund. The Exchange Agent shall invest any cash included in the Exchange Fund as directed by Parent on a daily basis; provided that no such gain or loss thereon shall affect the amounts payable to the

stockholders of the Company pursuant to Article I or this Article II. Any interest and other income resulting from such investments shall promptly be paid to Parent.

Section 2.9 Lost Certificates. If any Certificate shall have been lost, stolen or destroyed, upon the making of an affidavit of that fact by the Person claiming such Certificate to be lost, stolen or destroyed and, if required by the Surviving Entity, the posting by such Person of a bond in such reasonable amount as the Surviving Entity may direct as indemnity against any claim that may be made against it with respect to such Certificate, the Exchange Agent shall deliver in exchange for such lost, stolen or destroyed Certificate the applicable Merger Consideration with respect to the shares of Company Common Stock formerly represented thereby, any cash in lieu of fractional shares of Parent Common Stock to which such holders are entitled pursuant to Section 2.5 and any dividends and distributions with respect to shares of Parent Common Stock to which such holders are entitled pursuant to Section 2.3.

Section 2.10 Withholding Rights. Each of the Surviving Entity and Parent shall be entitled to deduct and withhold from the consideration otherwise payable pursuant to this Agreement to any holder of shares of Company Common Stock, Company Restricted Shares or any other equity rights in the Company such amounts as it is required to deduct and withhold with respect to the making of such payment under the Code and the rules and regulations promulgated thereunder, or any provision of state, local or non-U.S. Law and shall further be entitled to sell Parent Common Stock otherwise payable pursuant to this Agreement to satisfy any such withholding requirement. To the extent that amounts are so withheld by the Surviving Entity or Parent, as the case may be, such withheld amounts shall be treated for all purposes of this Agreement as having been paid to the holder of the shares of Company Common Stock in respect of which such deduction and withholding was made by the Surviving Entity or Parent, as the case may be.

Section 2.11 Further Assurances. After the Effective Time, the officers and directors of the Surviving Entity will be authorized to execute and deliver, in the name and on behalf of the Company or Merger Sub, any deeds, bills of sale, assignments or assurances and to take and do, in the name and on behalf of the Company or Merger Sub, any other actions and things to vest, perfect or confirm of record or otherwise in the Surviving Entity any and all right, title and interest in, to and under any of the rights, properties or assets acquired or to be acquired by the Surviving Entity as a result of, or in connection with, the Merger.

Section 2.12 Stock Transfer Books. The stock transfer books of the Company shall be closed immediately upon the Effective Time and there shall be no further registration of transfers of shares of Company Common Stock thereafter on the records of the Company. At or after the Effective Time, any Certificates presented to the Exchange Agent or Parent for any reason shall be converted into the right to receive the Merger Consideration with respect to the shares of Company Common Stock formerly

represented thereby (including any cash in lieu of fractional shares of Parent Common Stock to which the holders thereof are entitled to pursuant to Section 2.5 and any dividends or other distributions to which the holders thereof are entitled pursuant to Section 2.3).

Section 2.13 Affiliates. Notwithstanding anything to the contrary herein, to the fullest extent permitted by Law, no certificates representing shares of Parent Common Stock or cash shall be delivered to a Person who may be deemed an "affiliate" of the Company in accordance with Section 6.13 hereof for purposes of Rule 145 under the Securities Act, until such Person has executed and delivered an Affiliate Agreement to Parent.

ARTICLE III

REPRESENTATIONS AND WARRANTIES OF THE COMPANY

Except as otherwise disclosed to Parent in a letter (the "Company Disclosure Letter") delivered to it by the Company prior to the execution of this Agreement (with specific reference to the representations and warranties in this Article III to which the information in such letter relates, subject to Section 9.3(b)) or as set forth in the Company SEC Documents filed prior to the date hereof (excluding any disclosures included in any such Company SEC Document that are predictive or forward-looking in nature), the Company represents and warrants to Parent and Merger Sub as follows:

Section 3.1 Organization. The Company is a corporation duly incorporated, validly existing and in good standing under the laws of the State of Delaware and has all requisite corporate power and authority to own, lease and operate its properties and assets and to carry on its business as now being conducted. The Company delivered or has made available to Parent and Merger Sub true, correct and complete copies of its certificate of incorporation and by-laws, as amended and in effect on the date of this Agreement.

Section 3.2 Subsidiaries.

(a) Exhibit 21.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 2003 includes all the Subsidiaries of the Company (individually, a "Company Subsidiary" and collectively, the "Company Subsidiaries"), which as of the date thereof were "Significant Subsidiaries" (as defined in Rule 1-02 of Regulation S-X of the SEC). Each Company Subsidiary is a corporation, limited liability company or partnership, as the case may be, duly organized, validly existing and in good standing under the laws of the jurisdiction of its incorporation or organization, as the case may be, and has all requisite corporate, limited liability company or partnership power and authority, as the case may be, to own, lease and operate its properties and assets and

to carry on its business as now being conducted, except where the failure to be so organized, validly existing, qualified or in good standing, or to have such power or authority, would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect. The Company has made available to Parent true, correct and complete copies of the certificate of incorporation, the by-laws, and all other organizational documents of each Company Subsidiary, as amended and in effect on the date of this Agreement.

(b) Except as set forth in Section 3.2(b) of the Company Disclosure Letter or in Exhibit 21.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 2003, the Company is, directly or indirectly, the record and beneficial owner of all of the outstanding shares of capital stock or other equity interests of each of the Significant Subsidiaries, free and clear of any Liens. All of such shares and other equity interests so owned by the Company are validly issued, fully paid and nonassessable (and no such shares have been issued in violation of any preemptive or similar rights).

Section 3.3 Capitalization.

(a) As of the date of this Agreement, the authorized capital stock of the Company consists of 3,000,000,000 shares of Company Common Stock.

(b) At the close of business on February 11, 2005, (i) 321,422,248 shares of Company Common Stock were issued and outstanding and (ii) no shares of Company Common Stock were held in treasury by the Company.

(c) The Company has delivered or made available to Parent a complete and correct copy of the Rights Agreement as in effect on the date hereof.

(d) Section 3.3(d) of the Company Disclosure Letter contains a schedule as of February 9, 2005 setting forth the aggregate number of shares of Company Common Stock relating to outstanding awards of Company Restricted Shares and Other Company Equity-Based Awards. As soon as practicable (but not later than 20 Business Days) after the date hereof, the Company shall provide Parent with a copy of the form of agreement related to each such award. Each of the Company's equity compensation plans (the "Company Stock Plans"), are set forth in Section 3.3(d) of the Company Disclosure Letter. As of February 11, 2005, 5,005,144 shares of Company Common Stock were reserved for issuance pursuant to the Chapter 11 Plan. Except as set forth above, at the close of business on February 11, 2005 no shares of capital stock of the Company were issued, reserved for issuance or outstanding. All issued and outstanding shares of Company Common Stock are duly authorized, validly issued, fully paid and nonassessable.

(e) There are no preemptive or similar rights on the part of any holder of any class of securities of the Company or any Company Subsidiary. Neither the Company nor any Company Subsidiary has outstanding any bonds, debentures, notes or other obligations the holders of which have the right to vote (or which are convertible into or exercisable for securities having the right to vote) with the stockholders of the Company or any such Company Subsidiary on any matter submitted to shareholders or a separate class of holders of capital stock. Except as set forth in Sections 3.3(d) or 3.3(e) of the Company Disclosure Letter and other than the rights to purchase Company Common Stock outstanding under the terms of the ESPP, as of the date of this Agreement, there are no options, warrants, calls, rights, convertible or exchangeable securities, "phantom" stock rights, stock appreciation rights, stock-based performance units, commitments, contracts, arrangements or undertakings of any kind to which the Company or any of the Company Subsidiaries is a party or by which any of them is bound (i) obligating the Company or any of the Company Subsidiaries to issue, deliver, sell or transfer or repurchase, redeem or otherwise acquire, or cause to be issued, delivered, sold or transferred or repurchased, redeemed or otherwise acquired, any shares of capital stock of the Company or any Company Subsidiary, any additional shares of capital stock of, or other equity interests in, or any security convertible or exercisable for or exchangeable into any capital stock of, or other equity interest in, the Company or any Company Subsidiary, (ii) obligating the Company or any Company Subsidiary to issue, grant, extend or enter into any such option, warrant, call, right, security, commitment, contract, arrangement or undertaking or (iii) that give any Person the right to receive any economic benefit or right similar to or derived from the economic benefits and rights accruing to holders of capital stock of, or other equity interests in, the Company or any Company Subsidiary. As of the date of this Agreement, there are no outstanding contractual obligations of the Company or any of the Company Subsidiaries to repurchase, redeem or otherwise acquire any shares of capital stock of, or other equity interests in, the Company or any of the Company Subsidiaries. There are no proxies, voting trusts or other agreements or understandings to which the Company is a party or is bound with respect to the voting of the capital stock of, or other equity interests in, the Company.

Section 3.4 Authorization.

(a) The Company has all requisite corporate power and authority to execute and deliver this Agreement, to perform its obligations hereunder and, subject to receipt of approval by the holders of a majority of the outstanding shares of Common Stock entitled to vote in accordance with the DGCL and the Company's Constituent Documents (the "Company Stockholder Approval"), to consummate the transactions contemplated hereby. The execution, delivery and performance of this Agreement and the consummation of the Merger and the other transactions contemplated hereby have been duly and validly authorized by all necessary corporate action, and no other corporate proceedings on the part of the Company are necessary for it to authorize this Agreement

or to consummate the transactions contemplated hereby, except for the adoption of this Agreement and the transactions contemplated hereby by Company Stockholder Approval. This Agreement has been duly and validly executed and delivered by the Company and, assuming due authorization, execution and delivery by Parent and Merger Sub, is a legal, valid and binding obligation of the Company, enforceable against the Company in accordance with its terms, subject to bankruptcy, insolvency, fraudulent transfer, reorganization, moratorium and similar laws of general applicability relating to or affecting creditors' rights and to general equity principles.

(b) The Board of Directors of the Company, at a meeting duly called and held, duly and unanimously adopted resolutions (i) approving this Agreement, the Merger and the other transactions contemplated by this Agreement, (ii) determining that the terms of the Merger and the other transactions contemplated by this Agreement are fair to and in the best interests of the Company and its stockholders, (iii) recommending that the Company's stockholders adopt this Agreement and (iv) declaring that this Agreement is advisable.

Section 3.5 Takeover Statute, No Restrictions on the Merger.

(a) Except as set forth in Section 3.5(a) of the Company Disclosure Letter, no state "fair price," "moratorium," "control share acquisition" or similar anti-takeover statute is applicable to the Merger or the other transactions contemplated by this Agreement.

(b) The Board of Directors has taken all necessary action to render the restrictions on business combinations contained in Section 203 of the DGCL hereby inapplicable to this Agreement and the transactions contemplated by this Agreement.

Section 3.6 Rights Agreement. The Board of Directors of the Company has taken all necessary action to render the Rights Agreement inapplicable to the Merger and the transactions contemplated hereby, and neither the execution and delivery of this Agreement nor the consummation of any of the transactions contemplated hereby will result in the occurrence of a Distribution Date, as defined in the Rights Agreement, or otherwise cause the Company Rights to become exercisable by the holders thereof.

Section 3.7 Consents and Approvals; No Violations.

(a) The execution and delivery of this Agreement by the Company does not and the consummation by the Company of the transactions contemplated hereby will not (i) conflict with any provisions of the Company's Constituent Documents or, except as, individually or in the aggregate, would not reasonably be expected to have a Company Material Adverse Effect, the certificate of incorporation or by-laws or any other organizational documents of any Company Subsidiary; (ii) violate any Law or

Order (assuming compliance with the matters set forth in Section 3.7(b)); (iii) result in any violation or default or loss of a benefit under, or permit the acceleration or termination of any obligation under, any mortgage, indenture, lease, agreement or other instrument, permit, concession, grant, franchise or license; (iv) result in the creation or imposition of any Lien upon any properties or assets of the Company or any Company Subsidiary; or (v) cause the suspension or revocation of any permit, license, governmental authorization, consent or approval necessary for the Company or any Company Subsidiary to conduct its business as currently conducted, except, in the case of clauses (ii), (iii) (iv) and (v), as, individually or in the aggregate, has not had and would not reasonably be expected to result in a Company Material Adverse Effect and as would not reasonably be expected to materially delay or impair the consummation of the Merger.

(b) No consent, approval, order or authorization of, or declaration, registration or filing with, or notice to any Governmental Entity is required to be made or obtained by the Company or any Company Subsidiary in connection with the execution or delivery of this Agreement by the Company or the consummation by the Company of the transactions contemplated hereby, except for (i) compliance by the Company with the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended ("HSR Act"), and such foreign antitrust and competition law requirements described in Section 3.7(b)(i) of the Company Disclosure Letter; (ii) the filing of the Certificate of Merger with the Secretary of State of the State of Delaware in accordance with the DGCL, (iii) the filings with the Securities and Exchange Commission ("SEC") of (A) the Proxy Statement and Prospectus in accordance with Regulation 14A promulgated under the Exchange Act, (B) the registration statement on Form S-4 promulgated under the Securities Act and (C) such reports under and such other compliance with the Exchange Act and the Securities Act and the rules and regulations thereunder as may be required in connection with this Agreement and the transactions contemplated hereby, (iv) with or to the Federal Communications Commission (the "FCC"), (v) with or to those State public service or public utility commissions or similar State regulatory bodies set forth in Section 3.7(b)(v) of the Company Disclosure Letter ("State Commissions"); (vi) with or to those foreign Governmental Entities regulating competition and telecommunications businesses or the use of radio spectrum or regulating or limiting investment set forth in Section 3.7(b)(vi) of the Company Disclosure Letter; (vii) with or to those State agencies or departments or local governments that have issued competitive access provider or other telecommunications franchises or any other similar authorizations; and (viii) any consent, approval, order or authorization of, or declaration, registration or filing with, or notice to any Governmental Entity (other than any of the foregoing addressed in clauses (i) through (vii) above), the failure to make or obtain would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect.

(c) The representations contained in Section 3.7(a) and 3.7(b) are true without taking into account the possibility of effecting the transactions under this Agreement in the form of the Alternative Merger.

(d) Effecting the transactions contemplated hereby in the form of the Merger will not be materially more burdensome to Parent and its Subsidiaries taken as a whole, or the Company and its Subsidiaries taken as a whole as compared to effecting such transactions in the form of the Alternative Merger.

Section 3.8 SEC Reports; Company Financial Statements.

(a) The Company and each Company Subsidiary has filed or furnished all reports, schedules, forms, statements and other documents required to be filed or furnished by it with or to the SEC since April 20, 2004 (the "Company SEC Documents"). As of its respective date, each of the Company SEC Documents, including any financial statements or schedules included or incorporated by reference therein, complied when filed or furnished and as amended in all material respects with the requirements of the Exchange Act or the Securities Act and the rules and regulations of the SEC promulgated thereunder applicable to such Company SEC Documents, and did not, and any Company SEC Documents filed with the SEC subsequent to the date hereof will not, contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or incorporated by reference therein or necessary in order to make the statements therein, in light of the circumstances under which they were made, not misleading.

(b) The Company Financial Statements have been derived from the accounting books and records of the Company and the Company Subsidiaries and have been prepared in accordance with United States generally accepted accounting principles ("GAAP") applied on a consistent basis throughout the periods presented, except as otherwise noted therein and subject, in the case of the unaudited interim financial statements, to the absence of notes. The consolidated balance sheets (including the related notes) included in the Company Financial Statements present fairly in all material respects the financial position of the Company and the Company Subsidiaries as at the respective dates thereof, and the consolidated statements of income, consolidated statements of shareholders' equity and consolidated statements of cash flows (in each case including the related notes) included in such Company Financial Statements present fairly in all material respects the results of operations, shareholders' equity and cash flows of the Company and the Company Subsidiaries for the respective periods indicated, in each case subject to normal year-end adjustments that have not been and are not expected to be material in amount.

Section 3.9 Absence of Undisclosed Liabilities. The Company and the Company Subsidiaries do not have any liabilities or obligations, known or unknown,

contingent or otherwise, except (a) Specified Included Liabilities, (b) liabilities and obligations in the respective amounts reflected on or reserved against in the consolidated balance sheet of the Company and the Company Subsidiaries included in the Company Financial Statements (or readily apparent in the notes thereto), (c) liabilities and obligations incurred in a commercially reasonable manner consistent with industry practice since the date of such balance sheet, and (d) liabilities and obligations that would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect.

Section 3.10 Form S-4; Proxy Statement/Prospectus. None of the information supplied or to be supplied by the Company for inclusion or incorporation by reference in (i) the registration statement on Form S-4 to be filed with the SEC by Parent in connection with the issuance of shares of Parent Common Stock in the Merger (the "Form S-4") will, at the time the Form S-4 is filed with the SEC or at any time it is supplemented or amended or at the time it becomes effective under the Securities Act, contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they are made, not misleading, or (ii) the Proxy Statement/Prospectus will, at the date mailed to stockholders of the Company and at the time of the Company Stockholder Meeting to be held in connection with the Merger, contain any untrue statement of a fact or omit to state any fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they are made, not misleading.

Section 3.11 Absence of Certain Changes. Except for liabilities incurred in connection with this Agreement or the transactions contemplated hereby, for the period beginning September 30, 2004 until the date hereof, (i) the Company and the Company Subsidiaries have conducted their respective businesses only in a commercially reasonable manner consistent with industry practice; (ii) there has not been any declaration, setting aside or payment of any dividend or other distribution in cash, stock or property in respect of the Company's capital stock, other than regular quarterly dividends and the $0.40 per share dividend declared on February 11, 2005; (iii) there has not been any action taken by the Company or any of the Company Subsidiaries that, if taken during the period from the date of this Agreement through the Effective Time, would constitute a material breach of Section 5.1; and (iv) except as required by GAAP, there has not been any change by the Company in its accounting principles, practices or methods. Since September 30, 2004 until the date hereof, there have not been any changes, circumstances or events that, individually and in the aggregate, have had or would reasonably be expected to result in a Company Material Adverse Effect.

Section 3.12 Litigation. Except as set forth in Section 3.12 of the Company Disclosure Letter, there is no suit, action, proceeding, claim, review or investigation (whether at law or in equity, before or by any Governmental Entity or before any

arbitrator) pending, affecting or, to the knowledge of the Company, threatened in writing against the Company or any of the Company Subsidiaries, or their respective properties or rights that, individually and in the aggregate for any such matters premised on common legal theories and similar facts, would reasonably be expected to result in a Company Material Adverse Effect. Except as set forth in Section 3.12 of the Company Disclosure Letter, there is no Order of any Governmental Entity or arbitrator outstanding against the Company or any of the Company Subsidiaries which would, individually or in the aggregate, reasonably be expected to result in a Company Material Adverse Effect.

Section 3.13 Compliance with Laws.

(a) Each of the Company and the Company Subsidiaries is, and since April 20, 2004, has been in compliance in all material respects with applicable Laws and, to the knowledge of the Company, is not under investigation with respect to, and has not been threatened to be charged with or given notice of, any material violation of any Law, in each case except for such failures to be in compliance, such investigations or such violations as would not, individually or in the aggregate, reasonably be expected to result in a Company Material Adverse Effect.

(b) Since December 31, 2003 (or such later date, if the Company only became subject to the applicable provisions, rules and regulations subsequent to December 31, 2003), the principal executive officer and the principal financial officer of the Company have complied in all material respects with (i) the applicable provisions of the Sarbanes-Oxley Act of 2002 and the related rules and regulations promulgated under such Act (the "Sarbanes-Oxley Act") and under the Exchange Act and (ii) the applicable listing and corporate governance rules and regulations of Nasdaq. The principal executive officer and the principal financial officer of the Company have made all certifications required by Sections 302 and 906 of the Sarbanes-Oxley Act with respect to each Company SEC Document filed by the Company. For purposes of the preceding sentence, "principal executive officer" and "principal financial officer" shall have the meanings given to such terms in the Sarbanes-Oxley Act. Except as permitted by the Exchange Act, including Sections 13(k)(2) and (3), since the enactment of the Sarbanes-Oxley Act, neither the Company nor any of its Affiliates has directly or indirectly extended or maintained credit, arranged for the extension of credit, renewed an extension of credit or materially modified an extension of credit in the form of personal loans to any executive officer or director (or equivalent thereof) of the Company or any Company Subsidiaries.

(c) The Company has (i) implemented disclosure controls and procedures (as defined in Rule 13a-15(e) of the Exchange Act) to ensure that material information relating to the Company is made known to the management of the Company by others within those entities, and (ii) has disclosed, based on its most recent evaluation, to the Company's outside auditors and the audit committee of the Board of Directors of

the Company (A) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial data and (B) any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal control over financial reporting.

(d) The Company has prepared a plan to comply with the requirements of Section 404 of the Sarbanes-Oxley Act on the date by which they must comply with such requirements. The Company is not aware of any reason it will not comply with the requirements of Section 404 of the Sarbanes-Oxley Act on the applicable compliance date.

(e) The Company has delivered to Parent copies of any written notifications it has received to date since December 31, 2003 of a (i) "significant deficiency" or (ii) "material weakness" in the Company's internal controls. For purposes of this Agreement, the terms "significant deficiency" and "material weakness" shall have the meanings assigned to them in the Statements of Auditing Standards No. 60, as in effect on the date hereof.

Section 3.14 Taxes.

(a) The Company and each Company Subsidiary have (i) duly and timely filed with the appropriate Governmental Entities all Tax Returns required to be filed by it in respect of any material Taxes, which Tax Returns were true, correct and complete in all material respects, (ii) duly and timely paid in full all Taxes shown as due on such Tax Returns, (iii) duly and timely paid in full or withheld, or established adequate reserves in accordance with GAAP for, all material Taxes that are due and payable by it, (iv) established reserves in accordance with GAAP that are adequate for the payment of all material Taxes not yet due and payable with respect to the results of operations of the Company and each Company Subsidiary through the date of this Agreement and (v) complied in all material respects with all laws applicable to the withholding and payment over of Taxes and has timely withheld and paid over to, or, where amounts have not been so withheld, established an adequate reserve under GAAP for the payment to, the respective proper Governmental Entities all material amounts required to be so withheld and paid over.

(b) There (i) is no deficiency, claim, audit, suit, proceeding, request for information or investigation now pending, outstanding or threatened against or with respect to the Company or any Company Subsidiary in respect of any material Taxes or material Tax Returns, and (ii) are no requests for rulings or determinations in respect of any material Taxes or material Tax Returns pending between the Company or any Company Subsidiary and any authority responsible for such Taxes or Tax Returns.

(c) The federal income Tax Returns of the Company and the Company Subsidiaries have been examined by the Internal Revenue Service (or the applicable statutes of limitation for the assessment of federal income Taxes for such periods have expired) for all periods through and including December 31, 1991, and no material deficiencies were asserted as a result of such examinations that have not been resolved and fully paid.

(d) Neither the Company nor any Company Subsidiary has any material liability as a result of being a party to any material tax sharing, tax indemnity or other agreement or arrangement with any entity not included in the most recent Company Financial Statements.

(e) None of the Company or any of the Company Subsidiaries has any liability for material Taxes as a result of having been a member of any affiliated group within the meaning of Section 1504(a) of the Code, or any similar affiliated or consolidated group for tax purposes under state, local or foreign law (other than a group the common parent of which is the Company), or has any liability for the Taxes of any Person (other than the Company and the Company Subsidiaries) under Treasury Regulations Section 1.1502-6 or any similar provision of state, local or foreign law, or as a transferee or successor, by contract or otherwise.

(f) There are no material adjustments under Section 481 of the Code (or similar or analogous provision of state, local or foreign law) for income tax purposes applicable to or required to be made by the Company or any of the Company Subsidiaries as a result of changes in methods of accounting or other events occurring on or before the date hereof.

(g) There are no Liens on any of the assets or properties of the Company or any Company Subsidiary that arose in connection with any failure (or alleged failure) to pay any material Tax.

(h) Neither the Company nor any Company Subsidiary has participated in a "listed transaction" within the meaning of Treasury Regulations §1.6011-4(b)(2) that has not been properly disclosed pursuant to such Regulation on a Tax Return previously made available to Parent.

Section 3.15 ESPP. No officer, employee, director, consultant, or other service provider to the Company or any of the Company Subsidiaries has any outstanding options to purchase any capital stock of the Company or any of the Company Subsidiaries, other than the rights to purchase Company Common Stock outstanding under the terms of the Company's ESPP.

Section 3.16 Sufficiency of Real Property, etc. The Owned Real Property and the Leased Real Property (collectively, the "Real Property") constitute all the fee and leasehold interests in real property required for the conduct of the Business as currently conducted. Except in any such case as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect, all buildings, structures, fixtures and improvements included within the Real Property (the "Improvements") are in good repair and operating condition, subject only to ordinary wear and tear, and are adequate and suitable for the purposes for which they are presently being used or held for use, and to the knowledge of the Company, there are no facts or conditions affecting any of the Improvements that, in the aggregate, would reasonably be expected to interfere with the current use, occupancy or operation thereof.

Section 3.17 Right-of-Way Agreements and Network Facilities.

(a) Except in any such case as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect, (i) each right-of-way agreement, license agreement or other agreement permitting or requiring the Company or any of its Subsidiaries to lay, build, operate, maintain or place cable, wires, conduits or other equipment and facilities over land, underwater or underground (each, a "Right-of-Way Agreement") is valid, legally binding, enforceable and in full force and effect, and none of the Company or any of its Subsidiaries is in breach of or default under any Right-of-Way Agreement, (ii) no event has occurred which, with notice or lapse of time, would constitute a breach or default by any of the Company or its Subsidiaries or permit termination, modification or acceleration by any third party thereunder and (iii) no third party has repudiated or has the right to terminate or repudiate any Right-of-Way Agreement.

(b) To the knowledge of the Company, the Company is not in violation of any Laws which, individually or in combination with any others, would materially and adversely affect the ability of the Company or any of its Subsidiaries to use any of the rights associated with the Right-of-Way Agreements, taken as a whole, in the manner and scope in which such rights are now being used.

(c) Except in any such case as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect:

(i) All Owned Network Facilities and Leased Network Facilities: (x) are in good working order and condition ("Good Condition") individually and in combination; (y) are, individually and in combination, operated, installed, and maintained by the Company, the Company Subsidiaries, or their contractors in a manner that is in compliance with (a) generally accepted industry standards for the United States telecommunications and foreign telecommunications industries (the latter with respect to Owned Network Facilities and Leased Network

Facilities outside the United States) (together "Industry Standards"), (b) performance requirements in service agreements with customers of Company and its Subsidiaries ("Customer Requirements"), and (c) all Laws, and (z) comply, individually and in combination, with applicable performance standards. The Company and the Company Subsidiaries will maintain or cause Owned Network Facilities and Leased Network Facilities, individually and in combination, to be maintained in Good Condition and in compliance with Performance Standards, Industry Standards, Customer Requirements, and all Laws through the Closing Date.

(ii) The Company owns, free of liens and other encumbrances, other than Permitted Liens, all right, title, and interest in Owned Network Facilities and will maintain the same through the Closing Date. No third Person can revoke or otherwise encumber or interfere with such right, title, and interest.

(iii) (x) Each Network Facility Agreement is valid, legally binding, enforceable and in full force and effect, and none of the Company or any of the Company Subsidiaries is in breach of or default under any Network Facility Agreement, (y) no event has occurred which, with notice or lapse of time, would constitute a breach or default by any of the Company or the Company Subsidiaries or permit termination, revocation, other interference with performance of, modification or acceleration by any third party of any Network Facility Agreement, and (z) no third Person has repudiated, revoked, terminated, or otherwise interfered with performance of or has the right to terminate, repudiate, revoke, or otherwise interfere with the performance of any Network Facility Agreement.

Section 3.18 Brokers. No Persons other than Greenhill & Co., LLC ("Greenhill"), Lazard, Fréres & Co. LLC ("Lazard") and J. P. Morgan Securities Inc. ("JPMorgan," and collectively with Greenhill and Lazard, the "Company Financial Advisors") are entitled to any brokerage, financial advisory, finder's or similar fee or commission payable by any party hereto in connection with the transactions contemplated by this Agreement based upon arrangements made by or on behalf of the Company or any Company Subsidiary. The Company has furnished to Parent and Merger Sub a true, correct and complete copy of each agreement between the Company, any Company Subsidiary and each Company Financial Advisor relating to the Merger and the other transactions contemplated by this Agreement.

Section 3.19 Employee Benefit Plans and Related Matters; ERISA.

(a) As soon as practicable (but not later than 20 Business Days) after the date hereof, the Company shall provide Parent with a schedule that sets forth a complete and correct list of the Company Benefit Plans. With respect to each such

Company Benefit Plan, on or before the date such schedule is provided, the Company shall provide to Parent a complete and correct copy of such Company Benefit Plan, if written, or a description of such Company Benefit Plan if not written, and to the extent applicable, (i) all trust agreements, insurance contracts or other funding arrangements, (ii) the most recent actuarial and trust report for both ERISA funding and financial statement purposes, (iii) the most recent Form 5500 with all attachments required to have been filed with the IRS or the Department of Labor or any similar report filed with any comparable governmental authority in any non-U.S. jurisdiction having jurisdiction over any Company Benefit Plan and all schedules thereto, (iv) the most recent IRS determination letter, (v) all current summary plan descriptions, (vi) all material communications received from or sent to the IRS, the Pension Benefit Guaranty Corporation or the Department of Labor, (vii) the most recent actuarial study of any pension, disability, post-employment life or medical benefits provided under any such Company Benefit Plan, (viii) all current employee handbooks and manuals, (ix) statements or other communications regarding withdrawal or other multiemployer plan liabilities (or similar liabilities pertaining to any non-U.S. employee benefit plan sponsored by the Company or any Company Subsidiary, if any), (x) all amendments and modifications to any such Company Benefit Plan or related document and (xi) in the case of any such Company Benefit Plan that is maintained primarily for the benefit of employees whose employment is principally outside the United States, information that is substantially comparable (taking into account differences arising from differences in applicable law and practices) to the information required to be provided in the foregoing subclauses of this Section 3.19(a).

(b) Qualification. Each Company Benefit Plan intended to be qualified under section 401(a) of the Code, and the trust (if any) forming a part thereof, has received a favorable determination letter from the IRS, and no event has occurred or circumstance exists since the date of such determination that would adversely affect such qualification. To the knowledge of the Company, each Company Benefit Plan that is maintained outside of the United States meets the conditions to qualify for tax exempt status, if applicable, or for such other favorable classification available in respect of such Company Benefit Plan under applicable Law. All amendments and actions required to bring each Company Benefit Plan into material conformity with the applicable provisions of ERISA, the Code and other applicable Law have been made or taken, except to the extent such amendments or actions are not required by Law to be made or taken until after the Closing Date. Each Company Benefit Plan has been operated in all material respects in accordance with applicable Law.

(c) Liability. There has been no event or circumstance that has resulted in any material liability to the Company or any of the Company Subsidiaries under or pursuant to Title I or IV of ERISA, the penalty, excise Tax or joint and several liability provisions of the Code relating to employee benefit plans or any applicable provision of Law in any jurisdiction outside of the United States. There has not been any

event or circumstance that could reasonably be expected to result in any material liability (other than for the payment of benefits in a commercially reasonable manner consistent with industry practice) in respect of the Company Benefit Plans. Except as is otherwise reflected in the Financial Statements, there are no "unfunded benefits liabilities" in respect of any Company Benefit Plan that is a defined benefit or similar type plan.

(d) Acceleration or Increases in Compensation. There is no contract, agreement, plan or arrangement to which the Company or any of the Company Subsidiaries is a party covering any employee, former employee, officer, director, shareholder or contract worker of the Company or any of the Company Subsidiaries, which, individually or collectively, could give rise to the payment of any material amount that would not be deductible pursuant to Section 280G of the Code or would otherwise result in the acceleration of payment of any benefits or a material increase in the amount of benefits (including, without limitation, any indemnity or redundancy pay) payable, whether pursuant to the terms of any such Company Benefit Plan, at Law, by contract or otherwise, the entering into, or the consummation of the transactions contemplated by, this Agreement.

(e) Independent Contractors. The Company and each of the Company Subsidiaries has properly classified all individuals (including but not limited to independent contractors and leased employees) under applicable Law, except where failure to properly classify such person would not result in material employment or benefit liability to the Company or the Company Subsidiaries. Any person (other than the non-employee members of the Company's board of directors) providing services to the Company or any of the Company Subsidiaries who has not been classified as an employee is not eligible to participate in any Company Benefit Plan and is not entitled to receive any benefits or other compensation under or pursuant to any such Company Benefit Plan in respect of such non-employee service.

Section 3.20 Employees, Labor Matters. As soon as practicable (but not later than 20 Business Days) after the date hereof, the Company shall provide Parent with a schedule that sets forth a complete and correct list of each collective bargaining agreement to which any of the Company or any of the Company Subsidiaries is party or by which any such entity may be bound. Since April 20, 2004, there has not occurred nor, to the knowledge of the Company has there been threatened, any material strike, slowdown, picketing, work stoppage, concerted refusal to work overtime or other similar labor activity or organizing campaign with respect to any employees of the Company or any of the Company Subsidiaries. There are no material labor disputes currently subject to any grievance procedure, arbitration or litigation and there is no representation petition pending or, to the knowledge of the Company, threatened with respect to any employee of the Company or any of the Company Subsidiaries.

Section 3.21 Intellectual Property Rights. Except as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect:

(a) The Company and the Company Subsidiaries are the exclusive owners of all Owned Intellectual Property that is issued as a patent, the subject of a patent application, registered or subject to an application for registration, free and clear of any Liens other than Permitted Liens. The Owned Intellectual Property, together with the Intellectual Property used pursuant to the Intellectual Property Licenses, constitutes all of the Intellectual Property necessary to the conduct of the Business as currently conducted. Immediately after the Effective Time, the Company and the Company Subsidiaries shall own or have licensed to them all the Company Intellectual Property, in each case free from Liens other than Permitted Liens, on the same terms and conditions as in effect prior to the Effective Time. "Owned Intellectual Property" means all material Intellectual Property owned by the Company or any of the Company Subsidiaries.

(b) To the knowledge of the Company, the conduct of the Business does not infringe or otherwise conflict with the rights of any Person in respect of any Intellectual Property. To the knowledge of the Company, none of the Company Intellectual Property is being infringed or otherwise used or being made available for use by any Person without a license or permission from the Company. None of the Company Intellectual Property is subject to any outstanding Order by or with any court, tribunal, arbitrator or other Governmental Entity.

(c) The Company or one of the Company Subsidiaries has taken all actions reasonably necessary to ensure full ownership (including by assignment from employees and from other Persons performing services for the Company or any Company Subsidiary), protection and enforceability of the Owned Intellectual Property under any applicable Law (including making and maintaining in full force and effect all necessary filings, registrations and issuances). Each of the Company and each Company Subsidiary has taken all actions reasonably necessary to maintain the secrecy of all non-public Intellectual Property, including Trade Secrets, used in the Business (including requiring the execution of valid and enforceable confidentiality agreements by employees or any other Person to whom such non-public Intellectual Property is made available). To the knowledge of the Company, none of the Company or any Company Subsidiary is using or enforcing any Owned Intellectual Property in a manner that would reasonably be expected to result in the cancellation or unenforceability of such Owned Intellectual Property or Trade Secret.

Section 3.22 Contracts.

(a) Except as listed in Section 3.22(a) of the Company Disclosure Letter, and except for Company Benefit Plans, neither the Company nor any Company Subsidiary is a party to or bound by, as of the date hereof:

(i) any agreement relating to Indebtedness (other than agreements among direct or indirect wholly owned Company Subsidiaries) in excess of $10,000,000;

(ii) any joint venture, partnership, limited liability company or other similar agreements or arrangements relating to the formation, creation, operation, management or control of any partnership or joint venture material to the Company or any of its Subsidiaries in which the Company or any Company Subsidiary owns any interest valued at more than $10,000,000 without regard to percentage voting or economic interest (unless pursuant to such agreement or arrangement the Company and/or the Company Subsidiaries, as the case may be, do not have a future funding obligation likely to require funding of more than $10,000,000 in the aggregate);

(iii) any agreement or series of related agreements, including any option agreement, relating to the acquisition or disposition of any material business or material real property (whether by merger, sale of stock, sale of assets or otherwise);

(iv) any material agreement other than an agreement with respect to compensation or similar arrangements not involving a director of the Company or one of the officers of the Company for purposes of Section 16 of the Exchange Act and any agreement entered into in a commercially reasonable manner consistent with industry practice with (A) any Person directly or indirectly owning, controlling or holding with power to vote, 5% or more of the outstanding voting securities of the Company or any Company Subsidiary, (B) any Person 5% or more of the outstanding voting securities of which are directly or indirectly owned, controlled or held with power to vote by the Company or any Company Subsidiary or (C) any current or former director or officer of the Company or any Company Subsidiary;

(v) any agreement (including any exclusivity agreement) that purports to limit or restrict in any material respect either the type of business in which the Company or the Company Subsidiaries (or, after the Effective Time, Parent or its Subsidiaries) may engage or the manner or locations in which any of them may so engage in any business including any covenant not to compete or could require the disposition of any material assets or line of business of the Company or the Company Subsidiaries;

(vi) any sales, distribution, agency or other similar agreement providing for the sale by the Company or any Company Subsidiary of materials, supplies, goods, services, equipment or other assets that are material to the

Company and the Company Subsidiaries taken as a whole and involving payments to the Company in excess of $17,500,000 annually;

(vii) any agreement relating to any material interest rate, currency or commodity derivatives or hedging transaction;

(viii) any agreement (including keepwell agreement) under which (A) any Person (other than the Company or a Company Subsidiary) has directly or indirectly guaranteed any liabilities or obligations of the Company or any Company Subsidiary or (B) the Company or any Company Subsidiary has directly or indirectly guaranteed liabilities or obligations of any other Person (other than the Company or a Company Subsidiary) (in each case other than endorsements for the purpose of collection in a commercially reasonable manner consistent with industry practice), unless such guarantor obligation is less than $10,000,000;

(ix) any material "take-or-pay" agreements; or

(x) any agreement the termination or breach of which or the failure to obtain consent in respect of is likely to have a Company Material Adverse Effect.

(b) The agreements, commitments, arrangements and plans listed or required to be listed in Section 3.22(a) of the Company Disclosure Letter are referred to herein as the "Company Contracts." Each Company Contract is a valid and binding agreement of the Company or a Company Subsidiary, as the case may be, and is in full force and effect, and none of the Company, any Company Subsidiary or, to the knowledge of the Company, any other party thereto is in default or breach in any material respect under the terms of any such Company Contract. True, correct and complete copies of (i) each such Company Contract (including all modifications and amendments thereto and waivers thereunder) and (ii) all form contracts, agreements or instruments used in and material to the Business have been made available to Parent.

Section 3.23 Environmental Laws and Regulations. Except as disclosed in Section 3.23 of the Company Disclosure Letter or as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect:

(a) The Company and each Company Subsidiary has complied and is in compliance in all material respects with all applicable Environmental Laws and has obtained and is in compliance in all material respects with all Environmental Permits.

(b) No notice of violation, notification of liability, demand, request for information, citation, summons or order has been received by the Company or any Company Subsidiary, no complaint has been filed, no penalty or fine has been assessed, and no investigation, action, claim, suit or proceeding is pending or, to the knowledge of

the Company, threatened by any Person involving the Company or any Company Subsidiary relating to or arising out of any Environmental Law.

(c) No Hazardous Substances are or were located and no disposal or Releases of Hazardous Substances have occurred at, on, above, under or from any properties currently or, to the knowledge of the Company at the time of the cessation of such ownership, lease, operation or use, formerly owned, leased, operated or used by the Company, any Company Subsidiary or any predecessors in interest that, in each case, has resulted in or would reasonably be expected to result in any material cost, liability or obligation of the Company or any Company Subsidiary under any Environmental Law.

(d) Neither the Company nor any Company Subsidiary, nor, to the knowledge of the Company, any other Person, has caused or taken any action that could reasonably be expected to result in any material liability or obligation relating to (i) the environmental conditions at, on, above, under, or about any properties or assets currently or formerly owned, leased, operated or used by the Company or any Company Subsidiary or any of their respective predecessors in interest, or (ii) the past or present use, management, handling, transport, treatment, generation, storage, disposal, Release or threatened Release of Hazardous Substances.

(e) The Company has provided to Parent all material environmental site assessments, audits, investigations and studies in the possession, custody or control of the Company or any Company Subsidiary relating to properties or assets currently or formerly owned, leased, operated or used by the Company or any Company Subsidiary.

(f) Neither the Company nor any Company Subsidiary has been in businesses other than those related to the provision of telecommunication services that would reasonably be expected to present environmental issues of a materially different scope or magnitude than those presented in the provision of telecommunication services. Without limiting the generality of the foregoing, neither the Company nor any Company Subsidiary has operated or currently operates: (i) any manufacturing facilities; (ii) any facilities that are or have been permitted under the Resource Conservation and Recovery Act; or (iii) any business that manages the hazardous wastes of any unrelated party. The representations contained in this Section 3.23(f) shall not deemed to be breached unless the operation or ownership of such other business or businesses has resulted in any material cost, liability or obligation of the Company or any Company Subsidiary under any Environmental Law.

Section 3.24 Insurance Coverage. The Company and the Company Subsidiaries maintain policies of insurance in such amounts and against such risks as are customary in the industries in which the Company and the Company Subsidiaries operate. Except as would not reasonably be expected to have a Company Material Adverse Effect, all such insurance policies are in full force and effect and will not in any way be affected by, or

terminate or lapse by reason of, this Agreement or the consummation of any of the transactions contemplated hereby.

Section 3.25 Consent Decrees. Section 3.25 of the Company Disclosure Letter sets forth a list of all material consent decrees to which the Company and the Company Subsidiaries are subject and any material voluntary agreements with any state or federal agency that impose any continuing duties on the Company, including any additional reporting or monitoring requirements.

Section 3.26 Foreign Corrupt Practices and International Trade Sanctions. Neither the Company, nor any Company Subsidiaries, nor any of their respective directors, officers, agents, employees or any other Persons acting on their behalf has, in connection with the operation of their respective businesses, (i) used any corporate or other funds for unlawful contributions, payments, gifts or entertainment, or made any unlawful expenditures relating to political activity to government officials, candidates or members of political parties or organizations, or established or maintained any unlawful or unrecorded funds in violation of Section 104 of the Foreign Corrupt Practices Act of 1977, as amended, or any other similar applicable foreign, Federal or state Law, (ii) paid, accepted or received any unlawful contributions, payments, expenditures or gifts, or (iii) violated or operated in noncompliance with any export restrictions, anti-boycott regulations, embargo regulations or other applicable domestic or foreign Laws, in each case, except as is not, individually or in the aggregate, reasonably likely to have a Company Material Adverse Effect.

Section 3.27 Compliance with Governance Requirements. The Company is in compliance in all material respects with the permanent injunction entered by the United States District Court for the Southern District of New York against the Company's predecessor company on November 26, 2002 and such court's related June 11, 2003 and December 17, 2003 orders.

Section 3.28 Opinions of Financial Advisors. The Company has received opinions from Greenhill, Lazard and JPMorgan, dated as of February 13, 2005, to the effect that, as of the date of such opinions and subject to the procedures followed, and the qualifications and limitations set forth therein, the Merger Consideration (without giving effect to any adjustment pursuant to Section 1.10), the Special Cash Dividend and the $0.40 per share cash dividend declared by the Board of Directors of the Company on February 11, 2005, taken together, are fair, from a financial point of view to the holders of shares of Company Common Stock.

ARTICLE IV

REPRESENTATIONS AND WARRANTIES OF PARENT AND MERGER SUB

Except as otherwise disclosed to the Company in a letter (the "Parent Disclosure Letter") delivered to it by Parent and Merger Sub prior to the execution of this Agreement (with specific reference to the representations and warranties in this Article IV to which the information in such letter relates) or as set forth in the Parent SEC Documents filed prior to the date hereof (excluding any disclosures included in any such Parent SEC Document that are predictive or forward-looking in nature), Parent and Merger Sub represent and warrant to the Company as follows:

Section 4.1 Organization. Each of Parent and Merger Sub is duly organized, validly existing and in good standing under the laws of the State of Delaware. Each of Parent and Merger Sub have all requisite corporate power and authority to own, lease and operate its properties and assets and to carry on its business as currently conducted.

Section 4.2 Capitalization.

(a) Parent owns all right, title and interest in and to all the outstanding membership interests of Merger Sub free and clear of any Liens.

(b) As of the date of this Agreement, the authorized capital stock of Parent consists of 4,250,000,000 shares of Parent Common Stock and 250,000,000 shares of preferred stock, par value $ 0.10 per share ("Parent Preferred Stock"). At the close of business on February 11, 2005, (i) 2,774,865,381 shares of Parent Common Stock were issued and outstanding, (ii) no shares of Parent Preferred Stock were issued and outstanding, (iii) 5,623,033 shares of Parent Common Stock were held in treasury by Parent, and (iv) 200,000,000 shares of Parent Common Stock were reserved for issuance pursuant to Parent's stock option plans. Except as set forth above, as of February 11, 2005, no shares of capital stock of Parent were issued, reserved for issuance or outstanding. All issued and outstanding shares of Parent Common Stock and Parent Preferred Stock are, and all shares of Parent Common Stock that may be issued pursuant to the exercise of outstanding options will be, when issued in accordance with the terms thereof, duly authorized, validly issued, fully paid and nonassessable and subject to no preemptive or similar rights.

(c) There are no preemptive or similar rights on the part of any holder of any class of securities of the Parent or any of its Significant Subsidiaries. Neither the Parent nor any of its Significant Subsidiaries has outstanding any bonds, debentures, notes or other obligations the holders of which have the right to vote (or which are convertible into or exercisable for securities having the right to vote) with the stockholders of the Parent or any such Significant Subsidiary on any matter submitted to

shareholders or a separate class of holders of capital stock. Except as set forth in Section 4.2(c) of the Parent Disclosure Letter, as of the date of this Agreement, there are no options, warrants, calls, rights, convertible or exchangeable securities, "phantom" stock rights, stock appreciation rights, stock-based performance units, commitments, contracts, arrangements or undertakings of any kind to which the Parent or any of the Significant Subsidiaries is a party or by which any of them is bound (i) obligating the Parent or any of the Significant Subsidiaries to issue, deliver, sell or transfer or repurchase, redeem or otherwise acquire, or cause to be issued, delivered, sold or transferred or repurchased, redeemed or otherwise acquired, any shares of the capital stock of the Parent or any Significant Subsidiary, any additional shares of capital stock of, or other equity interests in, or any security convertible or exercisable for or exchangeable into any capital stock of, or other equity interest in, the Parent or any Significant Subsidiary, (ii) obligating the Parent or any Significant Subsidiary to issue, grant, extend or enter into any such option, warrant, call, right, security, commitment, contract, arrangement or undertaking or (iii) that give any Person the right to receive any economic benefit or right similar to or derived from the economic benefits and rights accruing to holders of capital stock of, or other equity interests in, the Parent or any Significant Subsidiary. As of the date of this Agreement, there are no outstanding contractual obligations of the Parent or any of the Significant Subsidiaries to repurchase, redeem or otherwise acquire any shares of capital stock of, or other equity interests in, the Parent or any of the Significant Subsidiaries.

Section 4.3 Authorization. Parent and Merger Sub have all requisite corporate and limited liability company power and authority to execute and deliver this Agreement and to perform its obligations hereunder and, to consummate the transactions contemplated hereby. The execution, delivery and performance of this Agreement and the consummation of the Merger and the other transactions contemplated hereby have been duly and validly authorized by all necessary actions of Parent and Merger Sub, and no other corporate or limited liability company proceedings on the part of Parent or Merger Sub, as the case may be, are necessary for Parent or Merger Sub to authorize this Agreement and to consummate the transactions contemplated hereby. This Agreement has been duly and validly executed and delivered by each of Parent and Merger Sub and, assuming due authorization, execution and delivery by the Company, is a legal, valid and binding obligation of each of Parent and Merger Sub, enforceable against each of Parent and Merger Sub in accordance with its terms, subject to bankruptcy, insolvency, fraudulent transfer, reorganization, moratorium and similar laws of general applicability relating to or affecting creditors' rights and to general equity principles.

Section 4.4 Consents and Approvals; No Violations.

(a) The execution and delivery of this Agreement by Parent and Merger Sub do not and the consummation by Parent and Merger Sub of the transactions contemplated hereby will not (i) conflict with any provision of the certificate of

incorporation or by-laws or any other organizational documents of Parent or Merger Sub, (ii) violate any Law or Order (assuming compliance with the matters set forth in Section 4.4(b)); (iii) result in any violation of or default or loss of a benefit under, or permit the acceleration or termination of any obligation under, any mortgage, indenture, lease, agreement or other instrument, permit, concession, grant, franchise, license or result in the creation or imposition of any Lien upon any properties or assets of the Parent or any Parent Subsidiary; or (iv) cause the suspension or revocation of any permit, license, governmental authorization, consent or approval necessary for each of Parent and Merger Sub to conduct its business as currently conducted, except, in the case of clauses (ii) or (iii), for such violations that, in the aggregate, have not had and would not reasonably be expected to result in a Parent Material Adverse Effect and as would not reasonably be expected to materially delay or impair the consummation of the Merger.

(b) No consent, approval, order or authorization of, or declaration, registration or filing with, or notice to any Governmental Entity is required to be made or obtained by Parent or Merger Sub in connection with the execution and delivery of this Agreement by Parent and Merger Sub or the consummation by Parent of Merger Sub of the transactions contemplated hereby, except for (i) compliance by Parent and Merger Sub with the HSR Act and such foreign antitrust and competition law requirements set forth in Section 4.4(b)(i) of the Parent Disclosure Letter, (ii) the filing of the Certificate of Merger with the Secretary of State of the State of Delaware in accordance with the DGCL, (iii) the filing with the SEC of (A) the Proxy Statement and Prospectus in accordance with Regulation 14A promulgated under the Exchange Act, (B) the registration statement on Form S-4 promulgated under the Securities Act and (C) such reports under and such other compliance with the Exchange Act and the Securities Act and the rules and regulations thereunder as may be required in connection with this Agreement and the transactions contemplated hereby, (iv) the reports, filings, registrations, consents, approvals, permits, authorizations and/or notices with or to the FCC, (v) the reports, filings, registrations, consents, approvals, permits, authorizations and/or notices with or to the State Commissions set forth in Section 4.4(b)(v) of the Parent Disclosure Letter; and (vi) the reports, filings, registrations, consents, approvals, permits, authorizations and/or notices with or to those foreign Governmental Entities regulating competition and telecommunications businesses or the use of radio spectrum or regulating or limiting investment set forth in Section 4.4(b)(vi) of the Parent Disclosure Letter.

Section 4.5 SEC Reports; Financial Statements.

(a) Parent has filed or furnished, as applicable, all reports, schedules, forms, statements and other documents required to be filed or furnished with or by it to the SEC since December 31, 2003 (the "Parent SEC Documents"). As of its respective date, each of the Parent SEC Documents, complied when filed or furnished and as amended in all material respects with the requirements of the Exchange Act or the

Securities Act and the rules and regulations of the SEC promulgated thereunder applicable to such Parent SEC Documents, and did not, and any Parent SEC Documents filed with the SEC subsequent to the date hereof will not, contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they were made, not misleading.

(b) The consolidated financial statements of Parent and its consolidated Subsidiaries included in the Parent SEC Documents have been derived from the accounting books and records of Parent and its consolidated Subsidiaries and have been prepared in accordance with GAAP applied on a consistent basis during the periods involved (except as may be indicated in the notes thereto). The consolidated balance sheets included in such consolidated financial statements present fairly in all material respects the consolidated financial position of Parent and its consolidated Subsidiaries as at the respective dates thereof and the consolidated statements of income and consolidated statements of cash flows included in such consolidated financial statements present fairly in all material respects the results of operations and cash flows of Parent and its consolidated Subsidiaries for the respective periods indicated.

Section 4.6 Absence of Undisclosed Liabilities. Parent and its Subsidiaries do not have any liabilities or obligations, known or unknown, contingent or otherwise, except (a) liabilities and obligations in the respective amounts reflected on or reserved against in the consolidated balance sheet of the Parent and its Subsidiaries included in the Parent Financial Statements (or readily apparent in the notes thereto), (b) liabilities and obligations incurred in the ordinary course of business, consistent with past practice, since the date of such balance sheet, and (c) liabilities and obligations that would not, individually or in the aggregate, reasonably be expected to have a Parent Material Adverse Effect.

Section 4.7 Form S-4; Proxy Statement/Prospectus. None of the information supplied or to be supplied by Parent or Merger Sub for inclusion or incorporation by reference in the Proxy Statement/Prospectus, at the date such Proxy Statement is first mailed to stockholders of the Company, and at the time of the Company Stockholders Meeting, will contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they are made, not misleading. None of the information contained or incorporated by reference in the Form S-4, at the time the Form S-4 is filed with the SEC, at any time it is amended or supplemented and at the time the Form S-4 becomes effective under the Securities Act, will contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they are made, not misleading, except that no representation is made by Parent or Merger Sub with respect to statements made in the Form S-4 based on information

supplied by the Company in writing for inclusion in the Form S-4. The Form S-4 will comply as to form in all material respects with all Laws.

Section 4.8 Absence of Certain Changes. Except for liabilities incurred in connection with this Agreement or the transactions contemplated hereby and except as set forth in Schedule 4.8 of the Parent Disclosure Letter, for the period beginning September 30, 2004 until the date hereof, the Parent and its Subsidiaries have conducted their respective businesses only in the ordinary course consistent with past practice. Except as disclosed in the Parent SEC Documents filed prior to the date of this Agreement, since December 31, 2003, there have not been any changes, circumstances or events that, individually and in the aggregate, have had or would reasonably be expected to result in a Parent Material Adverse Effect.

Section 4.9 Litigation. Except as set forth in Section 4.9 of the Parent Disclosure Letter, there is no suit, action, proceeding, claim, review or investigation (whether at law or in equity, before or by any Governmental Entity or before any arbitrator) pending, affecting or, to the knowledge of the Parent, threatened against the Parent or any of its Subsidiaries, or their respective properties or rights that, individually and in the aggregate for any such matters premised on common legal theories and similar facts, would reasonably be expected to result in a Parent Material Adverse Effect. Except as set forth in Section 4.9 of the Parent Disclosure Letter, there is no Order of any Governmental Entity or arbitrator outstanding against Parent or any of its Subsidiaries which would, individually or in the aggregate, reasonably be expected to result in a Parent Material Adverse Effect.

Section 4.10 Compliance with Laws. Each of the Parent and its Subsidiaries is, and since December 31, 2003, has been in compliance with all applicable Laws and, to the knowledge of the Parent, is not under investigation with respect to, and has not been threatened to be charged with or given notice of, any violation of any Law, in each case except for such failures to be in compliance, such investigations or such violations as would not, individually or in the aggregate, reasonably be expected to result in a Parent Material Adverse Effect.

Section 4.11 Brokers. No Person other than Bear, Stearns & Co. Inc. (the "Parent Financial Advisor") is entitled to any brokerage, financial advisory, finder's or similar fee or commission payable by Parent or Merger Sub in connection with the transactions contemplated by this Agreement based upon arrangements made by or on behalf of Parent or Merger Sub.

ARTICLE V

COVENANTS RELATING TO CONDUCT OF BUSINESS

Section 5.1 Covenants of the Company. From the date of this Agreement until the Effective Time, unless Parent shall otherwise consent in writing or except as set forth in Section 5.1 of the Company Disclosure Letter or as otherwise expressly provided for in this Agreement, the Company shall, and shall cause each of the Company Subsidiaries to, conduct its business in a commercially reasonable manner consistent with industry practice, and shall use its commercially reasonable efforts to preserve intact its business organization and goodwill and relationships with customers, suppliers and others having business dealings with it, to keep available the services of its current officers and key employees and to maintain its current rights and franchises, in each case, consistent with industry practice. In addition to and without limiting the generality of the foregoing, except as expressly set forth in Section 5.1 of the Company Disclosure Letter or as otherwise expressly provided for in this Agreement or as required by applicable Law, from the date hereof until the Effective Time, without the prior written consent of Parent, the Company shall not, and shall not permit any Company Subsidiary to:

(a) adopt or propose any change in the Company's certificate of incorporation or by-laws;

(b) (i) declare, set aside, make or pay any dividend or other distribution (whether in cash, stock or property) in respect of any of its capital stock, other than (x) pursuant to Section 6.16 of this Agreement, (y) regular quarterly cash dividends consistent with past practice (which in no event shall exceed $1,947,000,000 in the aggregate since February 1, 2005) which are paid prior to the Special Cash Dividend or (z) dividends or distributions by wholly owned Company Subsidiaries, (ii) split, combine or reclassify any of its capital stock or issue or propose or authorize the issuance of any other securities (including options, warrants or any similar security exercisable for, or convertible into, such other security) in respect of, in lieu of, or in substitution for, shares of its capital stock, (iii) repurchase, redeem or otherwise acquire any shares of the capital stock of the Company or any Company Subsidiary, or any other equity interests or any rights, warrants or options to acquire any such shares or interests, other than pursuant to the Company Stock Plans and the redemption of Company Rights;

(c) issue, sell, grant, pledge or otherwise encumber any shares of its capital stock or other securities (including any options, warrants or any similar security exercisable for or convertible into such capital stock or similar security) (other than (i) issuances of Company Common Stock (and the associated Company Rights) in connection with the ESPP, Company Restricted Shares or Other Equity-Based Awards, in each case, in accordance with their terms (*it being understood* that grants of Company Restricted Shares and Other Equity-Based Awards after the date hereof shall be in

accordance with Schedule 5.1(g) of the Disclosure Letter), (ii) issuances by a wholly owned Company Subsidiary of capital stock to such Company Subsidiary's parent or another wholly owned Company Subsidiary, (iii) issuances in accordance with the Rights Agreement; and (iv) issuances pursuant to the Chapter 11 Plan;

(d) merge or consolidate with any Person (other than the Company or a wholly owned Company Subsidiary) or acquire a material amount of the assets or equity of any other Person (other than the Company or a Company Subsidiary), other than (i) acquisitions disclosed on the Section 5.1(d) of the Company Disclosure Letter and (ii) acquisitions the fair market value of the total consideration (including the value of indebtedness acquired or assumed) for which does not exceed $50,000,000 for any individual acquisition, or $100,000,000 in the aggregate;

(e) sell, lease, license, subject to a Lien, other than a Permitted Lien, encumber or otherwise surrender, relinquish or dispose of any assets, property or rights (including capital stock of a Company Subsidiary) except (i) pursuant to existing written contracts or commitments (the terms of which have been disclosed in writing to Parent prior to the date hereof), (ii) sales of network capacity in the ordinary course consistent with past practice, (iii) sales of assets listed on Schedule 9.12 or (iv) in an amount not in excess of $50,000,000 in the aggregate;

(f) (i) make any loans, advances or capital contributions to, or investments in, any other Person other than (x) by the Company or any Company Subsidiary to or in the Company or any Company Subsidiary or (y) pursuant to any contract or other legal obligation existing at the date of this Agreement set forth on Section 5.1(f) of the Company Disclosure Letter, (ii) create, incur, guarantee or assume any Indebtedness, issuances of debt securities, guarantees, loans or advances not in existence as of the date of this Agreement, except Indebtedness incurred in the ordinary course of business not to exceed $25,000,000 in the aggregate, Indebtedness in replacement of existing Indebtedness on customary commercial terms, and guarantees by the Company of Indebtedness of wholly owned Subsidiaries of the Company or guarantees by Subsidiaries of Indebtedness of the Company, or (iii) other than in the ordinary course of business consistent with past practice or as set forth in the Company's capital budget, a copy of which was delivered to Parent prior to the date hereof, make or commit to make any capital expenditure;

(g) amend or otherwise modify benefits under any Company Benefit Plan, accelerate the payment or vesting of benefits or amounts payable or to become payable under any Company Benefit Plan as currently in effect on the date hereof, fail to make any required contribution to any Company Benefit Plan, merge or transfer any Company Benefit Plan or the assets or liabilities of any Company Benefit Plan, change the sponsor of any Company Benefit Plan, or terminate or establish any Company Benefit Plan, except (i) as reasonably appropriate to reflect changes in applicable Law or

generally accepted accounting principles, (ii) in the ordinary course of business, consistent with existing policies and practices, or (iii) as identified on Schedule 5.1(g) of the Disclosure Letter;

(h) grant any increase in the compensation or benefits of directors, officers, employees or consultants of the Company or any Company Subsidiary, provided, however, that the Company or any of its Subsidiaries may grant increases in base salaries in the ordinary course of business consistent with existing policies and practices (including pursuant to the Company's "focal point review" and the Company's salary administration program outlined on Schedule 5.1(g) of the Disclosure Letter), so long as such increases, in the aggregate, do not exceed 4% in any calendar year;

(i) enter into or amend or modify any severance, consulting, retention or employment agreement, plan, program or arrangement, (i) other than in the ordinary course of business, consistent with existing policies and practices or (ii) except as identified on Schedule 5.1(i) of the Disclosure Letter;

(j) hire or terminate the employment or contractual relationship of any officer, employee or consultant of the Company or any Company Subsidiary, as the case may be, other than hirings or terminations (i) in the ordinary course, consistent with existing policies and practices, (ii) identified on Schedule 5.1(i) of the Disclosure Letter or (iii) that, individually and in the aggregate, would not result in (x) in the case of hirings, a material increase in the number of persons providing services to the Company and its Subsidiaries in all such capacities, (y) in the case of hirings, a material increase in the aggregate payroll and other benefits costs to the Company or such Company Subsidiary (such increase to be determined, in the case of a hiring to replace an employee or other service provider in a pre-existing position based solely on the costs in excess of the costs associated with the replaced service provider), and (z) in the case of terminations, material liability to the Company or any of its Subsidiaries in excess of the costs savings, if any, directly derived from such terminations;

(k) settle or compromise any action, suit, claim, litigation, proceeding, arbitration, investigation, audit or controversy (each, a "Proceeding") or enter into any consent, decree, injunction or similar restraint or form of equitable relief in settlement of any material Proceeding other than (i) such settlements and compromises that (A) relate to Taxes (which are the subject of Section 5.1(l)), (B) relate to Bankruptcy Claims (which are the subject of Section 6.18), (C) are in the ordinary course consistent with past practice or (D) do not require payments by the Company in excess of $10,000,000 and (ii) such consents, decrees, injunctions or similar restraints or forms of equitable relief that, individually or in the aggregate, are not material to the Company and the Company Subsidiaries, taken as a whole;

(l) (i) make or rescind any material election relating to Taxes, (ii) settle or compromise any Proceeding relating to Taxes (other than Taxes that relate to Bankruptcy Claims (which are the subject of Section 6.18)), (iii) make a request for a written ruling of a Taxing Authority relating to Taxes, other than any request for a determination concerning qualified status of any Company Benefit Plan intended to be qualified under Code Section 401(a), (iv) enter into a written and legally binding agreement with a Taxing Authority relating to material Taxes, or (v) except as required by Law, change any of its methods of reporting income or deductions for federal income tax purposes from those employed in the preparation of its federal income tax returns for the taxable year ending December 31, 2003;

(m) other than in the ordinary course of business consistent with past practice or the indenture amendments disclosed in Section 3.7 of the Company Disclosure Letter, (i) modify or amend in any material respect or terminate any Company Contract, (ii) enter into any successor agreement to an expiring Company Contract that changes the terms of the expiring Company Contract in a way that is materially adverse to the Company or any Company Subsidiary, or (iii) enter into any new agreement that would have been considered a Company Contract if it were entered into at or prior to the date hereof;

(n) enter into or renew or extend any agreements or arrangements that limit or otherwise restrict the Company or any of the Company Subsidiaries or any of their respective Affiliates or any successor thereto, or that could, after the Effective Time, limit or restrict Parent or any of its Affiliates (including the Surviving Entity) or any successor thereto, from engaging or competing in any line of business or in any geographic area, which agreements or arrangements, individually or in the aggregate, would reasonably be expected to have a Parent Material Adverse Effect, after giving effect to the Merger;

(o) change any method of accounting or accounting principles or practices by the Company or any Company Subsidiary, except for any such change required by a change in GAAP or by a Governmental Entity;

(p) terminate or cancel, or amend or modify in any material respect, any material insurance policies maintained by it covering the Company or the Company Subsidiaries or their respective properties which is not replaced by a comparable amount of insurance coverage;

(q) adopt or implement a plan of complete or partial liquidation, dissolution, restructuring, recapitalization or other reorganization of the Company or any of the Company Subsidiaries organized in jurisdictions other than the United States or any political subdivision thereof;

(r) take any actions or omit to take any actions that would or would be reasonably likely to (i) result in any of the conditions to the consummation of the Merger set forth in Article VII not being satisfied or (ii) materially impair the ability of the Company, Parent or Merger Sub to consummate the Merger in accordance with the terms hereof or materially delay such consummation; or

(s) agree or commit to do any of the foregoing.

Section 5.2 Covenants of Parent. From the date of this Agreement until the Effective Time, unless the Company shall otherwise consent in writing, or except as set forth in Section 5.2 of the Parent Disclosure Letter or as otherwise expressly provided for in this Agreement, Parent shall, and shall cause each of its Subsidiaries to, conduct its business in the ordinary course, consistent with past practice, and shall use all commercially reasonable efforts to preserve intact its business organization and goodwill and relationships with customers, suppliers and others having business dealings with it and maintain its current rights and franchises, subject to the terms of this Agreement. In addition to and without limiting the generality of the foregoing, except as expressly set forth in Section 5.2 of the Parent Disclosure Letter or as otherwise expressly provided for in this Agreement, from the date hereof until the Effective Time, without the prior written consent of the Company, Parent shall not, and shall not permit any Subsidiary of Parent to:

(a) adopt or propose any change in its certificate of incorporation or by-laws or other comparable organizational documents in a manner that would adversely affect the economic benefits of the Merger to the Company's stockholders;

(b) declare, set aside, make or pay any dividend or other distribution (whether in cash, stock or property) in respect of any of its capital stock, except for dividends or distributions by wholly owned Subsidiaries of Parent for the declaration and payment of regular quarterly cash dividends or for any distribution of stock or property for which adjustment is made pursuant to Section 1.12;

(c) take or omit to take any action, including engaging in an acquisition of a business, that would be reasonably likely to prevent the consummation of the Merger by the Outside Date; or

(d) agree or commit to do any of the foregoing.

Section 5.3 Certain Actions. If, in conformity with Section 5.2(c), Parent or any Subsidiary of Parent takes any action that is reasonably likely to materially delay the consummation of the Merger, including engaging in an acquisition of a business which is reasonably likely to result in its being materially more difficult to obtain any approval or authorization required in connection with the Merger under Laws, Parent or such

Subsidiary shall, or shall authorize the Company or its Subsidiaries to, take all necessary Specified Efforts to consummate the Merger, notwithstanding anything to the contrary in Section 6.4(e). If such action results in a delay of the consummation of the Merger, then, during the period after which the Merger would otherwise have been consummated, Parent shall not be entitled to invoke the condition set forth in Section 7.2(f) or the condition set forth in Section 7.2(a), except to the extent the failure of such conditions to be satisfied is caused by a breach of a representation or warranty caused by the Company during such period.

ARTICLE VI

ADDITIONAL AGREEMENTS

Section 6.1 Preparation of Proxy Statement.

(a) As promptly as reasonably practicable following the date hereof, Parent and the Company shall prepare and file with the SEC mutually acceptable proxy materials that shall constitute the Proxy Statement/Prospectus (such proxy statement/prospectus, and any amendments or supplements thereto, the "Proxy Statement/Prospectus") and Parent shall prepare and file the Form S-4. The Proxy Statement/Prospectus will be included in and will constitute a part of the Form S-4 as Parent's prospectus. The Form S-4 and the Proxy Statement/Prospectus shall comply as to form in all material respects with the applicable provisions of the Securities Act and the Exchange Act and the rules and regulations thereunder.

(b) Each of Parent and the Company shall use commercially reasonable efforts to have the Form S-4 declared effective by the SEC as promptly as practicable after the date hereof and to keep the Form S-4 effective as long as is necessary to consummate the Merger and the transactions contemplated thereby.

(c) Parent and the Company shall, as promptly as practicable after receipt thereof, provide the other party copies of any written comments and advise the other party of any oral comments, with respect to the Proxy Statement/Prospectus received from the SEC. Parent shall provide the Company with a reasonable opportunity to review and comment on any amendment or supplement to the Form S-4 and any communications prior to filing such with the SEC, and will promptly provide the Company with a copy of all such filings and communications made with the SEC.

(d) The Company will use commercially reasonable efforts to cause the Proxy Statement/Prospectus to be mailed to the Company's stockholders as soon as reasonably practicable after the Form S-4 is declared effective under the Securities Act. Parent shall take any action (other than qualifying to do business in any jurisdiction in which it is not now so qualified or to file a general consent to service of process) required

to be taken under any applicable state securities laws in connection with the Share Issuance and the Company shall furnish all information concerning the Company and the holders of Company Common Stock as may be reasonably requested in connection with any such action. Each party will advise the other party, promptly after it receives notice thereof, of the time when the Form S-4 has become effective, the issuance of any stop order, the suspension of the qualification of the Parent Common Stock issuable in connection with the Merger for offering or sale in any jurisdiction, or any request by the SEC for amendment of the Proxy Statement/Prospectus or the Form S-4.

(e) If at any time prior to the Effective Time any information relating to Parent or the Company, or any of their respective Affiliates, officers or directors, should be discovered by Parent or the Company which should be set forth in an amendment or supplement to any of the Form S-4 or the Proxy Statement/Prospectus so that any of such documents would not include any misstatement of a material fact or omit to state any material fact necessary to make the statements therein, in light of the circumstances under which they were made, not misleading, the party that discovers such information shall promptly notify the other party hereto and, to the extent required by law, rules or regulations, an appropriate amendment or supplement describing such information shall be promptly filed with the SEC and disseminated to the stockholders of the Company.

Section 6.2 Stockholders Meeting; Company Recommendation. The Company shall duly take all lawful and commercially reasonable action to call, give notice of, convene and hold a meeting of its stockholders on a date as soon as reasonably practicable after the S-4 Registration Statement is declared effective (the "Company Stockholders Meeting") for the purpose of obtaining the Company Stockholder Approval with respect to the adoption of this Agreement and shall take all lawful and commercially reasonable action to solicit the adoption of this Agreement by the Company Stockholder Approval; and the Board of Directors of the Company shall recommend adoption of this Agreement by the stockholders of the Company to the effect as set forth in Section 3.4(b) (the "Company Recommendation"), and shall not withdraw, modify or qualify (a "Change") in any manner adverse to Parent such recommendation or make any statement in connection with the Company Stockholders Meeting inconsistent with such recommendation including, without limitation, approving or recommending a third party Takeover Proposal with respect to the Company or failing to recommend the adoption of this Agreement (collectively, a "Change in the Company Recommendation"); provided that the Board of Directors of the Company may make a Change in the Company Recommendation pursuant to Section 6.5(c).

Section 6.3 Access to Information; Confidentiality. Upon reasonable notice, the Company shall, and shall cause the Company Subsidiaries to, afford to the officers, directors, employees, accountants, counsel, financial advisors, consultants, financing sources and other advisors or representatives (collectively, "Representatives") of Parent

access during normal business hours to all of the Company's and its Subsidiaries' properties, books, records, contracts, commitments and personnel and shall furnish, and shall cause to be furnished, as promptly as practicable to Parent (a) a copy of each report, schedule and other document filed, furnished, published, announced or received by it during such period pursuant to the requirements of federal or state securities laws or a Governmental Entity, and (b) all other information as Parent may reasonably request; provided that the Company may restrict the foregoing access to the extent required by applicable Law and provided, further, that the foregoing shall not require the Company to permit any inspection, or to disclose any information, that in the reasonable judgment of the Company would result in the disclosure of any trade secrets of third parties or violate any of its obligations with respect to confidentiality if the Company shall have used reasonable best efforts to obtain the consent of such third party to such inspection or disclosure. In addition, the Company shall use best efforts to furnish, within twelve weeks of the date hereof, to Parent the items listed on Section 6.3 of the Company Disclosure Letter. The Company shall (i) keep Parent reasonably informed from time to time as to status and developments regarding any audit, investigation, claim, suit or other proceeding with respect to Taxes and (ii) provide to Parent, when available and prior to filing, drafts of any U.S. federal, U.K., French and German income Tax Returns relating to the Company or any Company Subsidiary. All information furnished pursuant to this Section 6.3 shall be subject to the confidentiality agreement, dated as of September 10, 2004, between the Company and Parent (the "Confidentiality Agreement"). No investigation pursuant to this Section 6.3 shall affect the representations, warranties or conditions to the obligations of the parties contained herein.

Section 6.4 Commercially Reasonable Efforts.

(a) Subject to the terms and conditions of this Agreement, each of the Company and Parent will use its commercially reasonable efforts to take, or cause to be taken, all actions and to do, or cause to be done, all things necessary, proper or advisable under this Agreement and applicable Laws and regulations to consummate the Merger and the other transactions contemplated by this Agreement in the most expeditious manner practicable after the date of this Agreement, including (i) preparing and filing as promptly as practicable all documentation to effect all necessary applications, notices, petitions, filings and other documents and to obtain as promptly as practicable all consents, clearances, waivers, licenses, orders, registrations, approvals, permits and authorizations necessary or advisable to be obtained from any third party and/or any Governmental Entity in order to consummate the Merger or any of the other transactions contemplated by this Agreement and (ii) taking all reasonable steps as may be necessary to obtain all such material consents, clearances, waivers, licenses, registrations, permits, authorizations, orders and approvals. In furtherance and not in limitation of the foregoing, each of the Company and Parent agrees to make an appropriate filing of a Notification and Report Form pursuant to the HSR Act and any other Regulatory Law (as defined below) with respect to the transactions contemplated hereby as promptly as

practicable after the date of this Agreement and to supply as promptly as practicable any additional information and documentary material that may be requested pursuant to the HSR Act and any other Regulatory Law and use commercially reasonable efforts to cause the expiration or termination of the applicable waiting periods under the HSR Act in the most expeditious manner practicable.

(b) To the extent permissible under applicable Law or any rule, regulation or restriction of a Governmental Entity, each of the Company and Parent shall, in connection with the efforts referenced above to obtain all requisite material approvals, clearances and authorizations for the transactions contemplated by this Agreement under the HSR Act or any other Regulatory Law, use its commercially reasonable efforts to (i) cooperate in all respects with each other in connection with any filing or submission and in connection with any investigation or other inquiry, including any proceeding initiated by a private party, (ii) promptly inform the other party of any communication received by such party from, or given by such party to, the Antitrust Division of the Department of Justice (the "DOJ"), the Federal Trade Commission (the "FTC") or any other Governmental Entity and of any material communication received or given in connection with any proceeding by a private party, in each case regarding any of the transactions contemplated hereby, (iii) permit the other party, or the other party's legal counsel, to review any communication given by it to, and consult with each other in advance of any meeting or conference with, the DOJ, the FTC or any such other Governmental Entity or, in connection with any proceeding by a private party, with any other Person and (iv) to the extent permitted by such Governmental Entity or other Person, give the other party the opportunity to attend and participate in such meetings and conferences. For purposes of this Agreement, "Regulatory Law" means the Communications Act of 1934, as amended, and the rules and regulations thereunder, the laws, rules, regulations and orders of the state public service or public utility commissions, or similar state regulatory bodies regulating telecommunications businesses or the use of radio spectrum, Sherman Act, as amended, the Clayton Act, as amended, the HSR Act, as amended, the Federal Trade Commission Act, as amended, and all other Federal, state and foreign, if any, statutes, rules, regulations, orders, decrees, administrative and judicial doctrines and other Laws that are designed or intended to prohibit, restrict or regulate actions having the purpose or effect of monopolization or restraint of trade or lessening of competition.

(c) To the extent permissible under applicable Law or any rule, regulation or restriction of a Governmental Entity, each of the Company and Parent shall, in connection with the efforts referenced above, obtain all requisite material approvals, clearances and authorizations for the transactions contemplated by this Agreement and will use its commercially reasonable efforts to (i) cooperate in all respects with each other in connection with any filing or submission and in connection with any investigation or other inquiry and (ii) promptly inform the other party of any communication received by such party from, or given by such party to, the Governmental Entities regulating

competition and telecommunications businesses or the use of radio spectrum or regulating or limiting investment and State agencies or departments or local governments that have issued competitive access provider or other telecommunications franchises or any other similar authorizations.

(d) If any objections are asserted with respect to the transactions contemplated hereby under any Regulatory Law or if any suit is instituted by any Governmental Entity or any private party challenging any of the transactions contemplated hereby as violative of any Regulatory Law, each of the Company and the Parent shall use its commercially reasonable efforts (which for these purposes shall include taking Specified Efforts (as defined below)) to resolve any such objections or challenge as such Governmental Entity or private party may have to such transactions under such Regulatory Law so as to permit consummation of the transactions contemplated by this Agreement.

(e) If necessary to obtain any consents, approvals, permits or authorizations or to remove any impediments to the Merger or the transactions contemplated hereby relating to any Regulatory Law or to avoid the entry of, or to effect the dissolution of, any injunction, temporary restraining order or other order in any suit or proceeding relating to Regulatory Law, each of Parent and the Company shall cooperate with each other and take such lawful steps as shall be necessary or appropriate to secure such end ("Specified Efforts"); provided that neither Parent nor the Company shall be required to take any Specified Efforts to the extent that such Specified Efforts, individually or in the aggregate, would reasonably be expected to have a Specified Material Adverse Effect. "Specified Material Adverse Effect" means a Company Material Adverse Effect or a Parent Material Adverse Effect following the Effective Time (provided, however, that for purposes of determining whether any adverse effect upon Parent constitutes a Parent Material Adverse Effect for purposes of this definition of Specified Material Adverse Effect, Parent and its Subsidiaries, taken as a whole, shall be deemed to be a consolidated group of entities of the size and scale of the Company and its Subsidiaries, taken as a whole).

Section 6.5 No Solicitation.

(a) The Company shall not, nor shall it authorize or permit any of the Company Subsidiaries to, and the Company shall use its commercially reasonable efforts to cause its and its Subsidiaries' respective Representatives not to, directly or indirectly (i) initiate or solicit or knowingly facilitate or encourage any inquiry or the making of any proposal that constitutes a Takeover Proposal (as defined in Section 6.5(e)), (ii) enter into any letter of intent, memorandum of understanding, merger agreement or other agreement, arrangement or understanding relating to any Takeover Proposal, or (iii) continue or otherwise participate in any discussions or negotiations regarding, furnish to any Person any information or data with respect to, or otherwise cooperate with

or take any other action to facilitate any proposal that (A) constitutes any Takeover Proposal or (B) requires the Company to abandon, terminate or fail to consummate the Merger or any other transactions contemplated by this Agreement. Notwithstanding the foregoing, prior to the receipt of the Company Stockholder Approval, the Company may, in response to a *bona fide* written Takeover Proposal that was unsolicited and did not otherwise result from a breach of this Section 6.5(a), and subject to compliance with Section 6.5(c):

(x) furnish information with respect to the Company and the Company Subsidiaries to the Person making such Takeover Proposal and its Representatives pursuant to and in accordance with a confidentiality agreement containing terms and conditions no less restrictive than those contained in the Confidentiality Agreement, provided that such confidentiality agreement shall not be required to contain standstill provisions and shall not contain any provisions that would prevent the Company from complying with its obligation to provide the required disclosure to Parent pursuant to Section 6.5(b), and provided further that all such information provided to such Person has previously been provided to Parent or is provided to Parent prior to or concurrently with the time it is provided to such Person; and

(y) participate in discussions or negotiations with such Person or its Representatives regarding such Takeover Proposal;

provided, in each case, that the Board of Directors of the Company determines in good faith after consultation with its outside legal counsel and a financial advisor of nationally recognized reputation, that (i) the failure to furnish such information or participate in such discussions or negotiations could be reasonably expected to result in a breach of its fiduciary duties to the stockholders of the Company under applicable Law and (ii) such Takeover Proposal could reasonably be expected to lead to a Superior Proposal (as defined in Section 6.5(e)). The Company shall (A) immediately cease and cause to be terminated any existing activities, discussions or negotiations with any Persons or their Representatives conducted prior to the date of this Agreement with respect to any Takeover Proposal and will request the prompt return of any confidential information previously furnished to such Persons in connection therewith, and (B) use its commercially reasonable efforts promptly to inform its Representatives of the obligations undertaken in this Section 6.5. Without limiting the foregoing, any violation of the restrictions set forth in this Section 6.5 by any Representative of the Company or any of its Subsidiaries shall be deemed to be a breach of this Section 6.5 by the Company.

(b) As promptly as practicable after the receipt by the Company of any Takeover Proposal or any inquiry with respect to, or that could reasonably be expected to lead to, any Takeover Proposal, and in any case within 24 hours after the receipt thereof, the Company shall provide oral and written notice to Parent of (i) such Takeover

Proposal or inquiry, (ii) the identity of the Person making any such Takeover Proposal or inquiry, and (iii) the material terms and conditions of any such Takeover Proposal or inquiry (including any amendments or modifications thereto). The Company shall keep Parent fully informed on a current basis of the status of any such Takeover Proposal, including, without limitation, any changes to the terms and conditions thereof, and promptly provide Parent with copies of all Takeover Proposals (and modifications thereof) and related agreements, draft agreements and modifications thereof.

(c) Neither the Board of Directors of the Company nor any committee thereof shall, directly or indirectly, (i) effect a Change in the Company Recommendation or (ii) approve any letter of intent, memorandum of understanding, merger agreement or other agreement, arrangement or understanding relating to any Takeover Proposal. Notwithstanding the foregoing, at any time prior to the Company Stockholder Approval, the Board of Directors of the Company may, in response to a Superior Proposal or an Intervening Event, effect a Change in the Company Recommendation, provided that the Board of Directors of the Company determines in good faith, after consultation with its outside legal counsel and a financial advisor of nationally recognized reputation, that the failure to do so would be reasonably expected to result in a breach of its fiduciary duties to the stockholders of the Company under applicable Law, and provided, further, that the Board of Directors of the Company may not effect such a Change in the Company Recommendation unless (i) the Board of Directors shall have first provided prior written notice to Parent that it is prepared to effect a Change in the Company Recommendation in response to a Superior Proposal or an Intervening Event, which notice shall, in the case of a Superior Proposal, attach the most current version of any written agreement relating to the transaction that constitutes such Superior Proposal, and, in the case of an Intervening Event, attach information describing such Intervening Event in reasonable detail, and (ii) Parent does not make, within five Business Days after the receipt of such notice (or, in the event of a Takeover Proposal that has been materially revised or modified, within two Business Days of such modification, if later), a proposal that the Board of Directors determines in good faith, after consultation with a financial advisor of nationally recognized reputation, is at least as favorable to the stockholders of the Company as such Superior Proposal or obviates the need for a Change in the Company Recommendation as a result of the Intervening Event, as the case may be. The Company agrees that, during the five Business Day period prior to its effecting a Change in the Company Recommendation, the Company and its Representatives shall negotiate in good faith with Parent and its Representatives regarding any revisions to the terms of the transaction contemplated by this Agreement proposed by Parent. Notwithstanding any Change in the Company Recommendation as a result of an Intervening Event, Parent shall have the option, exercisable within five Business Days after such Change in the Company Recommendation, to cause the Board of Directors to submit this Agreement to the stockholders of the Company for the purpose of adopting this Agreement and approving the Merger. If Parent exercises such option, Parent shall not be entitled to terminate this Agreement pursuant to Section 8.1(c)(iii). If Parent fails to exercise such

option, the Company may terminate this Agreement pursuant to and in accordance with Section 8.1(d)(ii).

(d) Nothing contained in this Section 6.5 shall prohibit the Company from complying with Rule 14d-9 and Rule 14e-2 promulgated under the Exchange Act in respect of any Takeover Proposal or making any disclosure to the stockholders of the Company if the Board of Directors determines in good faith, after consultation with its outside counsel, that the failure to make such disclosure could be reasonably expected to result in a of breach its fiduciary duties to the stockholders of the Company under applicable Law, provided, however that neither the Board of Directors of the Company nor any committee thereof shall, except as expressly permitted by Section 6.5(c), effect a Change in Company Recommendation or approve or recommend, or publicly propose to approve or recommend, a Takeover Proposal.

(e) For purposes of this Agreement:

"Intervening Event" shall mean an event, unknown to the Board of Directors of the Company as of the date hereof, which becomes known prior to the Company Stockholder Approval and which causes the Board of Directors to conclude in good faith, after consultation with its outside legal counsel and a financial advisor of nationally recognized reputation, that its failure to effect a Change in the Company Recommendation would be reasonably likely to result in a breach of its fiduciary duties to the stockholders of the Company under applicable Law.

"Takeover Proposal" means any proposal or offer in respect of (i) a merger, consolidation, business combination, share exchange, reorganization, recapitalization, liquidation, dissolution, or similar transaction involving (x) the Company or (y) any of the Company Subsidiaries which represent, individually or in the aggregate, 15% or more of the Company's consolidated assets (any of the foregoing, a "Business Combination Transaction") with any Person other than Parent, Merger Sub or any Affiliate thereof (a "Third Party") in which such Third Party or the shareholders of the Third Party immediately prior to consummation of such Business Combination Transaction will own more than 15% of the Company's outstanding capital stock immediately following such Business Combination Transaction, including the issuance by the Company of more than 15% of any class of its voting equity securities as consideration for assets or securities of a Third Party, or (ii) any direct or indirect acquisition, whether by tender or exchange offer or otherwise, by any Third Party of 15% or more of any class of capital stock of the Company or of 15% or more of the consolidated assets of the Company and the Company Subsidiaries, in a single transaction or a series of related transactions.

"Superior Proposal" means any *bona fide* written proposal or offer made by a Third Party in respect of a Business Combination Transaction involving, or any transaction involving the purchase or acquisition of, (i) all or substantially all of the

voting power of the Company's capital stock or (ii) all or substantially all of the consolidated assets of the Company and the Company Subsidiaries, which transaction the Board of Directors determines in good faith, after consultation with its outside counsel and a financial advisor of nationally recognized reputation, (x) would be, if consummated, more favorable to the stockholders of the Company than the Merger and the Special Cash Dividend, taking into account all of the terms and conditions of such proposal and of this Agreement (including any proposal by Parent to amend the terms of this Agreement) as well as any other factors deemed relevant by the Board of Directors, and (y) is reasonably capable of being consummated on the terms so proposed, taking into account all financial, regulatory, legal and other aspects of such proposal.

Section 6.6 Employee Matters.

(a) Until the first anniversary of the Effective Time (the "Benefits Continuation Period"), the Surviving Entity shall pay or cause to be paid to each employee of the Company and the Company Subsidiaries who continues as an employee of the Company, the Company Subsidiaries or the Surviving Entity during the Benefits Continuation Period (the "Continuing Employees") a base salary at a rate not less than the rate of such base salary in effect at the Effective Time. During the Benefits Continuation Period, the Surviving Entity shall provide or cause to be provided an incentive compensation opportunity not less than the incentive compensation opportunity in effect at the Effective Time. The Surviving Entity shall also provide or cause to be provided to any Continuing Employee during the Benefits Continuation Period medical benefits and other welfare benefit plans, programs and arrangements (i) that are substantially comparable to those provided under the Company Benefit Plans as in effect at the Effective Time; (ii) which are substantially comparable to those provided to management employees of the Parent or its Subsidiaries; or (iii) any combination of the foregoing; provided that (x) with respect to Continuing Employees who are subject to collective bargaining or employment agreements (including change in control agreements), compensation, benefits and payments shall be provided in accordance with such agreements, and the Surviving Entity expressly assumes such collective bargaining or employment agreements (including change in control agreements) and (y) during the Benefits Continuation Period, the Surviving Entity shall pay, subject to such terms and conditions as it shall establish, any such Continuing Employee whose employment is involuntarily terminated by the Parent, the Surviving Entity or any of their Subsidiaries without cause an amount of severance pay in cash equal to the amount of cash severance pay that would have been payable to such Continuing Employee under the terms of the severance plan maintained by the Company and its Subsidiaries and applicable to such Continuing Employee immediately prior to the date of this Agreement. The foregoing provisions of this Section 6.6 shall not be construed or interpreted to restrict in any way the Surviving Entity's or Parent's ability to amend, modify or terminate any Company Benefit Plan (including, without limitation, to change the entities who administer such Company Benefit Plans, or the manner in which such Company Benefits Plans are

administered) to the extent not inconsistent with such foregoing restrictions or any other plan made available to the Continuing Employees or to terminate any person's employment at any time or for any reason.

(b) The Surviving Entity shall (i) waive any applicable pre-existing condition exclusions and waiting periods with respect to participation and coverage requirements in any replacement or successor welfare benefit plan of the Surviving Entity that an employee of the Company or any of the Company Subsidiaries is eligible to participate in following the Effective Time to the extent such exclusions or waiting periods were inapplicable to, or had been satisfied by, such employee immediately prior to the Effective Time under the relevant Company Benefit Plan in which such employee participated, (ii) provide each such employee with credit for any co-payments and deductible paid prior to the Effective Time (to the same extent such credit was given under the analogous Company Benefit Plan prior to the Effective Time) in satisfying any applicable deductible or out-of-pocket requirements and (iii) to the extent that any Continuing Employee is allowed to participate in any employee benefit plan of the Parent, the Surviving Entity or any of their Subsidiaries following the Effective Time, cause such plan to recognize the service of such Continuing Employee with the Company and the Company Subsidiaries prior to the Effective Time for purposes of eligibility to participate, vesting and benefit accrual (but not for benefit accrual under any defined benefit, retiree welfare or similar plan) to the same extent such service was recognized by the Company and the Company Subsidiaries under any similar Company Benefit Plan in which such Continuing Employee participated immediately prior to the Effective Time; provided that the foregoing shall not apply to the extent it would result in any duplication of benefits for the same period of service.

(c) With respect to matters described in this Section 6.6, the Company will consult with Parent (and consider in good faith the advice of Parent) prior to sending any written notices or other communication materials (including, without limitation, any postings to any website) to its employees or former employees of the Company or any Company Subsidiary. Prior to the Effective Time, the Company shall provide Parent with reasonable access to such employees or former employees for purposes of Parent providing notices or other communication materials regarding Parent compensation and benefit plans and the matters described in this Section 6.6; provided that such notices or other communication materials are approved in advance by the Company, which approval shall not be unreasonably withheld.

(d) The Company and each of its Subsidiaries shall (i) provide any and all notices to, (ii) make any and all filings or registrations with, and (iii) obtain any and all consents or approvals of, any labor organization, works council or any similar entity, council or organization, required to be made or obtained in connection with this Agreement or the consummation of the transactions contemplated hereby.

(e) The Parent shall prepare and file with the SEC a registration statement on an appropriate form, or a post-effective amendment to a registration statement previously filed under the Securities Act, with respect to the shares of Parent Common Stock subject to any Other Company Equity-Based Award and, where applicable, shall use its reasonable best efforts to have such registration statement declared effective as soon as practicable following the Effective Time and to maintain the effectiveness of such registration statement covering such Other Company Equity-Based Award (and to maintain the current status of the prospectus contained therein) for so long as such Other Company Equity-Based Award remains outstanding. With respect to those individuals, if any, who, subsequent to the Effective Time, will be subject to the reporting requirements under Section 16 of the Exchange Act, where applicable, the Parent shall use all reasonable efforts to administer any applicable Company Stock Plan in a manner that complies with Rule 16b-3 under the Exchange Act to the extent such Company Stock Plan complied with such rule prior to the Effective Time.

Section 6.7 Fees and Expenses. Subject to Section 8.3, whether or not the Merger is consummated, all Expenses incurred in connection with this Agreement and the transactions contemplated hereby shall be paid by the party incurring such Expenses. As used in this Agreement, "Expenses" includes all out-of-pocket expenses (including, without limitation, all fees and expenses of counsel, accountants, investment bankers, experts and consultants to a party hereto and its Affiliates) incurred by a party or on its behalf in connection with or related to the authorization, preparation, negotiation, execution and performance of this Agreement and the transactions contemplated hereby, including the preparation, printing, filing and mailing, as the case may be, of the Proxy Statement/Prospectus and the Form S-4 and any amendments or supplements thereto, and the solicitation of the Company Stockholder Approval and all other matters related to the transactions contemplated hereby.

Section 6.8 Directors' and Officers' Indemnification and Insurance.

(a) From and after the Effective Time the Surviving Entity shall, and Parent shall cause the Surviving Entity to, (i) indemnify and hold harmless, against any costs or expenses (including attorney's fees), judgments, fines, losses, claims, damages or liabilities incurred in connection with any claim, action, suit, proceeding or investigation, whether civil, criminal, administrative or investigative, and provide advancement of expenses to, all past and present directors, officers and employees of the Company and the Company Subsidiaries (in all of their capacities) (A) to the same extent such persons are indemnified or have the right to advancement of expenses as of the date of this Agreement by the Company pursuant to the Company's Constituent Documents and indemnification agreements, if any, in existence on the date hereof with any directors, officers and employees of the Company and the Company Subsidiaries and (B) without limitation to clause (A), to the fullest extent permitted by Law, (ii) include and cause to be maintained in effect in the Surviving Entity's (or any successor's) certificate of

incorporation and bylaws, the current provisions regarding elimination of liability of directors, indemnification of officers, directors and employees and advancement of expenses contained in the Company's Constituent Documents and (iii) cause to be maintained for a period of six years after the Effective Time the current policies of directors' and officers' liability insurance and fiduciary liability insurance ("D & O Insurance") maintained by the Company (provided that the Surviving Entity (or any successor) may substitute therefor policies of at least the same coverage and amounts containing terms and conditions which are, in the aggregate, no less advantageous to the insured) with respect to claims arising from facts or events that occurred on or before the Effective Time (including for acts or omissions occurring in connection with the approval of this Agreement and the consummation of the transactions contemplated hereby); and provided, further, that in no event shall the Surviving Entity be required to expend in any one year more than 200% of the current annual premium expended by the Company and the Company Subsidiaries to maintain or procure such D & O Insurance immediately prior to the Effective Time (such 200% amount, the "Maximum Annual Premium"); provided, further, that if the annual premiums of such insurance coverage exceed such amount, the Surviving Entity shall be obligated to obtain a policy with the greatest coverage available for a cost not exceeding the Maximum Annual Premium. In addition, the Company may purchase a six-year "tail" prepaid policy prior to the Effective Time on terms and conditions no less advantageous to the insured than the existing D & O Insurance maintained by the Company; provided, that the amount paid by the Company shall not exceed six times the Maximum Annual Premium. If such "tail" prepaid policy has been obtained by the Company prior to the Closing, (i) the Surviving Entity shall not be obligated to maintain D & O Insurance as described above, and (ii) the Surviving Entity shall, and Parent shall cause the Surviving Entity to, maintain such "tail" policy in full force and effect, for its full term, and continue to honor their respective obligations thereunder. The obligations of the Surviving Entity under this Section 6.8 shall not be terminated or modified in such a manner as to adversely affect any indemnitee to whom this Section 6.8 applies without the consent of such affected indemnitee (it being expressly agreed that the indemnitees to whom this Section 6.8 applies shall be third party beneficiaries of this Section 6.8).

(b) If the Surviving Entity or any of its successors or assigns (i) shall consolidate with or merge into any other corporation or entity and shall not be the continuing or Surviving Entity or entity of such consolidation or merger or (ii) shall transfer all or substantially all of its properties and assets to any individual, corporation or other entity, then, and in each such case, proper provisions shall be made so that the successors and assigns of the Surviving Entity shall assume all of the obligations set forth in this Section 6.8.

Section 6.9 Public Announcements. Parent and the Company shall develop a joint communications plan and each party shall (i) ensure that all press releases and other public statements or communications with respect to the transactions contemplated

hereby shall be consistent with such joint communications plan and (ii) unless otherwise required by applicable law or by obligations pursuant to any listing agreement with or rules of any securities exchange, consult with each other before issuing any press release or, to the extent practical, otherwise making any public statement or communication with respect to this Agreement or the transactions contemplated hereby. In addition to the foregoing, except to the extent disclosed in or consistent with the Proxy Statement/Prospectus in accordance with the provisions of Section 6.1, neither Parent nor the Company shall issue any press release or otherwise make any public statement or disclosure concerning the other party or the other party's business, financial condition or results of operations without the consent of the other party, which consent shall not be unreasonably withheld or delayed.

Section 6.10 Notification of Certain Matters. The Company shall use its commercially reasonable efforts to give prompt notice to Parent, and Parent shall use its commercially reasonable efforts to give prompt notice to Company, to the extent that either acquires actual knowledge of (i) the occurrence or non-occurrence of any event the occurrence or non-occurrence of which would be reasonably likely to cause any representation or warranty contained in this Agreement to be untrue or inaccurate as of the date hereof or as of the Closing Date and (ii) any failure of Parent, Merger Sub or the Company, as the case may be, to comply with or satisfy any covenant, condition or agreement to be complied with or satisfied by it hereunder, provided, however, that the delivery of any notice pursuant to this Section 6.10 shall not limit or otherwise affect the remedies available hereunder to the party receiving such notice.

Section 6.11 Accountant's Letters.

(a) Parent shall use its commercially reasonable efforts to cause to be delivered to the Company two letters from Parent's independent public accountants, one dated approximately the date on which the Form S-4 shall become effective and one dated the Closing Date, each addressed to Parent and the Company, in form reasonably satisfactory to the Company and customary in scope for comfort letters delivered by independent public accountants in connection with registration statements similar to the Form S-4.

(b) The Company shall use its commercially reasonable efforts to cause to be delivered to Parent two letters from the Company's independent public accountants, one dated approximately the date on which the Form S-4 shall become effective and one dated the Closing Date, each addressed to the Company and Parent, in form reasonably satisfactory to Parent and customary in scope for comfort letters delivered by independent public accountants in connection with registration statements similar to the Form S-4.

Section 6.12 Listing of Shares of Parent Common Stock. Parent shall use its commercially reasonable efforts to cause the shares of Parent Common Stock to be issued in the Merger to be approved for listing on the NYSE, subject to official notice of issuance, prior to the Closing Date.

Section 6.13 Affiliates. Not later than 45 days prior to the Effective Time, the Company shall deliver to Parent a letter identifying all persons who, in the judgment of the Company, may be deemed at the time this Agreement is submitted to the stockholders of the Company for the Company Stockholder Approval, "affiliates" of the Company for purposes of Rule 145 under the Securities Act and applicable SEC rules and regulations, and such list shall be updated as necessary to reflect changes from the date thereof. The Company shall use commercially reasonable efforts to cause each person identified on such list to deliver to Parent not less than 30 days prior to the Effective Time, a written agreement substantially in the form attached as Exhibit A hereto (an "Affiliate Agreement"). Parent will give stop transfer instructions to its transfer agent with respect to any Parent Common Stock received pursuant to the Merger by any stockholder of the Company who may reasonably be deemed to be an affiliate of the Company for purposes of Rule 145 under the Securities Act and there will be placed on the certificates representing such Parent Common Stock, or any substitutions therefor, a legend stating in substance that the shares were issued in a transaction to which Rule 145 under the Securities Act applies and may only be transferred (i) in conformity with Rule 145 or (ii) in accordance with a written opinion of counsel, reasonably acceptable to Parent in form and substance, that such transfer is exempt from registration under the Securities Act.

Section 6.14 State Takeover Laws. If any "fair price," "business combination" or "control share acquisition" statute or other similar statute or regulation is or shall become applicable to the transactions contemplated hereby, Parent, the Company and their respective Boards of Directors shall use all reasonable efforts to grant such approvals and take such actions as are necessary so that the transactions contemplated hereby may be consummated as promptly as practicable on the terms contemplated hereby and shall otherwise act to minimize the effects of any such statute or regulation on the transactions contemplated hereby.

Section 6.15 Stockholder Litigation. The Company shall give Parent the opportunity to participate in the defense or settlement of any stockholder litigation against the Company and/or its directors relating to the transactions contemplated by this Agreement. The Company agrees that it shall not settle or offer to settle any litigation commenced on or after the date hereof against the Company or any of its directors or executive officers by any stockholder of the Company relating to this Agreement, the Merger, any other transaction contemplated hereby or otherwise, without the prior written consent of Parent.

Section 6.16 Special Cash Dividend. Following the date of adoption of this Agreement by the holders of Company Common Stock constituting the Company Stockholder Approval and prior to the Effective Time, the Company will, unless prohibited by applicable law or covenants in instruments of Indebtedness existing as of the date hereof, declare and pay a special cash dividend per share of Company Common Stock equal to (i) $4.10 *minus* (ii) the per share amount of any dividend declared by the Company during the period beginning on the date of this Agreement and ending on the Closing Date, excluding, for the avoidance of doubt, the $0.40 per share cash dividend approved by the Board on February 11, 2005 (the "Special Cash Dividend"). It is the expectation of the parties that such Special Cash Dividend will be paid as soon as practicable following the date the Company Stockholder Approval is obtained.

Section 6.17 Bankruptcy Court Order. The Company will use its reasonable efforts to obtain an order in form and in substance satisfactory to Parent, issued by the United States Bankruptcy Court for the Southern District of New York providing that following the Effective Time of the Merger, the Surviving Entity may issue shares of Parent Common Stock in lieu of shares of Company Common Stock to which certain general unsecured creditors would have been entitled prior to the Effective Time in satisfaction of their claims pursuant to the Debtors' Modified Second Amended Joint Plan of Reorganization dated October 21, 2003 (the "Bankruptcy Court Order"). In addition, the parties will cooperate with regard to the possibility of seeking an order to the effect that such shares of Parent Common Stock will be exempt from registration under the Securities Act pursuant to Section 1145(a) of the Bankruptcy Code.

Section 6.18 Settlement of Bankruptcy Claims. The Company will not settle any Bankruptcy Claims or any matter directly arising out of the Bankruptcy Claims for a plan-affected amount of cash in excess of $15,000,000 without first providing Parent with written notification setting forth the terms of such settlement. Such notification shall be delivered to Parent no less than three Business Days prior to the settlement date. Parent shall have an opportunity to comment on the terms of such settlement and the Company will consider Parent's comments in good faith. The Company shall provide Parent regular updates about the status of the Bankruptcy Claims in the format produced by Huron (or any replacement system used by the Company after the date hereof), which updates shall be provided no less often than monthly.

Section 6.19 No Amendment of Plan of Reorganization. Unless required by Law, the Company shall not take any action to amend or modify the Plan of Reorganization of WorldCom, Inc. and certain of its Subsidiaries under Chapter 11 of the Bankruptcy Code, confirmed by the United States Bankruptcy Court for the Southern District of New York on October 31, 2003 and consummated on April 20, 2004.

Section 6.20 Restoring Trust. The Company has, since November, 2002, had the oversight of a Corporate Monitor, pursuant to a permanent injunction entered by the

United States District Court for the Southern District of New York against the Company's predecessor company on November 26, 2002. As part of his oversight, the Corporate Monitor developed corporate governance principles and processes entitled Restoring Trust, which guided the Company's predecessor company and the Company through the present, and the Company has fully complied with Restoring Trust. The Company will use its reasonable best efforts to obtain an Order, satisfactory to Parent, from the United States District Court for the Southern District of New York (the "Corporate Monitor Order"), (i) confirming the successful conclusion of the efforts of the Corporate Monitor, (ii) concluding that the function of the Corporate Monitor is no longer necessary, (iii) relieving the Company from the oversight of the Corporate Monitor, prior to or upon the Effective Time, (iv) acknowledging that Parent and its Subsidiaries, including the Surviving Entity, will not be subject to Restoring Trust or any related or similar governance restrictions and (v) making such changes to the permanent injunctions entered by such Court as shall be necessary to effectuate the foregoing. In addition, the Company will use its reasonable best efforts to have such permanent injunctions dissolved.

Section 6.21 Network Facility Maintenance and Compliance. The Company and the Company Subsidiaries will maintain or cause Owned Network Facilities and Leased Network Facilities, taken as a whole, to be maintained in Good Condition and in compliance with standard industry practice through the Closing Date.

Section 6.22 Section 16 of the Exchange Act. Prior to the Effective Time, each of Parent and the Company shall take all such steps as may be required to cause any dispositions of Company Common Stock (including derivative securities with respect to Company Common Stock) or acquisitions of Parent Common Stock (including derivative securities with respect to Parent Common Stock) resulting from the transactions contemplated by Article I or Article II of this Agreement by each individual who is subject to the reporting requirements of Section 16(a) of the Exchange Act, to be exempt under Rule 16b-3 promulgated under the Exchange Act, such steps to be taken in accordance with the guidance provided by the SEC.

Section 6.23 Tax Treatment. Subject to Section 1.9, Parent and the Company and each of their respective Affiliates shall use their commercially reasonable efforts to cause the Merger to qualify as a reorganization within the meaning of Section 368(a) of the Code and to obtain the opinions of Debevoise & Plimpton LLP and Davis Polk & Wardwell referred to in Sections 7.4(a) and 7.4(b) of this Agreement, including by providing such customary representations as counsel may reasonably request in connection with such opinions. Notwithstanding the foregoing, nothing in this Section 6.23 shall limit Parent in providing cash consideration where permitted or required by this Agreement, even if doing so would jeopardize qualification of the Merger as a reorganization.

ARTICLE VII

CONDITIONS PRECEDENT

Section 7.1 Conditions to Each Party's Obligation to Effect the Merger. The respective obligations of the Company, Parent and Merger Sub to effect the Merger are subject to the satisfaction or waiver on or prior to the Closing Date of the following conditions:

(a) Stockholder Approval. The Company shall have obtained the Company Stockholder Approval.

(b) NYSE Listing. The shares of Parent Common Stock to be issued in the Merger and such other shares to be reserved for issuance in connection with the Merger shall have been approved for listing on the NYSE, subject to official notice of issuance.

(c) Regulatory Approval. (i) The waiting period (and any extension thereof) applicable to the Merger under the HSR Act shall have been terminated or shall have expired, any investigation opened by means of a second request for additional information or otherwise shall have been terminated or closed and no action shall have been instituted by the Department of Justice or the Federal Trade Commission challenging or seeking to enjoin the consummation of this transaction, which action shall not have been withdrawn or terminated, (ii) the authorization required to be obtained from the FCC for the consummation of the Merger shall have been obtained, (iii) all approvals, if any, required to be obtained (A) with or from any state public service or public utility commissions or similar state regulatory bodies listed in Section 7.1(c) of the Company Disclosure Letter or (B) under any foreign antitrust, competition or similar Laws, in each case in connection with the consummation of the Merger and the transactions contemplated by this Agreement, shall have been obtained (except, in the case of clause (B), for any failures to obtain such approvals that would not, individually or in the aggregate, reasonably be expected to result in a Specified Material Adverse Effect) and (iv) all other notices, reports, filings, consents, registrations, approvals, permits or authorizations required to be made prior to the Effective Time by the Company or Parent or any of their respective Subsidiaries with, or obtained prior to the Effective Time by the Company or Parent or any of their respective Subsidiaries from, any Governmental Entity in connection with the execution and delivery of this Agreement and the consummation of the Merger and the other transactions contemplated hereby, the failure of which to make or obtain would, individually or in the aggregate, provide a reasonable basis to conclude that the Company or the Parent or their respective directors or officers would be subject to the risk of criminal liability, shall have been made or obtained.

(d) No Injunctions or Restraints, Illegality. No Laws shall have been adopted or promulgated, and no temporary restraining order, preliminary or permanent injunction or other order, judgment, decision, opinion or decree issued by a court or other Governmental Entity of competent jurisdiction having the effect of making the Merger illegal or otherwise prohibiting consummation of the Merger, except by Governmental Entities outside the United States as would not, individually or in the aggregate, reasonably be expected to be material to Parent and which do not provide a reasonable basis to conclude that the Company, Parent or their respective directors or officers would be subject to the risk of criminal liability.

(e) Effectiveness of the Form S-4. The Form S-4 shall have been declared effective by the SEC under the Securities Act. No stop order suspending the effectiveness of the Form S-4 shall have been issued by the SEC and no proceedings for that purpose shall have been initiated or threatened by the SEC.

(f) Determination of Specified Included Liabilities Amount. The Specified Included Liabilities Amount shall have been determined pursuant to Section 1.10.

Section 7.2 Conditions to Obligations of Parent and Merger Sub. The obligations of Parent and Merger Sub to effect the Merger are subject to the satisfaction of, or waiver by Parent, on or prior to the Closing Date of the following additional conditions:

(a) Representations and Warranties. Each of the representations and warranties of the Company set forth in this Agreement, in each case, made as if none of such representations and warranties contained any qualifications or limitations as to "materiality" or Company Material Adverse Effect, shall be true and correct, in each case, as of the date of this Agreement and as of the Closing Date as though made on and as of the Closing Date (except to the extent in either case that such representations and warranties speak as of another date), except where the failure of such representations and warranties to be true and correct as so made does not have and is not, individually or in the aggregate, reasonably likely to have, a Company Material Adverse Effect, provided that the representations and warranties of the Company in Sections 3.3(a), (b), (d), and (e) (with respect to the Company only, and not the Company Subsidiaries) and 3.4 shall be true in all material respects. Parent shall have received a certificate of the chief executive officer or the chief financial officer of the Company to such effect.

(b) Performance of Obligations of the Company. The Company shall have performed or complied in all material respects with all agreements and covenants required to be performed by it under this Agreement at or prior to the Closing Date and Parent shall have received a certificate of the chief executive officer or the chief financial officer of the Company to such effect.

(c) No Litigation. There shall be no pending suit, action or proceeding by any U.S. Governmental Entity, in each case that has a reasonable likelihood of success, (i) challenging the acquisition by Parent or Merger Sub of any Company Common Stock, seeking to restrain or prohibit the consummation of the Merger or any other transaction or seeking to obtain from the Company, Parent or Merger Sub any damages that are material in relation to the Company and the Company Subsidiaries taken as a whole, (ii) seeking to prohibit or limit the ownership or operation by the Company, Parent or any of their respective Subsidiaries of any material portion of the business or assets of the Company, Parent or any of their respective Subsidiaries, or to compel the Company, Parent or any of their respective Subsidiaries to dispose of or hold separate any material portion of the business or assets of the Company, Parent or any of their respective Subsidiaries, as a result of the Merger or any other transaction, (iii) seeking to impose limitations on the ability of Parent to acquire or hold, or exercise full rights of ownership of, any shares of Company Common Stock, including the right to vote the Company Common Stock purchased by it on all matters properly presented to the stockholders of the Company, or (iv) seeking to prohibit Parent or any of its Subsidiaries from effectively controlling in any material respect the business or operations of the Company and the Company Subsidiaries.

(d) Receipt of Bankruptcy Court Order. The United States Bankruptcy Court for the Southern District of New York shall have issued the Bankruptcy Court Order in form and substance reasonably satisfactory to Parent.

(e) Corporate Monitor. The United States District Court for the Southern District of New York shall have issued the Corporate Monitor Order in form and substance reasonably satisfactory to Parent; and there shall have been no amendment after the date hereof to the permanent injunctions issued by such court adverse to Parent or its Subsidiaries.

(f) No Material Change. From the period beginning on the date of this Agreement, there shall not have been any state of facts, event, change, effect, development, condition or occurrence that, individually or in the aggregate, has had or would reasonably be expected to have a Company Material Adverse Effect.

(g) Regulatory Approval. The condition set forth in Section 7.1(c) shall have been satisfied on terms that, individually or in the aggregate, would not reasonably be expected to have a Specified Material Adverse Effect.

Section 7.3 Conditions to Obligations of the Company. The obligations of the Company to effect the Merger are subject to the satisfaction of, or waiver by the Company, on or prior to the Closing Date of the following additional conditions:

(a) Representations and Warranties. Each of the representations and warranties of Parent and Merger Sub set forth in this Agreement, in each case, made as if none of such representations and warranties contained any qualification or limitation as to "materiality" or Parent Material Adverse Effect, shall be true and correct, in each case, as of the date of this Agreement and as of the Closing Date as though made on and as of the Closing Date (except to the extent in either case that such representations and warranties speak as of another date), except where the failure of such representations and warranties to be true and correct as so made does not have and is not, individually or in the aggregate, reasonably likely to have, a Parent Material Adverse Effect, provided that the representations and warranties of Parent and Merger Sub in Sections 4.2 (with respect to Parent only, and not the Subsidiaries of Parent) and 4.3 shall be true in all material respects. and the Company shall have received a certificate of the chief executive officer or the chief financial officer of Parent to such effect.

(b) Performance of Obligations of Parent and Merger Sub. Parent and Merger Sub shall have performed or complied in all material respects with all agreements and covenants required to be performed by each of them under this Agreement at or prior to the Closing Date and the Company shall have received a certificate of the chief executive officer or the chief financial officer of Parent to such effect.

(c) No Material Change. From the period beginning on the date of this Agreement, there shall not have been any state of facts, event, change, effect, development, condition or occurrence that, individually or in the aggregate, has had or would reasonably be expected to have a Parent Material Adverse Effect.

Section 7.4 Additional Conditions. The obligations of Parent and the Company to effect the Merger as a merger of the Company with and into Merger Sub are subject to the satisfaction of, or waiver by the appropriate party, on or prior to the Closing Date of the following additional conditions:

(a) with respect to the obligations of Parent, that Parent shall have received the opinion of Debevoise & Plimpton LLP, counsel to Parent, dated the Closing Date, to the effect that the Merger will be treated for U.S. federal income tax purposes as a "reorganization" within the meaning of Section 368(a) of the Code, and that each of the Parent and the Company will be a party to that reorganization within the meaning of Section 368(b) of the Code;

(b) with respect to the obligations of the Company, that the Company shall have received the opinion of Davis Polk & Wardwell, counsel to the Company, dated the Closing Date, to the effect that the Merger will be treated for U.S. federal income tax purposes as a "reorganization" within the meaning of Section 368(a) of the Code, and that each of the Parent and the Company will be a party to that reorganization within the meaning of Section 368(b) of the Code.

In the event either of the above conditions fails to be satisfied or waived by the appropriate party, the transactions contemplated hereby shall be effected in the form of the Alternative Merger as provided in Section 1.9.

ARTICLE VIII

TERMINATION AND AMENDMENT

Section 8.1 Termination. This Agreement may be terminated and the transactions contemplated hereby may be abandoned at any time prior to the Effective Time, whether before or after receipt of the Company Stockholder Approval:

(a) by mutual written consent of Parent and the Company;

(b) by either Parent or the Company, if:

(i) the Merger shall not have been consummated by February 14, 2006, whether such date is before or after the date of the Company Stockholder Approval referred to in Section 7.1(a), (A) provided, that in the event that, as of February 14, 2006, the conditions set forth in Section 7.1(c) or 7.2(g) have not been satisfied, the termination date may be extended from time to time by Parent or the Company by up to an aggregate of 180 days and (B) provided, further, that in the event that as of February 14, 2006 (as such date may be extended pursuant to clause (A)), an agreement or resolution of any dispute regarding the adjustment for Specified Included Liabilities at the Closing pursuant to Section 1.10 has not been reached, the termination date may be extended from time to time by Parent or the Company by up to an aggregate of 120 days (such date, including any such permitted extensions thereof, the "Outside Date") and provided, further, that the right to terminate the Agreement pursuant to this Section 8.1(b)(i) shall not be available to any party whose failure to perform any of its obligations under this Agreement primarily contributes to the failure of the Merger to be consummated by such time;

(ii) any Governmental Entity of competent jurisdiction issues a final, non-appealable order, judgment, decision, opinion, decree or ruling, which prevents the fulfillment of the condition set forth in Section 7.1(d); or

(iii) the Company Stockholder Approval shall not have been obtained at the Company Stockholders Meeting or any adjournment or postponement thereof; provided that the right to terminate the Agreement pursuant to this Section 8.1(b)(iii) shall not be available to the Company if it has not complied with its obligations under Section 6.5.

(c) by Parent, if:

(i) the Company shall have breached or failed to perform in any material respect any of its representations, warranties or covenants contained in this Agreement, which breach or failure to perform (A) is incapable of being cured by the Company prior to the Outside Date or is not cured by the earlier of (x) 30 Business Days following written notice to the Company by Parent of such breach or (y) the Outside Date, and (B) would result in a failure of any condition set forth in Sections 7.2(a) or (b);

(ii) the Company or any of the Company Subsidiaries or their respective Representatives shall have breached in any respect their respective obligations under Section 6.5; or

(iii) subject to the penultimate sentence of Section 6.5(c), the Board of Directors shall (A) fail to authorize, approve or recommend the Merger, or (B) effect a Change in the Company Recommendation or, in the case of a Takeover Proposal made by way of a tender offer or exchange offer, fail to recommend that the Company's stockholders reject such tender offer or exchange offer within the ten Business Day period specified in Section 14e-2(a) under the Exchange Act;

(d) by the Company:

(i) if Parent shall have breached or failed to perform in any material respect any of its representations, warranties or covenants contained in this Agreement, which breach or failure to perform (A) is incapable of being cured by Parent prior to the Outside Date or is not cured by the Outside Date and (B) would result in a failure of any condition set forth in Sections 7.3(a) or (b); or

(ii) pursuant to the last sentence of Section 6.5(c) or if the Board of Directors of the Company authorizes the Company, subject to complying with the Section 6.5(c), to enter into a definitive agreement providing for the implementation of a Superior Proposal, and, in either case, the Company, prior to the termination of this Agreement, pays the Termination Fee (as defined in Section 8.3(a)) to Parent.

Section 8.2 Effect of Termination. In the event of any termination of this Agreement as provided in Section 8.1, the obligations of the parties hereunder shall terminate and there shall be no liability on the part of any party hereto with respect thereto, except for the confidentiality provisions of Section 6.3 and the provisions of this Section 8.2, Section 8.3 and Article IX, each of which shall remain in full force and

effect; provided, however, that no party hereto shall be relieved or released from any liability or damages arising from a willful breach of any provision of this Agreement.

Section 8.3 Termination Fee.

(a) If this Agreement is terminated pursuant to any of the following provisions, the Company shall pay to Parent a fee equal to $200,000,000 (the "Termination Fee"), which Termination Fee shall be Parent's sole remedy in respect of termination of this Agreement except in the case of any willful breach of this Agreement by the Company:

(i) Sections 8.1(c)(ii) or (iii);

(ii) Section 8.1(d)(ii);

(iii) Section 8.1(b)(iii), provided that (A) after the date of this Agreement, any Person makes a Takeover Proposal or amends or reasserts a Takeover Proposal made prior to the date of this Agreement and such Takeover Proposal becomes publicly known prior to the Company Stockholders Meeting (and such Takeover Proposal shall not have been withdrawn at the time of the Company Stockholders Meeting), and (B) within twelve months after the date of such termination, the Company enters into a definitive agreement to consummate, or consummates, the transactions contemplated by a Takeover Proposal; and provided, further, that, solely for purposes of this Section 8.3(a)(iii), the term "Takeover Proposal" shall have the meaning ascribed thereto in Section 6.5(e), except that all references to 15% shall be changed to 40%; or

(iv) Section 8.1(c)(i), provided, that such termination is based on a material breach of Section 6.2.

(b) If the Company is required to pay Parent a Termination Fee, such Termination Fee shall be payable immediately prior to termination of this Agreement in the event of termination by the Company, and not later than one Business Day after the receipt by the Company of a notice of termination from Parent in the event of termination by Parent, in each case by wire transfer of immediately available funds to an account designated by Parent (except that, in the case of termination pursuant to Section 8.1(b)(iii), such payment shall be made on the date of the first to occur of the events referred to in clause (B) of Section 8.3(a)(iii)).

(c) The parties each agree that the agreements contained in this Section 8.3 are an integral part of the transaction contemplated by this Agreement, and that, without these agreements, Parent would not enter into this Agreement; accordingly, if the Company fails promptly to pay any amounts due under this Section 8.3 and, in order to obtain such payment, Parent commences a suit that results in a judgment against

the Company for such amounts, the Company shall pay interest on such amounts from the date payment of such amounts were due to the date of actual payment at the prime rate of Citibank, N.A. in effect on the date such payment was due, together with the costs and expenses of Parent (including reasonable legal fees and expenses) in connection with such suit.

ARTICLE IX

GENERAL PROVISIONS

Section 9.1 Non-Survival of Representations, Warranties and Agreements. None of the representations, warranties, covenants and other agreements in this Agreement or in any instrument delivered pursuant to this Agreement, including any rights arising out of any breach of such representations, warranties, covenants and other agreements, shall survive the Effective Time, except for those covenants and agreements contained herein and therein (including Section 6.8) that by their terms apply or are to be performed in whole or in part after the Effective Time and this Article IX.

Section 9.2 Notices. All notices and other communications hereunder shall be in writing and shall be deemed duly given (i) on the date of delivery if delivered personally, or by telecopy or telefacsimile, upon confirmation of receipt, (ii) on the first Business Day following the date of dispatch if delivered by a recognized next-day courier service, or (iii) on the third Business Day following the date of mailing if delivered by registered or certified mail, return receipt requested, postage prepaid. All notices hereunder shall be delivered as set forth below, or pursuant to such other instructions as may be designated in writing by the party to receive such notice:

If to Parent or Merger Sub, to:

Verizon Communications Inc.
1095 Avenue of the Americas
New York, New York 10036
Telecopier: (212) 597-2518
Attention: Corporate Secretary

with a copy (which shall not constitute notice) to:

Debevoise & Plimpton LLP
919 Third Avenue
New York, New York 10022
Telecopier: (212) 909-6836
Attention: Jeffrey J. Rosen, Esq.
William D. Regner, Esq.

If to the Company, to:

MCI, Inc.
22001 Loudoun County Parkway
Ashburn, Virginia 20147
Telecopier: (703) 886-0860
Attention: Anastasia D. Kelly, Esq.

with a copy (which shall not constitute notice) to:

Davis, Polk & Wardwell
450 Lexington Avenue
New York, New York 10017
Telecopier: (212) 450-3800
Attention: Phillip R. Mills, Esq.

Section 9.3 Interpretation.

(a) When a reference is made in this Agreement to Sections, Exhibits or Schedules, such reference shall be to a Section of or Exhibit or Schedule to this Agreement unless otherwise indicated. The table of contents and headings contained in this Agreement are for reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement. Whenever the words "include," "includes" or "including" are used in this Agreement, they shall be deemed to be followed by the words "without limitation."

(b) Items disclosed on one particular party's disclosure letter relating to one section of this Agreement shall be deemed to be constructively disclosed or listed on such party's disclosure letter relating to other sections of this Agreement only to the extent it is reasonably apparent on the face of such disclosure letter that such disclosure is applicable to such other sections.

Section 9.4 Counterparts; Effectiveness. This Agreement may be executed in two or more counterparts, each of which shall be deemed to be an original but all of which shall constitute one and the same instrument. This Agreement shall become effective when each party hereto shall have received counterparts thereof signed and delivered (by telecopy or otherwise) by all of the other parties hereto.

Section 9.5 Entire Agreement; Third Party Beneficiaries.

(a) This Agreement (including the Exhibits and the parties' disclosure letters hereto) and the Confidentiality Agreement constitute the entire agreement, and

supersede all prior agreements and understandings, both written and oral, among the parties with respect to the subject matter hereof and thereof.

(b) This Agreement shall be binding upon and inure solely to the benefit of each party hereto, and nothing in this Agreement, express or implied, is intended to or shall confer upon any Person not a party to this Agreement any rights, benefits or remedies of any nature whatsoever, other than Section 6.8 (which is intended to be for the benefit of the Persons covered thereby and may be enforced by such Persons).

Section 9.6 Severability. If any term or other provision of this Agreement is invalid, illegal or incapable of being enforced by any law or public policy, all other terms and provisions of this Agreement shall nevertheless remain in full force and effect so long as the economic or legal substance of the transactions contemplated hereby is not affected in any manner materially adverse to any party. Notwithstanding the foregoing, upon such determination that any term or other provision is invalid, illegal or incapable of being enforced, the parties shall negotiate in good faith to modify this Agreement so as to effect the original intent of the parties as closely as possible in an acceptable manner in order that the transactions contemplated hereby are consummated as originally contemplated to the greatest extent possible.

Section 9.7 Assignment. Neither this Agreement nor any of the rights, interests or obligations hereunder shall be assigned by any of the parties, in whole or in part (whether by operation of law or otherwise), without the prior written consent of the other party, and any attempt to make any such assignment without such consent shall be null and void, except that Merger Sub may assign, in its sole discretion, any or all of its rights, interests and obligations under this Agreement to any direct wholly owned Subsidiary of Parent without the consent of the Company, but no such assignment shall relieve Merger Sub of any of its obligations under this Agreement. Subject to the preceding sentence, this Agreement will be binding upon, inure to the benefit of and be enforceable by the parties and their respective successors and assigns. Parent agrees to cause Merger Sub to fulfill all of its obligations hereunder.

Section 9.8 Amendment. This Agreement may be amended by the parties, by action taken or authorized by their respective Boards of Directors, at any time before or after approval of the matters presented in connection with the Merger by the stockholders of the Company, but, after such approval, no amendment shall be made which by law or in accordance with the rules of any relevant stock exchange requires further approval by such stockholders without such further approval. This Agreement may not be amended except by an instrument in writing signed on behalf of each of the parties.

Section 9.9 Extension; Waiver. At any time prior to the Effective Time, the parties, by action taken or authorized by their respective Boards of Directors, may, to the

extent legally allowed, (a) extend the time for the performance of any of the obligations or other acts of the other parties, (b) waive any inaccuracies in the representations and warranties contained herein or in any document delivered pursuant hereto and (c) waive compliance with any of the agreements or conditions contained herein. Any agreement on the part of a party hereto to any such extension or waiver shall be valid only if set forth in a written instrument signed on behalf of such party. The failure of any party to this Agreement to assert any of its rights under this Agreement or otherwise shall not constitute a waiver of those rights.

Section 9.10 GOVERNING LAW AND VENUE; WAIVER OF JURY TRIAL.

(a) THIS AGREEMENT SHALL BE DEEMED TO BE MADE IN AND IN ALL RESPECTS SHALL BE INTERPRETED, CONSTRUED AND GOVERNED BY AND IN ACCORDANCE WITH THE LAW OF THE STATE OF NEW YORK WITHOUT REGARD TO ITS RULES OF CONFLICTS OF LAW EXCEPT TO THE EXTENT THAT THE LAW OF THE STATE OF DELAWARE IS MANDATORILY APPLICABLE TO THE MERGER. The parties hereby irrevocably submit to the jurisdiction of the courts of the County and State of New York and the State of Delaware and the Federal courts of the United States of America located in the County and State of New York or the State of Delaware solely in respect of the interpretation and enforcement of the provisions of this Agreement and of the documents referred to in this Agreement, and in respect of the transactions contemplated hereby, and hereby waive, and agree not to assert, as a defense in any action, suit or proceeding for the interpretation or enforcement hereof or of any such document, that it is not subject thereto or that such action, suit or proceeding may not be brought or is not maintainable in said courts or that the venue thereof may not be appropriate or that this Agreement or any such document may not be enforced in or by such courts, and the parties hereto irrevocably agree that all claims with respect to such action or proceeding shall be heard and determined in such a New York State, Delaware State or Federal court. The parties hereby consent to and grant any such court jurisdiction over the person of such parties solely for such purpose and over the subject matter of such dispute and agree that mailing of process or other papers in connection with any such action or proceeding in the manner provided in Section 9.2 or in such other manner as may be permitted by law shall be valid and sufficient service thereof.

(b) EACH PARTY ACKNOWLEDGES AND AGREES THAT ANY CONTROVERSY WHICH MAY ARISE UNDER THIS AGREEMENT IS LIKELY TO INVOLVE COMPLICATED AND DIFFICULT ISSUES, AND THEREFORE EACH SUCH PARTY HEREBY IRREVOCABLY AND UNCONDITIONALLY WAIVES ANY RIGHT SUCH PARTY MAY HAVE TO A TRIAL BY JURY IN RESPECT OF ANY LITIGATION DIRECTLY OR INDIRECTLY ARISING OUT OF OR RELATING TO THIS AGREEMENT, OR THE TRANSACTIONS CONTEMPLATED BY THIS AGREEMENT. EACH PARTY CERTIFIES AND ACKNOWLEDGES

THAT (i) NO REPRESENTATIVE, AGENT OR ATTORNEY OF ANY OTHER PARTY HAS REPRESENTED, EXPRESSLY OR OTHERWISE, THAT SUCH OTHER PARTY WOULD NOT, IN THE EVENT OF LITIGATION, SEEK TO ENFORCE THE FOREGOING WAIVER, (ii) EACH PARTY UNDERSTANDS AND HAS CONSIDERED THE IMPLICATIONS OF THIS WAIVER, (iii) EACH PARTY MAKES THIS WAIVER VOLUNTARILY, AND (iv) EACH PARTY HAS BEEN INDUCED TO ENTER INTO THIS AGREEMENT BY, AMONG OTHER THINGS, THE MUTUAL WAIVERS AND CERTIFICATIONS IN THIS SECTION 9.10(b).

Section 9.11 Enforcement. The parties hereto agree that irreparable damage would occur in the event that any provision of this Agreement was not performed in accordance with its specific terms or was otherwise breached. It is accordingly agreed that the parties shall be entitled to an injunction or injunctions to prevent breaches of this Agreement and to enforce specifically the terms and provisions hereof in any court of competent jurisdiction, this being in addition to any other remedy to which they are entitled at law or in equity.

Section 9.12 Definitions. As used in this agreement:

An "Affiliate" of any Person means another Person that directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with, such first Person, where "control" means the possession, directly or indirectly, of the power to direct or cause the direction of the management policies of a Person, whether through the ownership of voting securities, by contract, as trustee or executor or otherwise.

"Aggregate Incremental Amount" equals the product of (i) the Incremental Amount multiplied by (ii) the sum of (x) the number of shares of Company Common Stock issued and outstanding immediately prior to the Effective Time (excluding any Excluded Shares) and (y) the number of shares of shares reserved for issuance pursuant to the Chapter 11 Plan that are unissued immediately prior to the Effective Time (which number shall not exceed 5,375,000 *minus* the number of shares so issued after the date here).

"Bankruptcy Cases" means the Debtors' cases under chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York, jointly administered under Chapter 11 Case No. 02-13533 (AJG).

"Bankruptcy Claims" means (i) all pre-petition claims filed in the Bankruptcy Cases as of the Closing Date, (ii) all administrative expense claims filed in the Bankruptcy Cases as of the Closing Date and (iii) all Tax claims filed, asserted in writing or of which Debtors have actual knowledge as of the Closing Date that constitute or would constitute administrative expense claims in the Bankruptcy Cases.

"Bankruptcy Code" means title 11 of the United States Code.

"beneficial ownership" or "beneficially own" has the meaning under Section 13(d) of the Exchange Act and the rules and regulations thereunder.

"Board of Directors" means the Board of Directors of any specified Person and any committees thereof.

"Business" means the business and operations of the Company and the Company Subsidiaries as currently conducted.

"Business Day" means any day on which banks are not required or authorized to close in the City of New York.

"Chapter 11 Plan" means the Debtors' Modified Second Amended Joint Plan of Reorganization Under Chapter 11 of the Bankruptcy Code, dated October 21, 2003 (as thereafter modified through October 31, 2003) filed in the Bankruptcy Cases by WorldCom, Inc. and certain of its direct and indirect Subsidiaries, as debtors and debtors in possession.

"Code" means the Internal Revenue Code of 1986, as amended from time to time.

"Company Benefit Plans" means each written or oral employee benefit plan, scheme, program, policy, arrangement and contract (including, but not limited to, any "employee benefit plan," as defined in Section 3(3) of ERISA, whether or not subject to ERISA, and any bonus, deferred compensation, stock bonus, stock purchase, restricted stock, stock option or other equity-based arrangement, and any employment, termination, retention, bonus, change in control or severance plan, program, policy, arrangement or contract) for the benefit of any current or former officer, employee or director of the Company or any Company Subsidiary that is maintained or contributed to by the Company or any Company Subsidiary, or with respect to which any of them could incur material liability under the Code or ERISA or any similar non-U.S. law.

"Company Common Stock" means the common stock, $.01 par value, of the Company.

"Company Financial Statements" means the consolidated financial statements of the Company and the Company Subsidiaries included in the Company SEC Documents together, in the case of year-end statements, with reports thereon by KPMG LLP, the independent auditors of the Company, including in each case a consolidated balance sheet, a consolidated statement of income, a consolidated statement of shareholders' equity and a consolidated statement of cash flows, and accompanying notes.

"Company Intellectual Property" means all Intellectual Property owned by or used by the Company or any of the Company Subsidiaries in the Business.

"Company Material Adverse Effect" means a material adverse effect on (i) the business, financial condition or results of operations of the Company and its Subsidiaries, taken as a whole, other than any such effect relating to or resulting from (x) changes or conditions affecting the economy or financial markets in general or changes in political or regulatory conditions generally, (y) general changes in the segments of the telecommunications industry in which the Company or any of its Subsidiaries operates or (z) the announcement or consummation of this Agreement or (ii) the ability of the Company to perform its obligations under this Agreement or to consummate the transactions contemplated by this Agreement.

"Company Restricted Share" shall mean each share of restricted Company Common Stock granted and awarded pursuant to a Company Benefit Plan.

"Company Rights" means the rights distributed to the holders of Company Common Stock pursuant to the Rights Agreement.

"Constituent Documents" means with respect to any entity, the Certificate or Articles of Incorporation, the Bylaws of such entity, the minute books, or any similar charter or other organizational documents of such entity.

"Debtors" has the meaning given in the Chapter 11 Plan.

"Dissenting Shares" means shares of Company Common Stock as to which the holder thereof has exercised appraisal rights pursuant to Section 262 of the DGCL.

"Environmental Law" means any foreign, federal, state or local law, treaty, statute, rule, regulation, order, ordinance, decree, injunction, judgment, governmental restriction or any other requirement of law (including common law) regulating or relating to the protection of human health, safety (as it relates to Releases to Hazardous Substances), natural resources or the environment, including, without limitation, laws relating to wetlands, pollution, contamination or the use, generation, management, handling, transport, treatment, disposal, storage, Release or threatened Release of Hazardous Substances.

"Environmental Permit" means any permit, license, authorization or consent required pursuant to applicable Environmental Laws.

"ERISA" means the Employee Retirement Income Security Act of 1974, as amended.

"Exchange Act" means the Securities and Exchange Act of 1934, as amended, and the rules and regulations promulgated thereunder.

"Excluded Shares" means any shares of Company Common Stock (a) held by the Company, Parent, Merger Sub, any other wholly owned Subsidiary of Parent or any wholly owned Subsidiary of the Company, in each case except for any such shares held on behalf of third parties, or (b) as to which the holder thereof has exercised appraisal rights pursuant to Section 262 of the DGCL.

"Final Remaining Specified Included Liabilities Amount" means the amount determined pursuant to Section 1.10(b) or Section 1.10(d), as the case may be, to be the final Remaining Specified Included Liabilities Amount, with Specified International Tax Liabilities translated into U.S. dollars using the most recent closing spot exchange rate as of the date of determination.

"Governmental Entity" means any nation or government or multinational body, any state, agency, commission (including, without limitation, the FCC), or other political subdivision thereof or any entity (including a court) exercising executive, legislative, judicial or administration functions of or pertaining to government, any stock exchange or self regulatory entity supervising, organizing and supporting any stock exchange.

"Hazardous Substances" means any substance that: (i) is or contains asbestos, urea formaldehyde insulation, polychlorinated biphenyls, petroleum, petroleum products or petroleum-derived substances or wastes, radon gas, microbial or microbiological contamination or related materials, (ii) requires investigation or remedial action pursuant to any Environmental Law or (iii) is defined, listed or identified as a "hazardous waste," "hazardous substance," "toxic substance" or words of similar import thereunder, or (iv) is regulated under any Environmental Law.

"Indebtedness" means, with respect to any Person, without duplication, (i) all obligations of such Person for borrowed money, or with respect to deposits or advances of any kind, (ii) all obligations of such Person evidenced by bonds, debentures, notes or similar instruments, (iii) all obligations of such Person upon which interest charges are customarily paid (other than trade payables incurred in the ordinary course of business consistent with past practices or, in the case of the Company or any Company Subsidiary, incurred in a commercially reasonable manner consistent with industry practice), (iv) all obligations of such Person under conditional sale or other title retention agreements relating to any property purchased by such Person, (v) all obligations of such Person issued or assumed as the deferred purchase price of property or services (excluding obligations of such Person to creditors for raw materials, inventory, services and supplies incurred in the ordinary course of business consistent with past practices, or, in the case of the Company or any Company Subsidiary, incurred in a commercially reasonable manner consistent with industry practice), (vi) all lease obligations of such Person

capitalized on the books and records of such Person, (vii) all obligations of others secured by a Lien on property or assets owned or acquired by such Person, whether or not the obligations secured thereby have been assumed, (viii) all obligations of such Person under interest rate, currency or commodity derivatives or hedging transactions, (ix) all letters of credit or performance bonds issued for the account of such Person (excluding (a) letters of credit issued for the benefit of suppliers to support accounts payable to suppliers incurred in the ordinary course of business consistent with past practices, or, in the case of the Company or any Company Subsidiary, incurred in a commercially reasonable manner consistent with industry practice, (b) standby letters of credit relating to workers' compensation insurance and surety bonds and (c) surety bonds and customs bonds) and (x) all guarantees and arrangements having the economic effect of a guarantee of such Person of any Indebtedness of any other Person.

"Intellectual Property" means all trademarks, service marks, trade names, trade dress, including all goodwill associated with the foregoing, domain names, copyrights, Software, Internet Web sites, mask works and other semiconductor chip rights, moral rights, and similar rights, and registrations and applications to register or renew the registration of any of the foregoing, patents and patent applications, Trade Secrets, and all other intellectual property rights.

"Intellectual Property Licenses" means all agreements to which the Company or any of the Company Subsidiaries is a party or by which any of them is otherwise bound that relate to Intellectual Property, including: (i) licenses of Intellectual Property to the Company or any of the Company Subsidiaries by any other Person; (ii) licenses of Intellectual Property to any other Person by the Company or any of the Company Subsidiaries; (iii) agreements otherwise granting or restricting the right to use any Intellectual Property; and (iv) agreements transferring, assigning, indemnifying with respect to or otherwise relating to Intellectual Property used or held for use in the Business.

"IRS" means the Internal Revenue Service.

"IRUs" means Indefeasible Rights to Use.

"known" or "knowledge" means, with respect to any party, the knowledge of such party's executive officers and senior management.

"Law" (and with the correlative meaning "Laws") means rule, regulation, statute, order, ordinance, guideline, code or other legally enforceable requirement, including, but not limited to common law, state and federal laws or securities laws and laws of foreign jurisdictions.

"Leased Network Facilities" means all of the Company's and the Company Subsidiaries' Network Facilities that are not owned by the Company or the Company Subsidiaries but are provided under lease, license, IRUs or other agreements, including Right-of-Way Agreements between the Company or the Company Subsidiaries and third persons or entities.

"Leased Real Property" means all interests leased pursuant to the Leases.

"Leases" means leases, subleases, licenses and occupancy agreements.

"Liens" means any mortgage, pledge, hypothecation, assignment, deposit arrangement, encumbrance, lien (statutory or other), other charge or security interest; or any preference, priority or other agreement or preferential arrangement of any kind or nature whatsoever (including, without limitation, any conditional sale or other title retention agreement, or any capital lease having substantially the same economic effect as any of the foregoing).

"Nasdaq" means The NASDAQ National Market.

"Network Facilities" means all of the Company's and the Company Subsidiaries' material network facilities (including, cable, wires, conduits, switches, and other equipment and facilities) and related material operating support systems, network operations centers, and land and buildings. For purposes of this definition "material" shall mean any network facility the absence of which would materially and adversely affect the ability of the Company or any of its Subsidiaries to use the Company's domestic or international networks, respectively, taken as a whole, in the manner and scope in which such respective network is currently being used.

"Network Facility Agreement" means agreements under which third Persons provide Network Facilities to the Company and the Company Subsidiaries, including leases, licenses, IRUs and Right-of-Way-Agreements.

"Order" means any charge, order, writ, injunction, judgment, decree, ruling, determination, directive, award or settlement, whether civil, criminal or administrative and whether formal or informal, applicable to the Company or any Company Subsidiary.

"other party" means, with respect to the Company, Parent and means, with respect to Parent, the Company, unless the context otherwise requires.

"Owned Network Facilities" means Network Facilities that are owned by the Company or the Company Subsidiaries.

"Owned Real Property" means real property, together with all improvements and fixtures presently or hereafter located thereon or attached or appurtenant thereto or owned

by the Company or any of the Company Subsidiaries, and all easements, licenses, rights and appurtenances relating to the foregoing.

"Paid Specified Included Liabilities Amount" means the amount of cash in U.S. dollars that has actually been spent from and after January 1, 2005 through the Closing Date to satisfy Specified Included Liabilities. If any such cash has been spent in a currency other than the U.S. dollar, such amount shall be translated into U.S. dollars using the closing spot exchange rate on the date of payment.

"Parent Common Stock" means the common stock, par value $0.10 per share, of Parent.

"Parent Material Adverse Effect" means a material adverse effect on (i) the business, financial condition or results of operations of the Parent and its Subsidiaries, taken as a whole, other than any such effect relating to or resulting from (x) changes or conditions affecting the economy or financial markets in general or changes in political or regulatory conditions generally, (y) changes in the segments of the telecommunications industry in which the Parent or any of its Subsidiaries operates or (z) the announcement or consummation of this Agreement or (ii) the ability of the Parent or Merger Sub to perform its obligations under this Agreement or to consummate the transactions contemplated by this Agreement.

"Permitted Liens" means (i) any liens for taxes not yet due or which are being contested in good faith by appropriate proceedings, (ii) carriers', warehousemen's, mechanics', materialmen's, repairmen's or other similar liens, (iii) pledges or deposits in connection with workers' compensation, unemployment insurance, and other social security legislation and (iv) easements, rights-of-way, restrictions and other similar encumbrances incurred in the ordinary course of business or, in the case of the Company or any Company Subsidiary, incurred in a commercially reasonable manner consistent with industry practice, which, in the aggregate, are not substantial in amount and which do not in any case materially detract from the value of the property subject thereto.

"Person" means an individual, corporation, limited liability company, partnership, association, trust, unincorporated organization, other entity or group (as defined in the Exchange Act).

"Release" means any releasing, disposing, discharging, injecting, spilling, leaking, leaching, pumping, dumping, emitting, escaping, emptying, seeping, dispersal, migration, transporting, placing and the like, including without limitation, the moving of any materials through, into or upon, any land, soil, surface water, groundwater or air, or otherwise entering into the indoor or outdoor environment.

"Restoring Trust" means the August 26, 2003 report entitled "Restoring Trust" issued by the Corporate Monitor of the Company appointed by the U.S. District Court for the Southern District of New York.

"Rights Agreement" means the rights agreement, dated as of April 20, 2004 between the Company and The Bank of New York, as rights agent.

"Securities Act" means the Securities Act of 1933, as amended, and the rules and regulations promulgated thereunder.

"Software" means any and all computer software, including application software, system software and firmware, including all source code and object code versions thereof, in any and all forms and media, and all related documentation.

"Specified Included Liabilities" means, without duplication, all Bankruptcy Claims and Specified International Tax Liabilities.

"Specified Included Liabilities Amount" means, without duplication, the sum of (x) the Paid Specified Included Liabilities Amount and (y) the Final Remaining Specified Included Liabilities Amount.

"Specified International Tax Liabilities" means all liabilities (whether accrued, contingent, asserted or unasserted) in respect of any Tax imposed on or measured by income (including interest and penalties thereon) imposed by any Taxing Authority of any jurisdiction other than the United States or any political subdivision thereof with respect to any period or portion thereof ending on or prior to April 20, 2004.

"Subsidiary" when used with respect to any party means any corporation or other organization, whether incorporated or unincorporated, (i) of which such party or any other Subsidiary of such party is a general partner (excluding partnerships, the general partnership interests of which held by such party or any Subsidiary of such party do not have a majority of the voting interests in such partnership) or (ii) at least a majority of the securities or other interests of which having by their terms ordinary voting power to elect a majority of the Board of Directors or others performing similar functions with respect to such corporation or other organization is directly or indirectly owned or controlled by such party or by any one or more of its Subsidiaries, or by such party and one or more of its Subsidiaries.

"Tax" (and with the correlative meaning "Taxes") shall mean (A) all federal, state, local or foreign net income, franchise, gross income, sales, use, ad valorem, property, gross receipts, license, capital stock, payroll, withholding, excise, severance, transfer, employment, alternative or add-on minimum, stamp, occupation, premium, environmental or windfall profits taxes, and other taxes or similar charges, fees, levies, imposts, customs, duties, licenses and other assessments, together with any interest and

any penalties, additions to tax or additional amounts imposed by any taxing authority, (B) any liability for payment of amounts described in clause (A) whether as a result of transferee liability, of being a member of an affiliated, consolidated, combined or unitary group for any period, transferor liability, successor liability or otherwise through operation of law, and (C) any liability for the payment of amounts described in clauses (A) or (B) as a result of any tax sharing, tax indemnity or tax allocation agreement or any other express or implied agreement to indemnify any other person.

"Taxing Authority" means, with respect to any Tax, the Governmental Entity that imposes such Tax, and the agency (if any) charged with the collection of such Tax for such Governmental Entity.

"Tax Return" means all federal, state, local and foreign tax returns, estimates, information statements and reports relating to Taxes.

"Trade Secrets" means all inventions (whether or not patentable), discoveries, processes, procedures, designs, formulae, trade secrets, know-how, Software, ideas, methods, research and development, data, databases, confidential information and other proprietary or non-public information and data.

IN WITNESS WHEREOF, Parent, Merger Sub and the Company have caused this Agreement to be signed by their respective officers thereunto duly authorized, all as of the date first written above.

VERIZON COMMUNICATIONS INC.

By: _____
Name:
Title:

ELI ACQUISITION, LLC

By: _____
Name:
Title:

MCI, INC.

By: _____
Name:

Index

	Page
Affiliate	70
Affiliate Agreement	56
Aggregate Base Merger Consideration	7
Aggregate Incremental Amount	70
Agreement	1
Alternative Merger	4
Bankruptcy Cases	70
Bankruptcy Claims	70
Bankruptcy Claims Proposals	5
Bankruptcy Claims Valuation Firm	4
Bankruptcy Code	70
Bankruptcy Court Order	57
Base Merger Consideration	3
beneficial ownership	70
beneficially own	70
Benefits Continuation Period	51
Board of Directors	70
Business	70
Business Combination Transaction	50
Business Day	71
By-Laws	2
Certificate of Formation	2
Certificate of Merger	2
Certificates	3
Change	44
Change in the Company Recommendation	44
Chapter 11 Plan	71
Closing	2
Closing Date	2
Code	71
Company	1
Company Benefit Plans	71
Company Common Stock	71
Company Contracts	29
Company Disclosure Letter	13
Company Financial Advisors	25
Company Financial Statements	71
Company Intellectual Property	71
Company Material Adverse Effect	71

Index
(cont.)

Page

Company Recommendation 44
Company Restricted Share 72
Company Rights 72
Company SEC Documents 18
Company Stock Plans 15
Company Stockholder Approval 16
Company Stockholders Meeting 44
Company Subsidiaries 14
Company Subsidiary 14
Confidentiality Agreement 45
Constituent Documents 72
Continuing Employees 51
Corporate Monitor Order 57
Customer Requirements 24
D & O Insurance 53
Debtors 72
DGCL 1
Dissenting Shares 72
Dissenting Stockholder 8
DOJ 45
Effective Time 2
Environmental Law 72
Environmental Permit 72
ERISA 72
ESPP 8
Exchange Act 72
Exchange Agent 9
Exchange Fund 9
Exchange Ratio 3
Excluded Shares 72
Expenses 53
FCC 17
Final Remaining Specified Included Liabilities Amount 73
Form S-4 19
FTC 45
GAAP 18
Good Condition 24
Governmental Entity 73
Greenhill 25
Hazardous Substances 73
HSR Act 17
Improvements 23
Incremental Amount 6

Index
(cont.)

Page

Indebtedness 73
Industry Standards 24
Intellectual Property 74
Intellectual Property Licenses 74
Intervening Event 50
IRS 74
IRUs 74
JPMorgan 25
knowledge 74
known 74
Law 74
Lazard 25
Leased Network Facilities 74
Leased Real Property 75
Leases 75
Liens 75
LLC Act 1
material weakness 21
Maximum Annual Premium 54
Merger 1
Merger Consideration 3
Merger Sub 1
Nasdaq 75
Network Facilities 75
Network Facility Agreement 75
Neutral Valuation Firms 4
NYSE 11
Order 75
Other Company Equity-Based Award 7
other party 75
Outside Date 63
Owned Intellectual Property 27
Owned Network Facilities 24, 75
Owned Real Property 75
Paid Specified Included Liabilities Amount 76
Parent 1
Parent Common Stock 76
Parent Disclosure Letter 32
Parent Financial Advisor 37
Parent Material Adverse Effect 76
Parent Preferred Stock 32
Parent Restricted Shares 7
Parent SEC Documents 35

Index
(cont.)

Page

parties 1
Per Share Cash Amount 3
Permitted Liens 76
Person 76
Proceeding 39
Proxy Statement/Prospectus 42
Real Property 23
Regulatory Law 46
Release 76
Remaining Specified Included Liabilities Amount 4
Representatives 44
Restoring Trust 77
Right-of-Way Agreement 23
Rights Agreement 77
Sarbanes-Oxley Act 20
SEC 17
Securities Act 77
significant deficiency 21
Software 77
Special Cash Dividend 56
Specified Efforts 47
Specified Included Liabilities 77
Specified International Tax Liabilities 77
Specified Material Adverse Effect 47
Specified Tax Liabilities Proposals 5
Specified Tax Liabilities Valuation Firm 4
State Commissions 18
Stock Consideration 3
Subsidiary 77
Superior Proposal 50
Surviving Entity 1
Takeover Proposal 50
Tax 77
Tax Return 78
Taxes 77
Taxing Authority 78
Termination Fee 64
Third Party 50
Trade Secrets 78
Trigger Notice 4

Table of Contents

Page

ARTICLE I

THE MERGER; CERTAIN RELATED MATTERS

Section 1.1 The Merger....1
Section 1.2 Closing....2
Section 1.3 Effective Time....2
Section 1.4 Certificate of Formation....2
Section 1.5 By-Laws....2
Section 1.6 Directors....2
Section 1.7 Officers....3
Section 1.8 Effect on Capital Stock....3
Section 1.9 Alternative Merger Structure....3
Section 1.10 Adjustment for Specified Included Liabilities at Closing....4
Section 1.11 Treatment of Company Restricted Shares and Other Equity-Based Awards....7
Section 1.12 Certain Adjustments....8
Section 1.13 Appraisal Rights....8
Section 1.14 Associated Rights....8

ARTICLE II

EXCHANGE OF CERTIFICATES

Section 2.1 Exchange Fund....9
Section 2.2 Exchange Procedures....9
Section 2.3 Distributions with Respect to Unexchanged Shares....10
Section 2.4 No Further Ownership Rights in Company Common Stock....10
Section 2.5 No Fractional Shares of Parent Common Stock....10
Section 2.6 Termination of Exchange Fund....11
Section 2.7 No Liability....11
Section 2.8 Investment of the Exchange Fund....11
Section 2.9 Lost Certificates....12
Section 2.10 Withholding Rights....12
Section 2.11 Further Assurances....12
Section 2.12 Stock Transfer Books....12
Section 2.13 Affiliates....13

ARTICLE III

REPRESENTATIONS AND WARRANTIES OF THE COMPANY

Section 3.1	Organization	13
Section 3.2	Subsidiaries.	13
Section 3.3	Capitalization.	14
Section 3.4	Authorization.	15
Section 3.5	Takeover Statute, No Restrictions on the Merger.	16
Section 3.6	Rights Agreement	16
Section 3.7	Consents and Approvals; No Violations.	16
Section 3.8	SEC Reports; Company Financial Statements.	18
Section 3.9	Absence of Undisclosed Liabilities	18
Section 3.10	Form S-4; Proxy Statement/Prospectus	19
Section 3.11	Absence of Certain Changes	19
Section 3.12	Litigation	19
Section 3.13	Compliance with Laws.	20
Section 3.14	Taxes.	21
Section 3.15	ESPP	22
Section 3.16	Sufficiency of Real Property, etc	23
Section 3.17	Right-of-Way Agreements and Network Facilities.	23
Section 3.18	Brokers	24
Section 3.19	Employee Benefit Plans and Related Matters; ERISA.	24
Section 3.20	Employees, Labor Matters	26
Section 3.21	Intellectual Property Rights	27
Section 3.22	Contracts.	27
Section 3.23	Environmental Laws and Regulations	29
Section 3.24	Insurance Coverage	30
Section 3.25	Consent Decrees	31
Section 3.26	Foreign Corrupt Practices and International Trade Sanctions	31
Section 3.27	Compliance with Governance Requirements	31
Section 3.28	Opinions of Financial Advisors	31

ARTICLE IV

REPRESENTATIONS AND WARRANTIES OF PARENT AND MERGER SUB

Section 4.1	Organization	32
Section 4.2	Capitalization.	32
Section 4.3	Authorization	33
Section 4.4	Consents and Approvals; No Violations.	33
Section 4.5	SEC Reports; Financial Statements.	34
Section 4.6	Absence of Undisclosed Liabilities	35

Section 4.7 Form S-4; Proxy Statement/Prospectus 35
Section 4.8 Absence of Certain Changes 36
Section 4.9 Litigation 36
Section 4.10 Compliance with Laws 36
Section 4.11 Brokers 36

ARTICLE V

COVENANTS RELATING TO CONDUCT OF BUSINESS

Section 5.1 Covenants of the Company 37
Section 5.2 Covenants of Parent 41
Section 5.3 Certain Actions 41

ARTICLE VI

ADDITIONAL AGREEMENTS

Section 6.1 Preparation of Proxy Statement. 42
Section 6.2 Stockholders Meeting; Company Recommendation 43
Section 6.3 Access to Information; Confidentiality 43
Section 6.4 Commercially Reasonable Efforts. 44
Section 6.5 No Solicitation. 46
Section 6.6 Employee Matters. 50
Section 6.7 Fees and Expenses 52
Section 6.8 Directors' and Officers' Indemnification and Insurance. 52
Section 6.9 Public Announcements 53
Section 6.10 Notification of Certain Matters 54
Section 6.11 Accountant's Letters. 54
Section 6.12 Listing of Shares of Parent Common Stock 55
Section 6.13 Affiliates 55
Section 6.14 State Takeover Laws 55
Section 6.15 Stockholder Litigation 55
Section 6.16 Special Cash Dividend 56
Section 6.17 Bankruptcy Court Order 56
Section 6.18 Settlement of Bankruptcy Claims 56
Section 6.19 No Amendment of Plan of Reorganization 56
Section 6.20 Restoring Trust 56
Section 6.21 Network Facility Maintenance and Compliance 57
Section 6.22 Section 16 of the Exchange Act 57
Section 6.23 Tax Treatment 57

ARTICLE VII

CONDITIONS PRECEDENT

Section 7.1	Conditions to Each Party's Obligation to Effect the Merger	58
Section 7.2	Conditions to Obligations of Parent and Merger Sub	59
Section 7.3	Conditions to Obligations of the Company	60
Section 7.4	Additional Conditions	61

ARTICLE VIII

TERMINATION AND AMENDMENT

Section 8.1	Termination	62
Section 8.2	Effect of Termination	63
Section 8.3	Termination Fee.	64

ARTICLE IX

GENERAL PROVISIONS

Section 9.1	Non-Survival of Representations, Warranties and Agreements	65
Section 9.2	Notices	65
Section 9.3	Interpretation.	66
Section 9.4	Counterparts; Effectiveness	66
Section 9.5	Entire Agreement; Third Party Beneficiaries.	66
Section 9.6	Severability	67
Section 9.7	Assignment	67
Section 9.8	Amendment	67
Section 9.9	Extension; Waiver	67
Section 9.10	GOVERNING LAW AND VENUE; WAIVER OF JURY TRIAL.	68
Section 9.11	Enforcement	69
Section 9.12	Definitions	69

EXHIBIT 2

AMENDMENT TO
AGREEMENT AND PLAN OF MERGER

This Amendment, dated as of March 29, 2005 (this "Amendment") to the Agreement and Plan of Merger, dated as of February 14, 2005, among Verizon Communications Inc., a Delaware corporation, Eli Acquisition, LLC, a Delaware limited liability company and a direct, wholly owned subsidiary of Verizon Communications Inc., and MCI, Inc., a Delaware corporation, as previously amended by letter agreement dated as of March 4, 2005, among the parties to the Merger Agreement (as so amended, the "Merger Agreement"), is entered into by the parties to the Merger Agreement. Capitalized terms used but not defined herein shall have the respective meanings specified in the Merger Agreement.

WHEREAS, Parent, Merger Sub and the Company have entered into the Merger Agreement;

WHEREAS, Parent, Merger Sub and the Company desire to amend the Merger Agreement as provided in this Amendment; and

WHEREAS, the respective Boards of Directors of Parent, Merger Sub and the Company have deemed this Amendment advisable and in the best interests of their respective companies;

NOW, THEREFORE, in consideration of the foregoing and the mutual agreements herein made and for other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties agree as follows:

1. Merger Consideration and Related Provisions.

(a) Section 1.8(a) of the Merger Agreement shall be amended and restated to read in its entirety as follows:

"At the Effective Time, by virtue of the Merger and without any action on the part of the holder thereof, each share of Company Common Stock issued and outstanding immediately prior to the Effective Time (excluding any Company Restricted Shares and Excluded Shares) shall be converted into the right to receive (i) a number (the "Exchange Ratio") of validly issued, fully paid and non-assessable shares of Parent Common Stock equal to the greater of (A) 0.4062 and (B) the quotient obtained by dividing $14.75 by the Average Parent Stock Price (the "Stock Consideration"), and (ii) an amount in cash equal to $8.35 *minus* the amount of the Special Cash Dividend declared pursuant to Section 6.16 (the "Per Share Cash Amount"), without interest, together with any cash in lieu of fractional shares of Parent Common Stock to be paid pursuant to Section 2.5 (such shares and cash, the "Base Merger Consideration"). Notwithstanding the foregoing, if the

Exchange Ratio is greater than 0.4062, then Parent shall have the right, in its absolute discretion, to reduce the Exchange Ratio to an amount no less than 0.4062 and, in such case, the Per Share Cash Amount shall be increased by an amount (rounded to the nearest hundredth of a cent) equal to the product of (x) the amount by which Parent has reduced the Exchange Ratio and (y) the Average Parent Stock Price. The Exchange Ratio and the Per Share Cash Amount determined above shall be subject to adjustment pursuant to Section 1.10 (as so adjusted, the "Merger Consideration"). For purposes of this Agreement, "Average Parent Stock Price" shall mean the volume weighted average of the closing prices of Parent Common Stock, as such prices are reported on the NYSE Composite Transactions Tape, for each of the 20 trading days ending on the third trading day immediately preceding the Effective Time."

(b) Section 1.10(g) of the Merger Agreement shall be amended by (i) deleting the words "shall be equal to the product of (x) 0.4062" and replacing them with the words "following such adjustment shall be equal to the product of (x) the Exchange Ratio prior to such adjustment", and (ii) deleting each reference to the number "$1,725,000,000" and replacing it with the number "$1,775,000,000".

(c) Section 3.28 of the Merger Agreement shall be amended by (i) deleting the words "February 13, 2005" and replacing them with the words "March 29, 2005", and (ii) deleting the words ", the Special Cash Dividend and the $0.40 per share cash dividend declared by the Board of Directors of the Company on February 11, 2005" and replacing them with the words "and the Special Cash Dividend".

(d) Section 6.16 of the Merger Agreement shall be amended by (i) deleting the words "unless prohibited by applicable law or covenants in instruments of Indebtedness existing as of the date hereof" and replacing them with the words "to the extent not prohibited by applicable law or covenants in instruments of Indebtedness existing as of the date hereof", and (ii) deleting the reference to the number "$4.10" and replacing it with the number "$5.60".

2. Representations and Warranties.

(a) The first paragraph of Article III of the Merger Agreement shall be amended by (i) adding, immediately after the words "prior to the date hereof", the words "or in the Company's Form 10-K for the year ended December 31, 2004", and (ii) adding, immediately after the words "any such Company SEC Document", the words "or such Form 10-K".

(b) The first paragraph of Article IV of the Merger Agreement shall be amended by (i) adding, immediately after the words "prior to the date hereof", the words "or in Parent's Form 10-K for the year ended December 31, 2004", and (ii) adding,

immediately after the words "any such Parent SEC Document", the words "or such Form 10-K".

3. Non-Solicitation. Section 6.5(c) of the Merger Agreement shall be amended by (a) deleting the words "two Business Days" in the parenthetical to clause (ii) in the second proviso of its second sentence and replacing them with the words "three Business Days", and (b) deleting the words "as a result of an Intervening Event" in its fourth sentence.

4. Termination and Termination Fee.

(a) Section 8.1(d)(ii) of the Merger Agreement shall be amended and restated to read in its entirety as follows:

"(ii) pursuant to the last sentence of Section 6.5(c), if the Company, prior to the termination of this Agreement, pays the Termination Fee (as defined in Section 8.3(a)) to Parent."

(b) Sections 8.3(a) and 8.3(b) of the Merger Agreement shall be amended and restated to read in their entirety as follows:

"(a) If this Agreement is terminated pursuant to any of the following provisions, the Company shall pay to Parent a fee equal to $240,000,000 (the "Termination Fee"), which Termination Fee, together with the reimbursement of Expenses pursuant to Section 8.3(b), shall be Parent's sole remedy in respect of termination of this Agreement except in the case of any willful breach of this Agreement by the Company:

(i) Sections 8.1(c)(ii) or (iii);

(ii) Section 8.1(d)(ii);

(iii) Section 8.1(b)(iii), provided that within twelve months after the date of such termination, the Company enters into a definitive agreement to consummate, or consummates, the transactions contemplated by any Takeover Proposal; and provided, further, that, solely for purposes of this Section 8.3(a)(iii), the term "Takeover Proposal" shall have the meaning ascribed thereto in Section 6.5(e), except that all references to 15% shall be changed to 40%; or

(iv) Section 8.1(c)(i), provided, that such termination is based on a material breach of Section 6.2.

(b) If the Company is required to pay Parent a Termination Fee, such Termination Fee shall be payable immediately prior to termination of this Agreement in

the event of termination by the Company, and not later than one Business Day after the receipt by the Company of a notice of termination from Parent in the event of termination by Parent, in each case by wire transfer of immediately available funds to an account designated by Parent (except that, in the case of termination pursuant to Section 8.1(b)(iii), such payment shall be made on the date of the first to occur of either of the events referred to in the first proviso to Section 8.3(a)(iii)). If the Company is required to pay Parent a Termination Fee, or this Agreement is terminated pursuant to Section 8.1(b)(iii), the Company shall, in addition to any Termination Fee that may be payable, reimburse Parent and Merger Sub for all of their Expenses, up to a maximum amount of $10,000,000, within one Business Day of receipt of written notice from Parent requesting payment thereof."

5. Ratification. Except as otherwise provided herein, all of the terms, covenants and other provisions of the Merger Agreement are hereby ratified and confirmed and shall continue to be in full force and effect in accordance with their respective terms. After the date hereof, all references to the Merger Agreement shall refer to the Merger Agreement as amended by this Amendment.

6. Miscellaneous. Section 9.10 of the Merger Agreement shall apply to this Amendment *mutatis mutandi*. This Amendment may be executed in one or more counterparts, each of which shall be deemed an original and all of which shall together constitute one and the same instrument and shall bind and inure to the benefit of the parties and their respective successors and assigns.

IN WITNESS WHEREOF, Parent, Merger Sub and the Company have caused this Amendment to be signed by their respective officers thereunto duly authorized, all as of the date first written above.

VERIZON COMMUNICATIONS INC.

By: /s/ Ivan Seidenberg
Name: Ivan Seidenberg
Title: Chairman and CEO

ELI ACQUISITION, LLC

By: /s/ John W. Diercksen
Name: John W. Diercksen
Title: Senior Vice President –Strategy, Development and Planning

MCI, INC.

By: /s/ Michael Capellas
Name: Michael Capellas
Title: President and CEO

EXHIBIT 3

10kWIZARD
SEC POWER SEARCH

FORM 10-K

MCI INC - MCIP

Filed: March 16, 2005 (period: December 31, 2004)

Annual report which provides a comprehensive overview of the company for the past year

Table of Contents

PART I

Item 1. Business 2
ITEM 1. BUSINESS
ITEM 2. PROPERTIES
ITEM 3. LEGAL PROCEEDINGS
ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF E
ITEM 6. SELECTED FINANCIAL DATA
ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK
ITEM 8. CONSOLIDATED FINANCIAL STATEMENTS
ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE
ITEM 9A. CONTROLS AND PROCEDURES
ITEM 9B. OTHER INFORMATION

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT
ITEM 11. EXECUTIVE COMPENSATION
ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATT
ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS
ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES
ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES
SIGNATURES
EX-10.5 (Material contracts)

EX-10.6 (Material contracts)

EX-10.7 (Material contracts)

EX-10.8 (Material contracts)

EX-10.12 (Material contracts)

EX-10.13 (Material contracts)

EX-10.14 (Material contracts)

EX-10.15 (Material contracts)

EX-21.1 (Subsidiaries of the registrant)

EX-23.1 (Consents of experts and counsel)

EX-23.2 (Consents of experts and counsel)

EX-31.1

EX-31.2

EX-32.1

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

FORM 10–K

(Mark One)

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

For the fiscal year ended December 31, 2004

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 Number 001–10415

MCI, Inc.
(Exact name of registrant as specified in its charter)

Delaware	**20–0533283**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
22001 Loudoun County Parkway, Ashburn, Virginia	**20147**
(Address of principal executive offices)	**(Zip Code)**

Registrant's telephone number, including area code: (703) 886–5600

Securities registered pursuant to Section 12(b) of the Act:

None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, $.01 Par Value

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S–K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10–K or any amendment to this Form 10–K. ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b–2 of the Act). Yes ☒ No ☐

The aggregate market value of common equity as of June 30, 2004, based on the average bid and asked prices of MCI common stock on such date of $14.43 per share was approximately $4.6 billion.

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to distribution of securities confirmed by a court. Yes ☒ No ☐

As of February 28, 2005, there were 324,755,920 shares outstanding of MCI, Inc. common stock.

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the Registrant's Proxy Statement in connection with the 2005 Annual Meeting (Part III)

TABLE OF CONTENTS

		Page
Cautionary Statement Regarding Forward–Looking Statements		1
	PART I	
Item 1.	Business	2
Item 2.	Properties	23
Item 3.	Legal Proceedings	23
Item 4.	Submission of Matters to a Vote of Security Holders	27
	PART II	
Item 5.	Market for Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities	28
Item 6.	Selected Financial Data	30
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations	33
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	61
Item 8.	Consolidated Financial Statements	63
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	63
Item 9A.	Controls and Procedures	63
Item 9B.	Other Information	63
	PART III	
Item 10.	Directors and Executive Officers of the Registrant	64
Item 11.	Executive Compensation	64
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	64
Item 13.	Certain Relationships and Related Transactions	64
Item 14.	Principal Accountant Fees and Services	65
	PART IV	
Item 15.	Exhibits and Financial Statement Schedules	66
Signatures		68
Index to Consolidated Financial Statements		F–1

CAUTIONARY STATEMENT REGARDING FORWARD–LOOKING STATEMENTS

The following statements in this Annual Report (and in other statements oral or written made by us) are or may constitute forward–looking statements within the meaning of the Private Securities Litigation Reform Act of 1995:

(i) any statements regarding possible or assumed future results of operations of our business, pricing trends, the markets for our services and products, anticipated capital expenditures, our cost reduction and operational restructuring initiatives, regulatory developments, or competition;

(ii) any statements preceded by, followed by, or that include the words "intends," "estimates," "believes," "expects," "anticipates," "plans," "projects," "should," "could" or similar expressions; and

(iii) other statements regarding matters that are not historical facts.

You are cautioned not to place undue reliance on these statements, which speak only as of the date this document is filed. These statements are based on management's current expectations and are subject to uncertainty and changes in circumstances. Actual results may differ materially from these expectations due to matters arising out of pending class action and other lawsuits and the ongoing internal and government investigations related to the previously announced restatements of WorldCom, Inc.'s financial results. Other factors that may cause actual results to differ materially from management's expectations include, but are not limited to:

- economic uncertainty;
- the effects of vigorous competition, including price compression;
- the impact of technological change on our business and alternative technologies;
- availability of transmission facilities;
- the impact of oversupply of capacity resulting from excess deployment of network capacity;
- the ongoing global and domestic trend toward consolidation in the telecommunications industry;
- risks of international business;
- regulatory risks in the United States and internationally;
- contingent liabilities;
- uncertainties regarding the collectibility of receivables;
- the availability and cost of capital;
- uncertainties associated with the success of acquisitions; and
- each of the factors discussed under *"Item 1—Business—Risk Factors"* below.

The cautionary statements contained or referred to in this section also should be considered in connection with any subsequent written or oral forward–looking statements that may be issued by us or persons acting on our behalf. We undertake no duty to update these forward–looking statements, even though our situation may change in the future.

PART I

ITEM 1. *BUSINESS*

Overview

We are one of the world's leading global communication companies, providing a broad range of services in over 200 countries on six continents. Each day, we provide Internet, data and voice communication services for thousands of businesses and government entities throughout the world and millions of consumer customers in the United States. We own and operate one of the most extensive communications networks in the world, comprising approximately 100,000 route miles of network connections linking metropolitan centers and various regions across North America, Europe, Asia, Latin America, the Middle East, Africa and Australia. In addition to transporting customer traffic over our network, we provide value-added services that make communications more secure, reliable and efficient and we provide managed network services for customers that outsource all or portions of their communications and information processing operations.

We conduct our business primarily using the brand name MCI. References herein to "MCI," "we," "us," "our" or the "Company" refer to MCI, Inc., a Delaware corporation, and, unless the context otherwise requires or is otherwise expressly stated, its subsidiaries and its predecessor. Our website address is www.mci.com, and we make available free of charge through our website our Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports filed or furnished under Sections 13(a) or 15(d) of the Securities Act of 1934 as soon as reasonably practicable after we file the material with the Securities and Exchange Commission ("SEC"). Our principal executive offices are located at 22001 Loudoun County Parkway, Ashburn, Virginia 20147 (telephone number 703-886-5600).

Company Background

MCI's predecessor was WorldCom, Inc., a Georgia corporation formed in 1983 ("WorldCom" or "Predecessor"). From its inception, WorldCom grew significantly as a result of numerous acquisitions. On December 31, 1996, WorldCom acquired MFS Communications, which owned UUNET, one of the world's most extensive Internet backbone networks. On September 14, 1998, WorldCom acquired MCI Communications Corporation, one of the world's largest providers of telecommunications services. On October 1, 1999, WorldCom acquired SkyTel Communications, Inc. ("SkyTel"), a leading provider of messaging services in the United States. On July 1, 2001, WorldCom acquired Intermedia Communications Inc. ("Intermedia"), a provider of voice and data services, and, as a result, a controlling interest in Digex, Incorporated ("Digex"), a provider of managed web and application hosting services.

These acquisitions, along with large capital expenditure programs, greatly expanded WorldCom's network operations, its customer base, the range of services it provided and the capabilities of its sales, service and technical personnel. However, these acquisitions and capital expenditure programs contributed to a sharp increase in WorldCom's outstanding debt, which was over $30 billion as of June 30, 2002.

On June 25, 2002, WorldCom announced that, as a result of an internal audit of its capital expenditure accounting, it was determined that its previously issued financial statements had not been prepared in accordance with accounting principles generally accepted in the United States. Following a comprehensive review, WorldCom restated its consolidated financial statements for the fiscal years ended December 31, 2000 and 2001 and for the first quarter of 2002. The restated 2000 and 2001 financial statements were audited by KPMG LLP ("KPMG"), which replaced Arthur Andersen LLP ("Andersen") as WorldCom's external auditors in May 2002.

On July 21, 2002, WorldCom and substantially all of its U.S. subsidiaries filed voluntary petitions for relief in the U.S. Bankruptcy Court for the Southern District of New York under Chapter 11 of Title 11 of the U.S. Bankruptcy Code. On April 20, 2004 (the "Emergence Date"), WorldCom's plan of reorganization was

consummated and WorldCom emerged from bankruptcy. On the emergence date, WorldCom merged with and into MCI whereby the separate existence of WorldCom ceased and MCI became the surviving company.

In addition to restating our consolidated financial statements and completing our plan of reorganization, we have made extensive changes in the composition of our senior management and our Board of Directors. Also, we have implemented numerous changes in our business processes, internal controls and corporate governance policies and procedures.

Merger with Verizon Communications

On February 14, 2005, Verizon Communications Inc. ("Verizon"), MCI and a wholly–owned subsidiary of Verizon ("Merger Sub") entered into an Agreement and Plan of Merger (the "Merger Agreement"). The Merger Agreement provides that, upon the terms and subject to the conditions set forth in the Merger Agreement, MCI will merge with and into the Verizon subsidiary (the "Merger"), with the Verizon subsidiary continuing as the surviving person (or, in certain situations, as provided in the Merger Agreement, a wholly–owned corporate subsidiary of Verizon will merge with and into MCI, with MCI as the surviving person.)

At the effective time and as a result of the Merger, MCI will become a wholly–owned subsidiary of Verizon and each share of MCI common stock will be converted into the right to receive (x) 0.4062 shares of Verizon common stock and (y) cash in the amount of $1.50 per share, which amount of cash and number of shares may be reduced pursuant to a purchase price adjustment based on MCI's bankruptcy claims and for certain tax liabilities, on the terms specified in the Merger Agreement. The Merger Agreement also provides for payment of a special cash dividend in the amount of $4.10 per share (less the per share amount of any dividend declared by MCI during the period beginning on February 14, 2005 and ending on the closing date of the merger) of MCI common stock after the Merger Agreement is approved by the shareholders. All outstanding MCI stock–based awards at the effective time will be replaced by a grant of Verizon stock–based awards.

Consummation of the Merger is subject to customary conditions, including (i) approval by the shareholders of MCI, (ii) expiration or termination of the applicable Hart–Scott–Rodino waiting period and receipt of certain other federal, state or international regulatory approvals, (iii) absence of any law or order prohibiting the closing, and (iv) subject to certain exceptions, the accuracy of representations and warranties and the absence of any Material Adverse Effect (as defined in the Merger Agreement) with respect to each party's business. In addition, Verizon's obligation to close is subject to other conditions, including (i) absence of any pending U.S. governmental litigation with a reasonable likelihood of success seeking to prohibit the closing or to impose certain limitations, (ii) receipt of a bankruptcy order issued by the Unites States Bankruptcy Court for the Southern District allowing for the substitution of shares of Verizon common stock for shares of MCI common stock to satisfy certain bankruptcy–related claims, and (iii) receipt of an order issued by the United States District Court for the Southern District of New York relating to MCI's Corporate Monitor and certain affirmative obligations imposed by prior order of the United States District Court for the Southern District of New York. The Merger Agreement contains certain termination rights for both MCI and Verizon, and further provides that, upon termination of the Merger Agreement under specified circumstances, MCI may be required to pay Verizon a termination fee of $200 million.

Consummation of the Merger will constitute a "Change of Control" under MCI's outstanding Senior Notes due 2007, Senior Notes due 2009 and Senior Notes due 2014 (collectively, the "Senior Notes"), which will obligate the surviving person to make an offer to purchase the Senior Notes within 30 days after the effective time at a purchase price equal to 101% of principal amount plus accrued interest.

Our merger with Verizon, as well as other recently announced mergers and acquisitions, is occurring within a communications industry that has undergone significant changes in recent years. These changes include severe price competition resulting in part from excess network capacity due to overbuilding and the substitution of email, instant messaging and wireless telephone service for traditional wireline voice communications. Other important changes in our industry are the entry of new competitors, such as Verizon and the other regional Bell operating companies ("RBOCs") into the long distance market, and cable television and other companies into the consumer telephony business. Also, there have been regulatory changes making it more difficult for competitive

local exchange carriers like us to provide traditional telephone service, particularly to consumer customers, in competition with the RBOCs and other incumbent local exchange carriers. At the same time, technology changes are enabling the development of advanced networking services primarily based on Internet protocol ("IP") communications and customer demand is increasing for such value-added services, including network management, application hosting and comprehensive security solutions.

We believe that consummation of our merger with Verizon will strengthen the services both companies provide and help the combined company better face the changing conditions within the communications industry. In addition, we believe that the combined company will have significant financial strength to maintain and improve MCI's network as well as have enhanced capabilities to develop new value-added services, including sophisticated IP-based services. Furthermore, we believe that business, government and consumer customers will benefit from having improved access to a broad range of services, including wireless communication services and Internet, data and voice services provided through the combined global networks of MCI and Verizon. See *"Risk Factors—The merger with Verizon may not occur or, if it does, may not provide all the anticipated benefits."*

On February 24, 2005, we received a revised proposal from Qwest Communications International, Inc. ("Qwest") to acquire us. Our board of directors announced that it would conduct a thorough review of the Qwest proposal. On March 2, 2005, we announced our intention to engage with Qwest to review its February 24, 2005 proposal. This decision was made with the concurrence of Verizon. Subsequently, MCI and Qwest have been in ongoing discussions regarding Qwest's proposal. These discussions are continuing as of the date of filing of this Annual Report on Form 10-K.

Strategy

We have developed the following four-part strategy based on our current competitive position, significant telecommunications and computing technological developments and the increasing demand for sophisticated services:

- **Achieve Undisputed IP Leadership**

  We have a strategically important position within the communications market due to the following:

  — **Our IP network and expertise**: We have one of the world's largest and fastest IP networks. Our network is widely recognized as playing a critical role in the movement of Internet traffic and has been described in industry publications as the world's most connected Internet backbone. Our expansive IP footprint, coupled with our direct interconnections, enables our customers to reach more destinations directly through our global IP backbone than any other communications provider. Adding to our competitive position is the extensive knowledge and experience we have developed in handling IP communications since the earliest days of the Internet.

  — **Growth in Internet usage**: Internet usage is continuing its rapid growth as a result of increasing availability of high speed broadband access, the decreasing cost of all types of Internet access, the expanding volume of informative and entertaining content, the continued rapid expansion in the use of email and instant messaging, and the ever increasing number of computers, telephones and other devices utilizing the Internet. Corporations and government entities have responded by developing additional applications to run over the Internet that allow communications and e-commerce transactions with customers, communications with employees, the transfer of data among offices and operating units and the transport of voice communications and digital media.

  — **Convergence of communications onto the Internet**: As the Internet continues to grow and evolve, the telecommunications market is shifting its focus from individual services based on distinct and separate circuit technologies to the convergence of voice and data services onto single networks. Also, for greater efficiency, simplicity and economy, corporations and governments are increasingly standardizing their applications and communication devices to operate on IP technology.

To capitalize on our current strategic position and to prepare for the progressively more sophisticated and expansive future IP needs of our customers, we are taking actions with the goal of achieving undisputed leadership in providing and enabling communications over the Internet. These actions include accelerating the convergence of all of our Internet, data and voice traffic onto a common IP backbone that will integrate our IP network with our existing frame relay, asynchronous transfer mode ("ATM") and voice networks and will operate under a unified standard IP protocol. Around the perimeter of this common core IP network, we are adding multi–service edge devices to consolidate IP, data and voice traffic onto this network and also adding converged packet access to allow such traffic to use common access circuits. By converting to this converged IP architecture, we will have a common set of network systems for all forms of traffic that should produce cost savings for our customers and us, as well as further improve our flexibility and reliability in delivering services and enable rapid introduction of new services on a global basis.

In addition, we are modifying our network operating systems and information technology systems to enable greater ease, efficiency and effectiveness in customer use of our converged network. This involves our adopting unified systems to allow common network management, provisioning and billing. Also, we are modifying our data center architecture to share computing resources on a grid basis as well as developing processes for distributing applications to users on demand which will reduce costs and increase network security. Furthermore, we are enhancing the portal access to our information systems and building greater web services capability into these systems to enable our software applications and those of our customers to communicate and work together across our IP network.

- **Build Next Generation Services**

We believe that new technology developments and changing customer preferences will drive the convergence of network communications and computing. In this environment, we expect that there will be opportunities to provide advanced services, such as grid computing in which computing, storage and software applications will be offered to customers as network utilities and made available on an as–needed basis.

In anticipation of this environment, we are developing next generation services and placing increased emphasis on the value–added services we currently provide to customers. For example, we have established centers of excellence for the enhancement and delivery of four types of services: managed network services; security services; contact center solutions; and web and application hosting. In addition, we are expanding and strengthening the range of service offerings for our customers by upgrading our own capabilities. Adding to our service capabilities is also likely to involve the formation of strategic partnerships with other firms having highly regarded expertise in specific areas or the acquisition of firms with special expertise, such as our recently completed acquisition of Network Security Technologies, Inc. ("NetSec"), a leading provider of managed security services. Consistent with the strategic emphasis we place on the Internet, we are also creating IP–based systems for the customer usage of these services. Furthermore, we are adding more field representatives with training and experience in network technology and engineering to improve the effectiveness of our sales programs and the delivery of value–added services.

Our objective is to be the leading communications company in enabling customers to do more with their computing and networking infrastructure and making them more effective in serving the needs of their customers. Consequently, we should earn stronger relationships with our customers on a strategic level and will be a more integral part of their communication and information systems. This will better position us to be the preferred supplier of both currently available and next generation value–added services.

- **Simplify How We Do Business**

Simplifying how we do business has three objectives: enhancing sales effectiveness, improving customer satisfaction and increasing operating efficiency. We plan to achieve these objectives by strengthening the technical and sales skills of our customer–facing field representatives, empowering our

branch sales offices to take more direct responsibility for developing and maintaining customer relationships, better aligning our corporate administrative and technical specialist personnel to support our business operations, establishing clear accountability for achieving business objectives, accurately measuring our success in achieving our objectives, and appropriately compensating our employees for the success that they achieve. In addition, we are changing our business processes, such as channeling the delivery of certain value–added services through centers of excellence and unifying and streamlining systems for sales, order entry, provisioning, billing, accounts receivable management and other similar functions.

Success in simplifying how we do business should result in better competitive positioning for us in the traditional telecommunications market and the emerging market for value–added services. It should also result in a lower cost structure and higher profit margins.

- **Improve Our Financial Structure**

Improvements in our financial structure include reductions in our operating costs, with an emphasis on decreasing access costs, the expenses we incur for transmissions over other carriers' networks. We are lowering our costs so that we are better positioned not only to offer our customers superior value in the network facilities and associated services they obtain from us, but also to earn a sufficient return on our investments. We believe our ongoing cost reduction efforts are appropriate because we anticipate continued pressure on market pricing.

Enhancements to our systems for measuring and reporting internal operating and financial results are also part of the improvements we are making in our financial structure. The focus of these enhancements is on our approach to fully allocating our costs among our individual business units so that comprehensive income statements are available to business unit managers and our executive management. With these fully allocated statements, we are better able to establish prices for the services we provide our customers, better align expense levels with revenue opportunities, identify cost cutting and profit improvement opportunities and improve the information used to make investment decisions. In addition, we are better able to establish accountability for business unit operating and financial results and more closely align internal goals and external financial measurements. With these enhanced internal reporting tools, our business should be more efficient and effective in serving the needs of our customers and generating returns for our investors. In addition, the business segment financial data included in the notes to our consolidated financial statements have been derived from these fully cost–allocated internal reports and will provide the external financial community with greater visibility and a clearer understanding of our performance.

Business Segments

We operate through three business segments, each of which focuses on specific customer groups:

- **Enterprise Markets** serves large global corporate enterprises and government entities with complex communication requirements, conferencing customers, and MCI Services customers;

- **U.S. Sales & Service** serves small to large domestic corporate customers as well as consumer customers and our SkyTel customers; and

- **International & Wholesale Markets** serves businesses, government entities and telecommunications carriers outside the United States as well as our wholesale accounts.

We began operating under these three business segments in the second quarter of 2004. However, we determined that it was impracticable to restate our 2002 results into the new business segment structure and as such, those results are not presented. The tables below display revenues, operating (loss) income, and assets of our business segments for 2004 and 2003 (in millions):

	Successor Company	Predecessor Company
	Year Ended December 31,	
	2004	2003
Revenues:		
Enterprise Markets	$ 4,811	$ 5,329
U.S. Sales & Service	9,076	11,115
International & Wholesale Markets	6,803	7,822
Total	$20,690	$ 24,266
Operating (Loss) Income:		
Enterprise Markets	$ (500)	$ 341
U.S. Sales & Service	(1,306)	636
International & Wholesale Markets	(1,385)	(317)
Total	$(3,191)	$ 660

	Successor Company	
	As of December 31,	
	2004	2003
Assets:		
Enterprise Markets	$ 2,447	$ 3,744
U.S. Sales & Service	4,335	6,753
International & Wholesale Markets	4,200	8,904
Corporate	6,078	8,069
Total	$17,060	$ 27,470

All of our business segments offer Internet, data and voice services, as described below. The specific mix of the services offered by each of the three business segments reflects the communication needs of the customers served by the segment. For example, our services related to more complex and higher value-added Internet and data communications account for a more significant portion of the revenues from the accounts within the Enterprise Markets business segment and the larger commercial accounts within the U.S. Sales & Service segment than they do for our other customers. Similarly, revenues from the consumer accounts within the U.S. Sales & Service segment are derived almost entirely from voice services.

For the International & Wholesale Markets business segment, basic transport services account for a substantial portion of revenues. We have organized our international and wholesale account groups within this segment since the revenues and operating income, along with the associated management decisions, from one account group often impact the other account group. This is largely due to existence of arbitrage activity in the cross-border markets between tariffs and wholesale pricing for transport services.

For further information on the results of these business segments and information on the results of the business segments by which we previously aligned our business, see Note 22 to our consolidated financial statements included elsewhere in this Annual Report on Form 10-K and see *"Item 7—Management's Discussion and Analysis of Financial Condition and Results of Operations."*

Internet Services

We offer not only a comprehensive range of alternatives for customers to access the Internet but also sophisticated value-added services that make Internet communications more economical, efficient, reliable and secure as well as easier, faster and more effective in conveying data, information and entertainment.

Access services are built around our global network providing connectivity in more than 2,700 cities in over 200 countries. We enable customers to access the Internet through dedicated broadband lines with speeds ranging from 768 kilobits per second to Gigabit Ethernet (equal to one billion bits per second) and up to OC-48 (2.5 billion bits per second). For customers using dial-up access, we have over two million modems located throughout the world. Once connected, the customer's traffic is routed over our networks to the desired location, whether on our network or elsewhere on the Internet.

We also provide Internet-based virtual private networks ("VPN") to customers desiring a high level of security when connecting their operating facilities, data centers, remote sites or mobile users over the public Internet. VPN services include encryption, bandwidth prioritization and centralized continuous monitoring and management. Customers utilizing these services are attracted to the combination of the low-cost public Internet network and the reliability and security we provide.

For high-volume customers that desire a more significant level of security and reliability for their VPN networks, we provide private Internet protocol ("PIP") networks using multi-protocol label switching ("MPLS") to deliver voice, data and video traffic. Our use of MPLS also enables customers to continue utilizing their existing non-IP data and voice networks as they transition over time to operating on standard IP.

In addition, we provide web hosting services that enable customers to outsource portions of their Internet operations so that they can more rapidly and cost-effectively provide online information and business transaction capabilities to their own customers and to employees, suppliers, investors and other interested parties. These services are provided through approximately 200 data centers, including over 40 special data centers that operate 24 hours a day with enhanced service levels. Our web hosting services include technical support and performance management for hardware, operating systems and applications. Other web hosting services include database management, server collocation, storage services, customized web site activity reporting, stress testing, firewall management, virus detection and elimination, and other enhanced security services.

To assist customers operating contact centers that receive Internet communications by email and web site contacts, we provide services for managing such contacts. These services include routing to balance the use of multiple contact centers or to direct contacts to agents with relevant knowledge and skills. Through using these services, our customers can increase the efficiency and effectiveness of their contact centers.

Data Services

We use our frame relay, ATM and IP networks to provide high bandwidth data transmission services over both public and private networks.

Frame relay services allow cost-effective and secure high-speed interconnection of data centers, local area networks, remote facilities, branch offices, point of sale terminals and other sites that send or receive data. Frame relay is a high-speed communications technology that divides the information into frames or packets. Through our frame relay switches strategically located in 47 countries and our correspondent relationships, we offer frame relay services in over 90 countries. In addition, our network access relationships with other communication companies enable customers to access frame relay locations in most countries in the world.

ATM services enable the integration of data, voice, video and multimedia communications over a single network. This consolidation of applications onto one network reduces network, equipment and operational costs. Through our ATM switches in 21 countries and interconnects with other data networks, we can extend ATM connectivity throughout most of the world.

For customers with high–volume data transmission requirements or the need for heightened levels of security or availability, we provide private line services in which a customer contracts for the use of a specific circuit on a dedicated basis. The private line connects directly to our network, thereby reducing originating access costs compared to using "switched" access that is shared among many network users. We offer dedicated circuits as Metro Private Lines between two points in a single metropolitan area, as well as Domestic Private Lines linking points within the United States and International Private Lines connecting points around the world.

For customers interested in creating, expanding, modifying or upgrading their networks, we provide network planning, design, implementation and optimization services. This may involve the configuration and installation of the customer's equipment, the design of custom or dedicated network operating centers and security services, including firewalls, virus detection and elimination and the encryption of traffic over the customer's network for added security. While the revenues from these activities are included in the data category within our business segment information in Note 22 to our consolidated financial statements included elsewhere in this Annual Report on Form 10–K, these services also are provided for Internet and voice communication networks.

For customers that outsource all or portions of their communications operations, we provide a variety of managed network services. These services extend from the operation and maintenance of individual network devices to the complete management of sophisticated global networks. Activities conducted on behalf of our clients include network monitoring and trouble–shooting, on–site repair services and the management of applications such as e–mail and other business programs that are used across a business enterprise or government agency. As of December 2004, we managed over 2,900 customer networks, including approximately 200,000 individual devices located in over 120 countries. While the revenues from these activities are included in the data category within our business segment information, we also provide managed network services for Internet and voice communication networks.

Voice Services

Through our local, long distance and international voice communication services, our customers can call to anywhere in the United States and to virtually any telephone number around the world. High–volume customers are connected to our global voice network through dedicated access lines, while lower volume customers are connected through switched access provided either by us or by an incumbent local exchange carrier.

Besides traditional telephone service, we also offer a range of enhanced voice communication services. For customers operating contact centers, these services include routing for work load balancing among multiple contact centers and among individual agents, as well as routing to match inbound calls with appropriately skilled agents. Other services include voice recognition and speech automation to facilitate contacts or to enable automated telephone access to databases and other electronic information services. During 2004, over 1.4 billion minutes per month of enhanced voice calls were handled through these services provided by MCI Services.

Another of our enhanced voice communication services is conferencing. We provide audio and video teleconferencing on both an automated basis and a moderator–assisted basis. In addition, we provide web–based audio and video conferencing hosted over the Internet and operate conferencing centers in the United States, the United Kingdom and Hong Kong.

Other voice communication services that we offer include calling cards, prepaid phone cards, toll–free services, voice messaging, speed dialing, caller identification, call waiting, call forwarding, three–way calling and information service access.

Sales and Marketing

We have organized our sales and marketing personnel by the customer segments that they serve. Approximately 7,600 sales and service representatives serve the mid and large–size corporate and government

customers of our Enterprise Markets and U.S. Sales & Service business segments. These representatives include highly trained and experienced network engineering, technology and operations experts, as well as specialists in specific services and applications. Some of these representatives have long–standing relationships with specific customers and their understanding of customer communication needs is a key aspect of our market strategy.

The majority of our sales and service representatives are located in our commercial branch organization, which consists of 85 sales offices organized under 46 branches and overseeing over 60,000 customers. For our larger customers, we have dedicated teams that serve their needs on a full–time basis. For small businesses, we sell primarily through telemarketing and sales agents and presently have approximately one million small business customers.

For our corporate and government customers with sophisticated communication systems and complex service requirements, we have established MCI Services. Within MCI Services, we have organized centers of excellence that are responsible for the development and delivery of the following services: managed network services, security services, contact center solutions and web and application hosting. These specialized groups provide comprehensive telecommunications industry expertise and broad understanding of network technology to solve customer problems and facilitate successful execution of their business operations. In addressing a customer's specific needs, MCI Services integrates specialized knowledge inside of our company with highly regarded firms outside of our company that have leading positions in relevant technical areas. We aim to deliver value–added solutions, strengthen our relationships with customers and integrate our problem–solving capabilities into the customer's internal business process.

For our consumer customers, we utilize a variety of sales channels according to the types of services being offered. Our consumer subscription services consist of local, long distance and international calling, operator assisted calling, inbound toll–free services, calling card services, collect calling and Internet access. At present, we have over seven million consumer customers for our long distance subscription service, and over three million of these customers also subscribe to our local telephone service. The primary sales channel for subscription services has been telemarketing by our own employees as well as third party telemarketing firms. Due in part to the implementation of do–not–call lists limiting the telephone numbers accessible by telemarketing and regulatory actions that have decreased the profitability of these services, we have decreased our telemarketing activities and expect further decreases during 2005.

In selling subscription services, we also use our customer service centers, some of which our employees operate and some of which are outsourced to third party firms. To increase effectiveness in assisting consumers and selling additional subscription services, our customer service operates 24 hours a day and provides customer support in ten languages. The other sales channel that we use to sell subscription services to consumers is direct response marketing, which includes direct mail, on–line marketing and use of marketing partners to offer customers unique awards and benefits.

For the marketing to consumers of pre–paid calling cards that are sold on a transaction basis rather than as subscription services, we distribute through retailers, often using co–branded or retailer branded cards. Our other transaction services are dial–around telephone services like 1–800–COLLECT, and we utilize direct response marketing.

Outside the United States, we offer our services solely to businesses, government entities and telecommunications carriers. For these international customers, we have approximately 2,500 sales and service representatives located in regional offices in 76 countries.

For our wholesale customers in the United States, which consist of Internet access providers, other telecommunication carriers and communication service resellers, we employ approximately 225 sales and service representatives. For our wholesale customers outside the United States, we utilize sales and service representatives located in our international regional offices.

Network

We own and operate one of the world's largest and most sophisticated networks for Internet, data and voice communications. On a typical day, our network processes billions of messages, including one petabyte (equal to one quadrillion bytes) of data and approximately one billion minutes of voice communications. The network described within this section is utilized by each of our three business segments.

Our long–haul network consists of approximately 100,000 route miles of fiber–optic cable that is capable of transporting traffic at speeds of 10 gigabits (10 billion bits) per second and connects with other networks around the world. Our IP network is one of the world's largest and fastest, with connectivity to more than 2,700 cities in more than 200 countries across six continents. We also operate global frame relay and ATM data networks.

In addition to our Internet and data networks, we operate a voice communications network handling telephone calls within the United States and around the world. Our global voice network is comprised of over 300 switches, and calls are automatically completed through more than 100 possible routes. Reliability of the voice network is maximized using a process called Dynamically Controlled Routing ("DCR") and by employing synchronous optical network ("SONET") rings. DCR monitors each trunk in the network for any path degradation such as congestion or fiber cuts and, as necessary, dynamically reroutes calls to alternative non–degraded paths. SONET rings allow restoration of service within 50 milliseconds following a network failure.

As part of our overall network, we have an extensive metropolitan network of over 13,000 route miles serving customers in all major United States and key international cities. We have local–to–global–to–local connectivity to over 100,000 buildings (with over 8,000 buildings directly connected to our network and approximately 92,000 indirectly connected). Deployed in business centers throughout the United States, Western Europe, the United Kingdom, Japan, Australia and Singapore, our local networks are constructed using closed–loop self–healing fiber rings.

In addition to land–based network facilities, we own or lease fiber optic capacity on most major intercontinental undersea cable systems in the Atlantic and Pacific Ocean regions. We also own and operate 27 gateway satellite earth stations that enhance our ability to offer Internet, data and voice communications to and from locations throughout the world.

In view of the substantial capacity of our networks and the slowdown in telecommunications spending by customers in recent years, we have focused our network planning and engineering efforts on further improving reliability and efficiency rather than expanding network capacity. Through these efforts, we believe that we have achieved service levels that lead the telecommunications industry.

With regard to efficiency, we continue to deploy Dense Wavelength Division Multiplexing ("DWDM") technology that allows an optical fiber to carry multiple wavelength signals. Originally, this technology allowed eight different wavelength signals to be transmitted. We have been a leader in further developing DWDM technology, enabling the deployment of systems capable of carrying 64, 80 and 160 separate wavelength signals per fiber. Consequently, we are able to handle additional network traffic at low incremental capital costs and with up to 160 channels within an optical fiber operating at 10 gigabits per second.

As part of our strategy of achieving undisputed IP leadership, we are further upgrading our backbone network. First, we are planning to convert 32,000 route miles to an Ultra–Long Haul ("ULH") network, with 5,000 route miles converted by the end of 2005. Converting to ULH will reduce network elements by approximately 70%, increase reliability, lower transport costs and can enable wavelength services such as grid computing and data center mirroring. Second, as part of converging all of our network traffic onto a common IP backbone, we are adding multi–service edge devices that consolidate IP, data and voice traffic onto our high–speed IP network. Third, we are implementing converged packet access ("CPA"), with the initial deployment expected in 2005. CPA enables the delivery of IP, data and voice traffic via common access circuits and will reduce our access costs, improve operating efficiency and enable us to provide our customers with scaleable

bandwidth on demand. Fourth, as part of our IP convergence, we are beginning to modify our traditional voice switches to advanced call processing Soft Switches that can simultaneously handle both circuit–based voice traffic as well as voice–over–IP ("VoIP") traffic. VoIP divides voice communications into digital packets and, instead of using a dedicated circuit, the individual packets seek the most efficient route over multiple transmission lines within IP networks before being reassembled at the destination point. The packet basis of VoIP and the IP focus of our network enhancements are allowing us to develop additional services, including electronic numbering ("ENUM") services that enable traditional telephone calls and VoIP communications to interwork seamlessly and session initiated protocol ("SIP") services that enable customers to communicate regardless of the communication device they use or where they are located.

Patents, Trademarks and Service Marks

We own or have licenses to various patents, trademarks, service marks, copyrights and other intellectual property used in our business. We do not believe that the expiration of any of our intellectual property rights, or the non–renewal of those rights, would materially affect our results of operations.

Competition

The telecommunications industry is highly competitive. Factors contributing to the industry's increasingly competitive market include regulatory changes, product substitution, technological advances, excess network capacity and the entrance of new competitors. In this environment, competition is based on price and pricing plans, the types of individual services offered, the combination of services into bundled offerings, customer service, the quality and reliability of services provided and the development of new products and services.

Our competitors include the following:

- regional phone companies, such as Verizon, SBC Communications, BellSouth Corporation and Qwest, which are permitted to offer long distance and other services;

- other telecommunications companies, such as AT&T, Sprint and Level 3 as well as numerous competitive local exchange carriers;

- wireless telephone companies, such as Verizon, Cingular, Sprint, Nextel, T–Mobile, and ALLTEL which have increased their network coverage, improved service quality, lowered prices and gained market share from providers of wireline voice communications;

- cable television companies, such as Comcast and Cox, which are offering high–speed Internet access and expanding their offerings of voice telephony services; and

- equipment manufacturers, such as IBM, which may provide consulting and outsourcing services in addition to producing telecommunications devices and systems.

Internationally, we compete primarily with incumbent telephone companies, some of which have special regulatory status and exclusive rights to provide certain services and have historically dominated their local markets. We also compete with other international service providers, some of which are affiliated with incumbent telephone companies in other countries.

While there has been a long history of mergers and acquisitions within the communications industry, several proposed combinations have been announced recently. These include the December 15, 2004 announcement of a merger between Sprint and Nextel, the January 10, 2005 announcement of ALLTEL's agreement to purchase Western Wireless and the January 31, 2005 announcement by SBC Communications of its proposed purchase of AT&T. We are also planning to participate in the industry consolidation that is occurring and, on February 14, 2005, we announced our agreement to merge with Verizon. See *"Merger with Verizon Communications."*

Employees

As of December 31, 2004, we employed approximately 40,000 full and part–time employees. Compared to other companies in the telecommunications industry, we have few employees who are represented by labor unions. As of December 31, 2004, we had 292 union employees, which is equal to less than 1% of our total employees.

As of December 31, 2004, our Enterprise Markets unit employed approximately 8% of our total employees, U.S. Sales & Service employed 33%, International & Wholesale employed 17% and approximately 42% were employed in our network operations, systems engineering and corporate functions. Approximately 82% of our total employees are located in the United States and 18% are located outside of the United States.

Regulation

We are subject to varying degrees of federal, state, local, and international regulation. In the United States, our telecommunications subsidiaries are most heavily regulated by the states, especially for the provision of local exchange services. Generally, our telecommunications subsidiaries must be licensed separately by the public utility commission ("PUC") in each state to offer local exchange and intrastate long distance services. No PUC, however, subjects us to rate of return regulation. Nor are we currently required to obtain authorization from the Federal Communications Commission ("FCC") for installation or operation of our network facilities used for domestic services, other than licenses for specific multi–channel multipoint distribution services ("MMDS"), wireless communications services, terrestrial microwave, and satellite earth station facilities that utilize radio frequency spectrum. FCC approval is required, however, for the installation and operation of our international facilities and services. We are subject to varying degrees of regulation in the foreign jurisdictions in which we conduct business, including authorization for the installation and operation of network facilities. No assurance can be given that changes in current or future regulations adopted by the FCC, state, or foreign regulators or legislative initiatives in the United States or abroad would not have a material adverse effect on us.

The FCC's Local Competition Rules. In August 1996, the FCC established nationwide rules pursuant to the Telecom Act, designed to encourage new entrants to compete in local service markets through interconnection with the incumbent local exchange companies ("incumbent LECs" or "ILEC"), resale of incumbent LECs' retail services, and use of individual and combinations of unbundled network elements ("UNEs") owned by the incumbent LECs. "Network elements" are defined in the Telecom Act as any "facility or equipment used in the provision of a telecommunications service," as well as "features, functions, and capabilities that are provided by means of such facility or equipment." UNEs are network elements provided on an unbundled, or separately priced, basis. The FCC makes certain network elements available on an unbundled basis after considering at a minimum whether the failure to provide those network elements would impair the ability of the telecommunications carrier seeking access to provide the services that it seeks to offer. One combination of UNEs, known as the unbundled network element platform ("UNE–P"), encompasses all the elements necessary to provide local telephone service. As a competitive local exchange carrier ("competitive LEC" or "CLEC"), MCI relies upon the UNE–P combination to provide local services to mass market customers. Small and medium–sized business and enterprise customers, on the other hand, can be served via UNEs such as unbundled loops and unbundled transport, although our service platforms for such companies occasionally include a UNE–P component. Substantial reduction in incumbent LEC unbundling requirements, including increased pricing for existing UNE–P arrangements and prohibitions on new UNE–P arrangements, as well as restrictions on the availability of unbundled loops and transport, limits our future range of options in provisioning local services to customers.

The FCC's 1996 *Local Competition Rules* were reviewed by the appellate courts, as were two subsequent decisions establishing incumbent LEC unbundling obligations. Most recently, on March 2, 2004, the U.S. Court of Appeals for the District of Columbia Circuit ("D.C. Circuit") issued a decision that vacated and remanded key aspects of the FCC's February 2003 *Triennial Review Order*, which had generally preserved the availability of unbundled switching, which is a required component of UNE–P, and the availability of loop and transport

facilities at certain capacity levels. The court's decision also affirmed the portions of the *Triennial Review Order* that had not required incumbents to lease unbundled elements for the provision of broadband services. The Supreme Court declined to grant the petition for certiorari filed by the competitive industry, thereby assuring that the D.C. Circuit's decision will remain intact.

On remand from the D.C. Circuit, the FCC released on February 4, 2005, its *Triennial Review Remand Order*, which establishes new rules effective March 11, 2005, concerning the incumbent LECs' unbundling obligations. In this decision, the FCC prohibited new UNE–P arrangements and established a twelve–month transition period for existing UNE–P arrangements. The FCC also curtailed the availability of some cost–based UNE access to DS–1 and DS–3 loops and transport. The transition periods will allow MCI to continue to serve our embedded base of UNE–P customers with rate increases; however, it might mean that no new UNE–P customers can be added at cost–based rates. The FCC directs parties to implement the new rules in their interconnection agreements and to complete change of law proceedings within twelve months of the transition date. The FCC's rules do not purport to nullify existing agreements. To the limited extent that the final rules do preserve the unbundling of loops and dedicated transport at the DS–1 and DS–3 capacity levels, ILECs have filed challenges to those rules in the D.C. Circuit, including asking the court to deny CLECs the ability to convert special access circuits to UNEs, which would further drive up CLEC costs. CLECs have likewise filed appeals of the final rules, and these appeals might challenge the elimination of UNE–P among other possible challenges. The FCC also set aside the "qualifying service" interpretations of the *Triennial Review Order*, but prohibited the use of UNEs for the exclusive provision of telecommunications services in the mobile wireless and long distance markets. The FCC also determined that in the context of the local exchange markets, a general rule prohibiting access to UNEs whenever a requesting carrier is able to compete using an ILEC's tariffed offering was inappropriate. As a result of such rules, we have been forced to raise residential phone service prices in some markets and may be forced to pull out of others, and have reduced our sales efforts pending clarity of our future pricing structure.

"Do Not Call" Registries. The Telephone Consumer Protection Act of 1991 authorized the FCC to create a national database of residential telephone numbers to which, with limited exceptions, companies would be prohibited from placing telemarketing calls. In 1992, the FCC declined to establish such a database, instead requiring carriers to create their own "Do Not Call" lists. In September 2002, the FCC initiated a rulemaking proceeding to revisit its previous decision. In December 2002, the Federal Trade Commission (the "FTC") issued rules establishing a national Do Not Call registry. On July 3, 2003, the FCC also issued rules establishing a national Do Not Call registry. As of December 2004, over 60 million telephone numbers had been registered with the Do Not Call registry. Numerous states have enacted similar legislation requiring their state agencies to create such registries on a state–wide level. Because telemarketing has been our primary consumer sales acquisition tool, to the extent that the FCC's adoption of such a registry affects the number of households to which we can place telemarketing calls, our sales will be affected.

Inmate Telephone Services. A group of alternative inmate service providers has filed two petitions with the FCC requesting that the FCC examine the telephone services provided to prison inmates. We provide a significant amount of interexchange collect call operator services to inmates and, if the petitions are granted, these proceedings could negatively impact our revenues.

Access Charges. Certain incumbent LECs have challenged the method we use to calculate the amount of switched access charges owed by us for Percentage of Interstate Use. If the incumbent LECs' challenges are upheld, these proceedings could negatively impact our costs.

Voice over IP. The FCC has opened a proceeding on the regulatory framework that will apply to various VoIP services and will address the extent to which switched access charges will apply to VoIP traffic. The outcome that the FCC reaches on these issues could have a material impact on MCI's business.

Suspension by the State of New Jersey. Effective February 9, 2004, the State of New Jersey (the "State") suspended us from entering new State contracts. As a result of this action by the State, our name was removed from the State's automated bidders list and was listed in the State Disqualification Report. The suspension was lifted on May 10, 2004.

International Regulation. We are subject, through our international operations, to regulations by foreign countries. These regulations are often as demanding as the requirements imposed on incumbent telephone companies, which frequently enjoy special regulatory status. We have played an active role in regulatory proceedings throughout Europe, at both the national and European Union levels, in an attempt to persuade regulators to impose measures that would reduce leased line costs and ensure timely delivery. Although many of the foreign countries where we operate are liberalizing their telecommunications markets, either as a result of domestic legislation or by virtue of international commitments, we are not certain as to the timing or continuation of these initiatives or as to whether we will benefit from such liberalization.

Overseas Fixed–to–Mobile Termination Rates. An increasing percentage of our U.S.–originated international voice calls terminate to mobile phones overseas. In addition, our overseas affiliates in a number of countries in Europe and in Asia originate voice calls, and a large proportion of these calls also terminate to mobile phones overseas. In both cases, we ultimately rely on a mobile operator, to whom we directly or indirectly pay mobile termination fees, to connect the call to the mobile operator's customer.

In general, the rates that we and other U.S. telecommunications carriers pay to our international correspondents for terminating U.S.–originated international voice calls to mobile phones overseas are much higher than corresponding international termination rates for wireline phones. Likewise, for overseas–originated calls, we pay significantly higher termination rates for calls made to overseas mobile phones than for calls made to overseas wireline phones.

We are actively encouraging the FCC and overseas governments to take appropriate action to reduce the rates required to be paid to terminate voice calls to mobile phones overseas. We cannot predict, however, whether the FCC and overseas regulators will eventually take action that will result in lower mobile termination rates.

Environmental Regulation. We are subject to various environmental, health and safety laws and regulations governing, among other things, the generation, storage, use and disposal of hazardous materials, the discharge of hazardous materials into the ground, air or water, and the health and safety of our employees. We have been required to pay fines in the past in connection with alleged violations of environmental laws, but these alleged violations have been resolved in all material respects. We have also been required, and may continue to be required, to remediate hazardous substance contamination at certain of our locations. Environmental laws are complex, change frequently and have tended to become stringent over time. We may incur additional capital or operating costs to comply with any such changes.

RISK FACTORS

You should carefully consider the risks described below before investing in our securities. The risks described below are not the only ones facing us. Additional risks not currently known to us or that we currently believe are immaterial may also impair our results of operations, cash flows, and financial condition.

We face substantial competition that has resulted in pricing pressures and reduced revenues

There is substantial competition in the telecommunications industry, which has caused pricing pressure and reduced revenues. Rapid technological advances, product substitution and deregulation have all contributed to the increasingly competitive atmosphere. We expect competition to intensify due to the efforts of competitors to address difficult market conditions through reduced pricing, bundled offerings or otherwise, as well as a result of the entrance of new competitors and the development of new technologies, products and services.

We have a variety of competitors, including:

- regional phone companies, such as Verizon, SBC Communications, BellSouth Corporation and Qwest, which are now offering long distance and other services;
- other telecommunications companies, such as AT&T, Sprint, Level 3 and numerous competitive local exchange carriers;
- VoIP providers, such as Vonage;
- wireless telephone companies, such as Verizon, Cingular, Sprint PCS, Nextel, T–Mobile, and ALLTEL, which have increased their network coverage, improved service quality, started to provide bundled wireless products and lowered prices to end users. As a result, customers are beginning to substitute wireless services for basic wireline service causing these companies to gain market share from providers of wireline voice communications. Wireless telephone services can also increasingly be used for data transmission;
- cable television companies, such as Comcast and Cox, which are offering high–speed Internet access and expanding their offerings of voice telephony services; and
- equipment manufacturers, such as IBM, and other system integrators which provide consulting and outsourcing services that may compete with us in the new products and services that we are offering.

These factors could also have a material adverse effect on our business, financial condition, results of operations or cash flows.

In recent months, there has been an increased trend towards consolidation in the telecommunications industry, as reflected in announced mergers involving two of our principal competitors, the mergers of Sprint with Nextel and AT&T with SBC Communications, and our pending merger with Verizon. While we expect our pending merger, once consummated, to strengthen our ability to compete, this consolidation trend will also strengthen the resources available to these other competitors, allowing them to offer larger bundles of services and reducing their cost structure.

Outside the United States, we compete with the incumbent telephone companies, some of which still have special regulatory status and exclusive rights to provide services, and virtually all of which historically dominated their local, long distance and international services business. These companies have numerous advantages, including existing facilities, customer loyalty and substantial financial resources. We may be dependent upon obtaining facilities from these incumbent telephone companies. For example, we require interconnection with the incumbent operator's network in order to provide ubiquitous service for our customers. Without interconnection, our customers would not be able to contact customers of the incumbent operator. We

also compete with other service providers, many of which are affiliated with incumbent telephone companies in other countries. Typically, we must devote extensive resources to obtain regulatory approvals necessary to operate overseas and then to obtain access and interconnection with the incumbent's network on a non-discriminatory basis.

Our ability to improve our operating results depends, in large part, upon our ability to successfully introduce new services at favorable prices while controlling our costs

To counter the impact of any continuing price declines in our industry, our strategy is to take advantage of technological developments, particularly utilization of Internet Protocol, to expand network traffic, offer new bundles of managed products and services at favorable prices, simplify our network and associated costs and enable traditional transport on a more favorable basis. Adoption of our strategy will require incremental capital expenditures and continued efforts to reduce our access and other costs to secure the benefits of our efforts. There are substantial risks that we will not be able to successfully implement these strategies or do so on favorable terms or on favorable terms that we can sustain. Among other things, our competitors may pursue the same strategies and may compete in terms of pricing that is itself subject to decline. Even if our strategy is successful, we cannot assure you that it will be sufficient to counter continuing price declines in our other revenues.

Our business will suffer if our technology and business methods become obsolete

The market for Internet, data and voice communication products and services is characterized by rapidly changing technology, evolving industry standards, emerging competition and frequent new product and service introductions. We may not be successful in identifying new product and service opportunities and developing and bringing new products and services to market in a timely manner. We are also at risk from fundamental changes in the way Internet, data and voice communication products and services are marketed, sold and delivered. Our pursuit of technological advances and new business methods may require substantial time and expense, and we may not succeed in adapting our business to the technologies, devices, protocols, regulations and marketing and sales methods that are anticipated and, in some cases, are currently being developed in the communications industry.

To access certain of our customers, we rely upon the cooperation of established local telephone companies

As a participant in the competitive local telecommunications services industry in the United States, we rely on the networks of established telephone companies or those of competitive local exchange carriers for some aspects of transmission. Federal law requires most of the established telephone companies to lease or "unbundle" elements of their networks and permit us to purchase the call origination and call termination services we need, thereby decreasing our operating expenses. However, as a result of recent litigation concerning portions of the FCC's Triennial Review Order that required the unbundling of switching, which is a critical component of UNE-P, the FCC has determined that beginning in 2006, certain discounts provided to us by the established telephone companies will cease. We are continuing to evaluate how the anticipated rise in UNE-P access costs will impact our ability to profitably provide Mass Markets subscription services, and the cost increase may force us to withdraw from certain markets. As a result, new local service account installations and revenue may decrease from current levels in future periods. These regulatory changes will also increase costs for our other business segments as well and could adversely affect our competitive position in these segments.

In most of our international operations, we are competing with incumbent telecommunications operators from whom we require services and support. For example, we require interconnection with the incumbent operator's network in order to provide ubiquitous service for our customers. Without interconnection, our customers would not be able to contact customers of the incumbent operator. There can be no assurance, however, that interconnection (or other services) will be provided by the incumbent operator in a timely manner or that the terms and conditions of any proposed interconnection, particularly the cost, will not have an adverse effect on our local operations.

Government regulation of our businesses significantly impacts our business

We are subject to varying degrees of federal, state, local and international regulation. In the United States, our subsidiaries are most heavily regulated by the states, especially for the provision of local exchange services. We are also subject to varying degrees of regulation in foreign jurisdictions in which we conduct business, including authorization for the installation and operation of network facilities. We consider regulatory developments impacting our "last mile" access to customers (such as access to various network elements for both our business and mass market customers permitting call origination and termination services), intercarrier compensation arrangements and the manner in which we are permitted to offer advanced IP–based services as being the most critical to our success. Changes in current or future regulations adopted by the FCC, state or foreign regulators or legislative initiatives in the United States or abroad could have a material adverse effect on us by restricting our ability to price or offer our products and services and/or otherwise placing us at a competitive disadvantage. For additional information, see *"Item 1—Regulation."*

In addition to the regulation of our business by the FCC, the FTC has introduced "Do Not Call" registries that permit consumers to request that they not be contacted by telemarketers. In addition, numerous states have enacted similar legislation requiring their state agencies to create such registries on a state–wide level. Such registries are the subject of litigation but could have a material adverse effect on telemarketing, which is one of our principal sales and marketing initiatives.

Telecommunications industry trends have materially and adversely impacted our revenues and cash flows

In 2001, the business environment for the telecommunications industry deteriorated significantly and rapidly. This environment has remained weak through 2004, primarily due to:

- the general weakness in the U.S. economy, which was exacerbated by the events of September 11, 2001 and concerns regarding terrorism;
- pressure on prices due to substantial competition; and
- failure of many companies to meet forecasted demand, the bankruptcy or liquidation of a substantial number of Internet companies and financial difficulties experienced by many telecommunications customers.

As a result of these trends, our revenues have declined from $28.5 billion in 2002 to $20.7 billion in 2004. We have a history of losses and may be unable to achieve and maintain profitability. We expect these trends to continue, including reduced business from financially troubled customers and downward pressure on prices. These trends could continue to have a material adverse impact on our business, financial condition, results of operations and cash flows.

Our prospects will depend in part on our ability to control our costs while maintaining and improving our service levels

In light of our declining revenues, we continue to seek ways of reducing access costs, reducing expenses and limiting our capital expenditures to maintenance and success–based projects as much as practicable while we pursue enhanced revenue opportunities. Our recent cost reductions were attributable to our efforts, aided by the nature of bankruptcy proceedings. However, our capital requirements relating to maintaining and routinely upgrading our network will continue to be significant in the coming years and we are undertaking new projects in furtherance of our IP–based strategies. Our prospects will depend in part on our ability to continue to control costs and operate efficiently, while maintaining and improving our existing service levels. The most substantial cost we must control is our access cost, which is the cost we must pay to other telecommunications providers to initiate or terminate traffic on their networks. Although we are able to attempt to influence these costs through, for example, influencing regulatory measures, these costs are not fully within our control. Regardless of the state of the economy, everyday business costs and the cost of access will continually be a concern for our business. If

we cannot continue to control our costs, there could be a material adverse effect on our business, operations, cash flows and financial condition.

We are subject to distinct risks relating to our international operations

For the year ended December 31, 2004, 19% of our revenues were derived from our international operations. Accordingly, our business is subject to risks inherent to international operations, including:

- Unexpected changes in regulatory requirements, export and import restrictions, tariffs and other trade barriers;
- Challenges in staffing and managing foreign operations;
- Employment laws and practices in foreign countries;
- Longer payment cycles and problems collecting accounts receivable;
- Fluctuations in currency exchange rates and imposition of currency exchange controls;
- Foreign taxation of earnings and payments received by us from our subsidiaries and affiliates;
- Potential inflation in the foreign countries where we conduct operations;
- Differences in technology standards;
- Exposure to different legal standards; and
- Political, economic and social conditions in the foreign countries where we conduct operations.

Our international operations are conducted through a variety of different methods, including wholly–owned subsidiaries, joint ventures and operating agreements with local telecommunications companies. Each of these methods presents risks. For example, certain countries have foreign ownership limitations with respect to companies that provide telecommunications services within their borders. These restrictions obligate us to partner with one or more local companies if we want to participate in the market. As a result, our ability to control or direct the operations of the local entity is limited, either contractually or statutorily, by our obligations to our local partners.

In the event of any dispute arising from our international operations, we may be subject to the exclusive jurisdiction of foreign courts and may not be successful in subjecting foreign persons or entities to the jurisdiction of the courts of the United States. We may also be hindered or prevented from enforcing our rights with respect to foreign governments because of the doctrine of sovereign immunity. In addition, there can be no assurance that the laws, regulations or administrative practices of foreign countries relating to our ability to do business in that country will not change.

Although most of the foreign countries where we operate are liberalizing their telecommunications market, whether as a result of domestic legislation or by virtue of international commitments, there are no guarantees as to the continuation, timing or effectiveness of such liberalization. For example, certain countries have bound themselves to undertake liberalizing measures in their telecommunications market pursuant to treaty commitments under the World Trade Organization. There can be no assurance, however, that such liberalizing measures will be implemented in a timely manner or at all. In addition, if there is a failure to implement those liberalizing measures, there may not be adequate or effective recourse against the foreign government for such failure.

While we have a growing dependence on Internet–related services, the rate of development and adoption of the Internet has been slower outside the United States. Laws in the U.S. and foreign countries regarding the Internet and related data privacy issues are largely unsettled, but are becoming an increasing focus for lawmakers. Changes in these laws could require us to expend significant resources to comply or could limit our business. In addition, the application of multiple sets of laws and regulations may subject us to regulation,

taxation, enforcement or other liability in unexpected ways, which could make it more expensive to conduct our business or limit our ability to conduct business. Regulation of the Internet may also harm our customers' businesses, which could lead to reduced demand for our services.

The rates that we charge our customers for international services may decrease in the future due to the entry of new carriers with substantial resources and aggressiveness on the part of new or existing carriers. In addition, the consummation of mergers, joint ventures and alliances among large international carriers that facilitate targeted pricing and cost reductions, and the availability of international circuit capacity on new undersea fiber optic cables and new high capacity satellite systems, may have a negative impact on our pricing ability.

Customers of our international operations may be invoiced in United States dollars or in foreign currencies. Customers invoiced in United States dollars whose revenues are derived in other currencies may be subject to unpredictable and indeterminate increases in the event those currencies devalue relative to the United States dollar. Furthermore, those customers may become subject to exchange control regulations restricting the conversion of their revenue currencies into United States dollars. In that event, the affected customers may not be able to pay us in United States dollars. In addition, where we invoice for our services in currencies other than United States dollars, our results of operations may suffer due to currency translations in the event that those currencies devalue relative to the United States dollar and we do not elect to enter into currency hedging arrangements in respect of those payment obligations.

Our future growth may include additional acquisitions that may not be successfully integrated and may not achieve expected benefits.

Acquisitions to fill out our product offerings are a component of our growth strategy. Consistent with this strategy, we continue to engage in discussions with, and evaluate, potential acquisition targets, some of which may be material and require significant cash outlays, although we currently have no binding definitive agreements for any significant acquisitions. In the future, we may acquire other businesses. As a result of these acquisitions, we may need to utilize our available cash or seek additional financing (which could adversely affect our financial condition) and integrate product lines, dispersed operations and distinct corporate cultures. These integration efforts may not succeed or may distract our management from operating our existing business. Our failure to successfully manage future acquisitions could harm our operating results.

We depend in large part on the efforts and integrity of our key personnel. Retaining key personnel is vital for our business, and there is no guarantee we can keep such personnel

Our future success largely depends on the continued employment of certain of our key personnel, any of whom could terminate their employment at any time. In addition, in response to the conduct of the former WorldCom management and WorldCom's accounting fraud and practices, we have undertaken to conduct our businesses at the highest ethical levels and in accordance with stringent practices embodied in our charter and our by–laws. Ultimately, for us to succeed, we will need to continue to employ and retain personnel of integrity and skill. We can offer no assurance that we will not lose key personnel and this could have a material adverse effect on our business and operations.

Historical financial information for our predecessor is not comparable to our own after emergence from bankruptcy

We adopted fresh–start reporting under the provisions of the American Institute of Certified Public Accountants Statement of Position ("SOP") 90–7, *"Financial Reporting by Entities in Reorganization Under the Bankruptcy Code,"* ("SOP 90–7") as of December 31, 2003. Upon adoption, our reorganization value was $14.5 billion and was allocated to our assets and liabilities. Our assets were stated at fair value in accordance with Statement of Financial Accounting Standards ("SFAS") No. 141, *"Business Combinations,"* ("SFAS No. 141") and liabilities were recorded at the present value of amounts estimated to be paid. In addition, our accumulated

deficit was eliminated, and our new debt and equity were recorded in accordance with distributions pursuant to the plan of reorganization. The adoption of fresh-start reporting had a material effect on our consolidated financial statements. As a result, our consolidated balance sheets as of December 31, 2004 and 2003 included elsewhere in this Annual Report on Form 10-K and our consolidated financial statements published for periods following December 31, 2003 are not fully comparable with those related to prior periods. This situation may make it difficult to properly evaluate an investment in our company.

The practices of our predecessor and former management continue to be scrutinized, and the results of this scrutiny may have a material and adverse effect on us

As a result of the financial fraud committed by, and the operating practices of, some of WorldCom's former officers and employees and its bankruptcy reorganization, we have been the subject of various civil and criminal investigations by the SEC, the FCC, the U.S. Attorney's Office, various state attorney generals and other governmental entities into our accounting and related controls, call routing practices, payment of state income taxes and other matters. As a result, our senior management team and Board of Directors have been required to devote substantial time to the resolution process for these investigations and related matters. We continue to engage in dialog with these government agencies in order to reach reasonable conclusions to these investigations, but we cannot predict what the specific resolution for each of these investigations may be. In addition to penalties that have been announced to date, it is possible that we will be required to pay other material fines, consent to additional injunctions on future conduct, conduct business with government agencies under restrictive terms, or lose our ability to conduct such business or suffer other penalties, each of which could have a material adverse effect on our business, financial condition and liquidity. In addition, we continue to be the subject of continuing scrutiny and negative publicity focused on these subjects, and this scrutiny and negative publicity may impact the terms under which, and whether, customers and suppliers continue to do business with us and may affect the tone of our dealings with regulators and others.

We have been actively working to improve our internal controls and procedures, but there can be no assurance that new material weaknesses in our internal controls will not be identified

Through reports and letters generated by our auditors, examiners and court-appointed monitors and a special committee of WorldCom's Board as part of WorldCom's bankruptcy, a substantial number of material weaknesses and problems were identified in our internal controls and procedures and corporate governance. We have made significant efforts to establish a framework to improve our internal controls over financial reporting. While our internal controls over financial reporting are significantly improved, management has identified a material weakness in internal control over accounting for income tax and has also identified certain other areas that it believes should be further enhanced. See *"Item 9A—Controls and Procedures."* Any failure by us to have appropriate controls or to comply with the other high standards for corporate governance that we have established for ourselves could materially and adversely affect our company.

We continue to be subject to significant pending litigation, which if adversely determined could have a material and adverse effect on our operating licenses, liquidity and financial condition

We are party to significant litigation, which is described in more detail in *"Item 3—Legal Proceedings."* If any of these proceedings is decided against us, we could be subject to substantial damages or other penalties. These penalties and other effects of litigation could have a material adverse effect on our operating licenses, liquidity and financial condition.

We have a significant amount of debt and other payment obligations, which could adversely affect our financial health and prevent us from fulfilling our obligations under the notes.

As of December 31, 2004, we had total indebtedness of approximately $5.9 billion. In addition to our indebtedness, we are required to make substantial additional payments in settlement of bankruptcy claims. As of

December 31, 2004, our estimated remaining cash payments to settle pre–petition creditor claims were approximately $0.8 billion. However, that estimate is based on various assumptions and reflects our judgment based upon our prior pre–petition claims settlement history and the terms of our plan of reorganization and, if these assumptions prove incorrect, actual payments could differ from the estimated amounts.

The level of our indebtedness and other liabilities could have important consequences, including:

- limiting cash flow available for general corporate purposes, including capital expenditures and acquisitions, because a substantial portion of our cash flow from operations must be dedicated to servicing our debt and settling outstanding claims;

- limiting our ability to obtain additional debt financing in the future for working capital, capital expenditures or acquisitions; and

- limiting our flexibility in reacting to competitive and other changes in our industry and economic conditions generally.

Covenants in our debt instruments prohibit us from engaging in certain activities, which we might otherwise wish to pursue

The indentures relating to our Senior Notes impose restrictions on our operations and financial transactions that we may wish to pursue. These restrictions will affect, and in many respects limit or prohibit, among other things, our and our subsidiaries' ability to incur additional indebtedness; make investments; sell assets; declare or pay dividends or other distributions to shareholders; and repurchase equity interests. The restrictions contained in the terms of each of these debt instruments, as well as the terms of other indebtedness we may incur from time to time, could limit our ability to plan for or react to market conditions or meet capital needs, or otherwise restrict our activities or business plans. These restrictions could also adversely affect our ability to finance our operations or other capital needs, or to engage in other business activities that would be in our interest.

The merger with Verizon may not occur or, if it does, may not provide all the anticipated benefits

We must obtain shareholder approval and certain approvals and consents in a timely manner from federal, state and foreign agencies prior to the completion of the merger with Verizon. If we do not receive these approvals, or do not receive them on terms that satisfy the conditions set forth in the Merger Agreement, then we or Verizon will not be obligated to complete the merger. The governmental agencies from which we will seek these approvals have broad discretion in administering the governing regulations. As a condition to approval of the merger, agencies may impose requirements, limitations or costs that could negatively affect the way the combined company conducts business. These requirements, limitations or costs could jeopardize or delay the completion of the merger. If we and Verizon agree to any requirements, limitations or costs in order to obtain any approvals required to complete the merger, these requirements, limitations or additional costs could adversely affect the two companies' ability to integrate their operations or reduce the anticipated benefits of the merger.

If we are able to consummate the merger, we expect to achieve various integration benefits. Achieving the anticipated benefits of the merger will depend in part upon whether our two companies integrate our businesses in an efficient and effective manner. We may not be able to accomplish this integration process smoothly or successfully. The integration of certain operations following the merger will require the dedication of significant management resources, which may temporarily distract management's attention from the day–to–day business of the combined company. Employee uncertainty and lack of focus during the integration process may also disrupt the business of the combined company. Any inability of management to integrate successfully the operations of our two companies could have a material adverse effect on the combined company.

If we are unable to consummate the merger, we would continue to be exposed to the general competitive pressures and risks in the industry described above, which could be increased if certain of the other recently announced mergers in the communications industry are consummated, strengthening the competitive position of some of our competitors.

ITEM 2. *PROPERTIES*

Our owned properties consist primarily of equipment and buildings used to provide Internet, data and voice communication services in North America, Latin America, Europe, the Middle East, Africa, Australia and Asia. We also lease certain switching equipment and several general office facilities. In addition, we have been granted easements, rights–of–way and rights–of–occupancy, mainly by railroads and other private land owners, for our fiber–optic network.

As of December 31, 2004, properties used by us that are significant to our operations are as follows:

Property Location	Type of Property	Owned/ Leased	Square Footage
Ashburn, VA (corporate headquarters)	Office	Owned	1,851,653
Tulsa, OK	Office and Technical	Owned	860,000
Colorado Springs, CO	Office and Technical	Owned	744,142
Hilliard, OH	Office	Owned	428,000
Clinton, MS	Office and Technical	Owned	420,000
Richardson, TX	Office	Owned	408,540
Weldon Springs, MO	Office	Owned	368,688
Richardson, TX	Office and Technical	Owned	338,366
Cary, NC	Office and Technical	Owned	257,726
Alpharetta, GA	Office	Owned	243,740
Omaha, NE	Office and Technical	Owned	200,000
Reading, UK	Office	Leased	369,000
Rye Brook, NY	Office	Leased	180,000
Sydney, AU	Office	Leased	121,079
Hong Kong	Office	Leased	27,557

We also own or lease other office facilities for sales, maintenance and administrative operations in the markets in which we operate. We had approximately 20 owned and 240 leased facilities as of December 31, 2004, including approximately 85 leased properties in international markets. The leases generally have terms ranging from one to five years, not including extensions related to the exercise of renewal options.

In addition, we own or lease other facilities which primarily support our telecommunications equipment. We have approximately 300 owned and 4,900 leased facilities as of December 31, 2004, including approximately 20 owned and 1,400 leased properties in international markets. The majority of these leases have terms generally ranging from month–to–month to 25 years. These property leases tend to have renewal options ranging from one to five years.

During 2004, we disposed of some significant facilities which were in excess of 100,000 square feet. These disposals include the sale of an owned property totaling approximately 106,000 square feet and the early termination of a leased facility totaling approximately 122,000 square feet. These facilities are not included in the table above.

See Notes 7 and 18 of our consolidated financial statements included elsewhere in this Annual Report on Form 10–K for the carrying value of our property, plant and equipment and the future minimum payments under our operating and capital leases.

ITEM 3. *LEGAL PROCEEDINGS*

Bankruptcy Filings

On July 21, 2002, (the "Petition Date"), WorldCom and substantially all of its direct and indirect domestic subsidiaries (the "Initial Filers") filed voluntary petitions for relief in the United States Bankruptcy Court for the

Southern District of New York (the "Bankruptcy Court") under chapter 11 of Title 11 of the United States Code (the "Bankruptcy Code"). On November 8, 2002, WorldCom filed additional chapter 11 petitions for 43 of its subsidiaries (collectively with the Initial Filers, the "Debtors"), most of which were effectively inactive and none of which had significant debt. Throughout the bankruptcy proceedings, the Debtors continued to operate their businesses and manage their properties as debtors–in–possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code. By orders dated July 22, 2002 and November 12, 2002, the Debtors' chapter 11 cases were declared to be jointly administered. In addition, pursuant to section 362 of the Bankruptcy Code, most of the litigation against the Debtors was stayed.

By order dated October 31, 2003, after due notice and a hearing, the Bankruptcy Court confirmed the Debtors' Modified Second Amended Joint Plan of Reorganization dated October 21, 2003 (the "Plan"). The confirmation order determined that the Plan complied with the applicable requirements of the Bankruptcy Code. On April 20, 2004, WorldCom emerged from bankruptcy.

On the Emergence Date, pursuant to the Plan and as part of its emergence from bankruptcy protection, WorldCom merged with and into MCI whereby the separate existence of WorldCom ceased and MCI became the surviving company. On April 29, 2004, we filed our Annual Report on Form 10–K for the period ended December 31, 2003.

Restatements of Previously Issued Financial Statements

On June 25, 2002, WorldCom announced that as a result of an internal audit of its capital expenditure accounting, it was determined that certain transfers from line cost expenses (now referred to as access cost expenses) to capital accounts in the amount of $3.9 billion during 2001 and the first quarter of 2002 were not made in accordance with accounting principles generally accepted in the United States of America ("GAAP"). This announcement followed WorldCom's prior notification to Andersen, which had audited its consolidated financial statements for 2001 and reviewed such interim condensed consolidated financial statements for first quarter 2002, of these improperly reported amounts. On June 24, 2002, Andersen had advised us that in light of the inappropriate transfers of line costs, Andersen's audit report on our consolidated financial statements for 2001 and Andersen's review of its interim condensed consolidated financial statements for the first quarter of 2002 could not be relied upon. WorldCom subsequently engaged KPMG to audit our consolidated financial statements for the years ended December 31, 2001 and 2000.

On August 8, 2002, WorldCom announced that its ongoing internal review of its consolidated financial statements discovered an additional $3.9 billion in improperly reported pre–tax earnings for 1999, 2000, 2001, and the first quarter of 2002. On November 5, 2002, WorldCom announced that it expected a further restatement of earnings in addition to amounts previously announced and that the overall amount of the restatements could total in excess of $9 billion. On March 13, 2003, WorldCom announced that it had completed a preliminary review of its goodwill and other intangible assets and property, plant and equipment accounts. This review resulted in the write–off of all existing goodwill and a substantial write–down of the carrying value of property, plant and equipment and other intangible assets, which was subsequently adjusted during WorldCom's restatement process.

A Special Committee of WorldCom's Board of Directors conducted an independent investigation of these matters. As a result of this investigation, we have made a number of changes to our financial and corporate governance practices. Also, Richard C. Breeden, former Chairman of the SEC, was appointed as Corporate Monitor. In his role, Mr. Breeden has closely overseen the overall process under which WorldCom reviewed its prior accounting practices, the carrying value of its assets and the quality of its internal controls. Mr. Breeden has made reports on such issues to both the SEC and the District Court from July 2002 through the present time. Certain other investigations involving the Corporation's corporate governance and accounting practices have now been concluded. The Company's past accounting practices remain the subject of an open investigation by the U.S. Attorney's Office.

As a result of the process of reviewing and restating its financial statements, WorldCom was unable to timely file periodic reports with the SEC. On March 12, 2004, WorldCom filed its Annual Report on Form 10–K for the period ended December 31, 2002. Such Annual Report contains audited financial statements for the years ended December 31, 2000, 2001 and 2002 and reflect each of the restatements and adjustments discussed above.

Regulation

We are subject to varying degrees of federal, state, local and international regulation. For more information, see *"Item 1—Business—Regulation."*

Litigation

WorldCom and various current or former directors, officers, and advisors were named as defendants in a number of lawsuits alleging violations of federal and state securities laws and related claims. The filing of the Chapter 11 cases automatically stayed proceedings in private lawsuits relating to pre–petition claims as to the Debtors. Pre–petition litigation claims against the Company were discharged on the Emergence Date. Claims arising after the filing date generally were not discharged.

Merger Related Securities Litigation. On February 15, 2005, the Company received notice that an individual shareholder filed a putative class action on behalf of himself and all shareholders of the Company against the Company and all of the individual members of the Board of Directors in Chancery Court in the State of Delaware. Subsequently, Plaintiff filed an amended complaint that added among other things Verizon as a defendant in the case. Plaintiff alleges that the Company and the Board of Directors breached their fiduciary duties to shareholders in entering into the Merger Agreement with Verizon rather than accepting the merger proposal propounded by Qwest. As a remedy, Plaintiff requests that the Chancery Court issue an injunction prohibiting consummation of the Merger Agreement. Additionally, the Company has received notice that three additional putative class actions containing similar allegations were filed on February 18, 2005 against the Company and the Board of Directors in the Chancery Court in the State of Delaware. The Company will aggressively defend itself in these cases.

SEC Lawsuit and Related Proceedings. The Predecessor Company and various current or former directors, officers and advisors were named as defendants in a number of lawsuits alleging violations of federal and state securities laws and related claims.

On June 26, 2002, the SEC filed suit against the Predecessor Company and certain members of former management for violations of sections 10(b) and 13(a) of the Exchange Act and SEC Rules 10b–5, 12b–20, 13a–1 and 13a–13, alleging that from at least the first quarter of 2001 through the first quarter of 2002, WorldCom defrauded investors by disguising its true operating performance via improper accounting methods that materially overstated its income by approximately $3.9 billion. On November 5, 2002, the SEC filed an amended complaint that broadened the scope of the claims, including a claim under section 17(a) of the Securities Act, to reflect among other things the Predecessor Company's disclosure that the overall restatements could total in excess of $9 billion. On May 19, 2003, the SEC filed a second amended complaint that added a claim for disgorgement of unlawful gains obtained as a result of the alleged misstatements.

The Company has resolved all claims brought by the SEC in this suit. The Company remains subject to the ongoing obligations imposed by the permanent injunction entered by the Court on November 26, 2002, as modified, including the oversight of Corporate Monitor Richard Breeden.

Insurance Coverage Litigation. On June 17, 2004, SR International Business Insurance Company, Ltd., one of the insurance carriers that had issued excess directors and officers ("D&O") liability insurance coverage to WorldCom, Inc. for the period December 31, 2001 to December 31, 2002, filed an action in the United States District Court for the Southern District of New York against MCI and certain of its former directors and officers,

seeking, among other things, rescission of its policy or, alternatively, a declaration of non–coverage under it ("SRI Action"). On May 28, 2004, one of WorldCom's former directors, Bert C. Roberts, Jr., had filed a complaint for declaratory adjudication of rights and ancillary and supplemental relief against WorldCom's excess D&O liability insurance carriers ("D&O Carriers") in the United States District Court for the Southern District of New York ("Roberts Action"). By his action, Mr. Roberts sought a declaration of coverage against the D&O Carriers with respect to various underlying securities claims pending against him. Shortly thereafter, in or about August 2004, certain of the defendant D&O Carriers filed answers and counterclaims in the Roberts Action ("Carrier Counterclaims"). In their respective counterclaims, the D&O Carriers have named MCI and certain of WorldCom's former directors and officers as counterclaim defendants and sought, among other things, to rescind the respective D&O policies issued by them or, alternatively, a declaration of no coverage under those policies. The SRI Action and the Roberts Action have been consolidated before Judge Cote and have functionally been stayed, while settlement discussions by and between the directors and officers, D&O Carriers, and underlying securities plaintiffs have been progressing. However, on February 3, 2005, Judge Cote issued a preliminary injunction requiring the insurers to pay Roberts' defense costs as they are incurred. MCI has not yet appeared in either action and, if forced to do so, will aggressively defend itself by seeking dismissal of the SRI Action and the Carrier Counterclaims on the ground, among others, of non–justiciability.

Call Routing Investigation. On July 23, 2003, WorldCom received a subpoena from the United States Attorney's Office for the Southern District of New York asking for information and documents concerning its projects relating to the routing of interstate or intrastate voice or data transmission that originate or terminate on the network of local exchange companies. The U.S. Attorney's Office is investigating the Company's practices relating to call routing that allegedly have the purpose of avoiding or reducing our payment of access charges to local exchange companies. We are cooperating fully with the U.S. Attorney's Office, and have conducted an internal review of practices identified by the subpoena. Based on an internal review, we believe that our current practices in originating and terminating calls comply with all legal and regulatory requirements.

Investigation of the FCC Into Allegations of Improper Routing of Network Traffic. The Enforcement Bureau of the FCC has also initiated a review of the Company's call routing practices, and has requested information from the Company regarding any conduct that might involve withholding, substituting, or modifying automatic number identification ("ANI") or calling party number ("CPN") information associated with interstate interexchange traffic. We are fully cooperating with the FCC in this matter and are providing the information requested. Based upon an internal review, we believe that our current practices comply with FCC regulations.

Right–of–Way Litigation. Prior to the Petition Date, the Predecessor Company was named as a defendant in five putative nationwide and twenty–five putative state class actions involving fiber optic cable on railroad, pipeline and utility rights–of–way. The complaints allege that the railroad, utility and/or pipeline companies from which the Predecessor Company obtained consent to install its fiber optic cable held only an easement in the right–of–way, and that the consent of the adjoining landowners holding the fee interest in the right–of–way did not authorize installation. The complaints allege that because such consent was not obtained, the fiber optic network owned and operated by the Predecessor Company trespasses on the property of putative class members. The complaints allege causes of action for trespass, unjust enrichment and slander of title, and seek injunctive relief, compensatory damages, punitive damages and declaratory relief. By the Petition Date, twenty–two putative class actions remained pending. In the remaining eight cases, class certification had been denied and/or the action had been dismissed. These cases were stayed as a result of the Predecessor Company's bankruptcy filing, initially as a result of the automatic stay provisions of the Bankruptcy Code, and presently by operation of the discharge injunction incorporated into the modified Second Amended Joint Plan of Reorganization. To date, the Bankruptcy Court has denied all motions to lift the automatic stay or the discharge injunction.

Certain of the right–of–way plaintiffs filed individual and/or putative class proofs of claim in the bankruptcy proceedings. To date, the Bankruptcy Court has denied all pending motions to certify classes with respect to these proofs of claim, and has declined to extend the bar date to allow the late–filing of claims by unnamed class members. As a result of these rulings, the Company's exposure in these matters has been substantially reduced.

The Company also is litigating in the Bankruptcy Court, and in several federal appellate courts, the question of whether the discharge injunction contained in the Modified Second Amended Joint Plan of Reorganization bars the initiation or continuation of actions outside of the Bankruptcy Court based on the continued presence of the fiber optic cable after the Company's discharge from bankruptcy. To date, one federal appellate court has agreed with the Company's position, and the Bankruptcy Court recently issued decisions in two right–of–way cases finding that any further prosecution after the bankruptcy violates the discharge injunction.

The Predecessor Company executed a settlement agreement in February 2002 regarding all right–of–way litigation in Louisiana, and in June 2002 regarding all other railroad right–of–way litigation nationwide. However, following the Petition Date, the Predecessor Company opted out of the nationwide settlement agreement because the Oregon court did not approve it, and the Predecessor Company did not elect to proceed to seek approval in Illinois. During the bankruptcy proceedings, the Predecessor Company rejected the Louisiana right–of–way settlement agreement, but has since entered into an agreement in principle to implement the Louisiana agreement as a pre–petition claim against the Predecessor Company. The Company accrued for its estimate to settle the pre–petition litigation as of December 31, 2004 and 2003.

State Tax. In conjunction with the Predecessor Company's bankruptcy claims resolution proceeding, certain states have filed claims concerning the Predecessor Company's state income tax filings and its approach to related–party charges. To date, various states have filed proofs of claims in the aggregate amount of approximately $750 million. In addition, the State of Mississippi has filed a claim in the aggregate amount of approximately $2 billion. The Company is in discussions with the appropriate state taxing officials on these and other similar issues related to state income taxes owed by the Company and its subsidiaries.

On March 17, 2004, the Commonwealth of Massachusetts on behalf of itself and thirteen other states filed a motion to disqualify KPMG from serving as the Company's accountant, auditor and tax advisor on the grounds that KPMG is not disinterested as required by Section 327(a) of the Bankruptcy Code. The Company believes that the filing of this motion was merely a litigation tactic and that the motion has no merit. The bankruptcy court held hearings on the motion, at the conclusion of which the bankruptcy court took the matter under advisement. On June 30, 2004, the bankruptcy court denied this motion and the states have appealed to the Southern District of New York the order denying the motion. That appeal has been stayed pending discussions with the Commonwealth concerning its tax–related proofs of claim against the Company.

Other Investigations. In addition, following WorldCom's June 25, 2002, restatement announcement, various investigations have been initiated by, among others, the U.S. Attorney's Office, and a state agency. These investigations are ongoing and we are cooperating fully in those inquiries.

In the normal course of our business, we are subject to proceedings, lawsuits and other claims, including proceedings under government laws and regulations related to environmental and other matters. Such matters are subject to many uncertainties and outcomes are not predictable with assurance. Consequently, we are unable to ascertain the ultimate aggregate amount of monetary liability or financial impact with respect to these matters at December 31, 2004. While these matters could affect our operating results when resolved in future periods, based on the information available to us today, we do not believe any monetary liability or financial impact would be material.

ITEM 4. *SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS*

No matters were submitted to a vote of security holders during the year ended December 31, 2004, other than matters voted on by holders of our debt securities in the ordinary course of our bankruptcy proceedings.

PART II

ITEM 5. *MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES*

Market Information

Prior to WorldCom's bankruptcy proceedings and continuing through July 29, 2002, shares of WorldCom group common stock and MCI group common stock traded on the NASDAQ National Market under the symbols "WCOM" and "MCIT," respectively. On July 29, 2002, WorldCom issued a press release announcing NASDAQ's decision to delist the shares of the WorldCom group common stock and MCI Group common stock due to WorldCom's July 21, 2002, bankruptcy filing and the pending restatement of WorldCom's financial statements. On July 30, 2002, the shares of WorldCom group common stock and MCI group common stock commenced trading on the over–the counter ("OTC") market under the symbols "WCOEQ" and "MCWEQ." Pursuant to the Plan, all shares of WorldCom group common stock and MCI group common stock were cancelled and rendered null and void on the Emergence Date.

On July 14, 2004, the new MCI common stock began trading on the NASDAQ National Market under the symbol "MCIP". Prior to the listing date, the MCI common stock was trading on a "when issued" basis through April 19, 2004 and after issuance, from April 20, 2004 to July 13, 2004 in the OTC market under the symbols "MCIAV" and "MCIA".

The following table sets forth the high and low bid quotations per share of WorldCom group common stock and MCI group common stock as reported on the OTC market from January 1, 2003 through April 19, 2004 and the MCI common stock from November 3, 2003 through December 31, 2004 as reported on the OTC market and the NASDAQ. The stock price information is based on published financial sources. OTC market quotations reflect inter–dealer prices, without retail mark–up, mark–down or commissions, and may not necessarily represent actual transactions.

As of December 31, 2004, there were 319,557,905 shares of MCI common stock issued and outstanding held by approximately 500 registered holders.

		WorldCom Group Common Stock		MCI Group Common Stock		MCI Common Stock[1]		
	Market	High	Low	High	Low	High	Low	Dividend Rate
2003								
First Quarter	OTC	$ 0.19	$ 0.12	$ 0.31	$ 0.10	$ —	$ —	$ —
Second Quarter	OTC	0.14	0.04	0.22	0.10	—	—	—
Third Quarter	OTC	0.09	0.03	0.38	0.11	—	—	—
Fourth Quarter	OTC	0.07	0.01	0.25	0.02	26.70	22.67	—
2004								
First Quarter	OTC	$ 0.04	$ 0.02	$ 0.13	$ 0.04	$ 26.00	$ 19.50	$ —
Second Quarter	OTC	0.02	0.00	0.08	0.01	22.60	13.00	—
Third Quarter	NASDAQ	—	—	—	—	17.71	13.84	0.40
Fourth Quarter	NASDAQ	—	—	—	—	20.24	15.90	0.40

(1) Share quotations include high and low bids for the "when issued" stock through April 19, 2004 and after issuance, from April 20, 2004 to July 13, 2004, on the OTC market until July 14, 2004. Thereafter, share quotations are for MCI common stock on NASDAQ.

Description of MCI Common Stock

MCI is authorized to issue 3,000,000,000 shares of common stock having a par value of $0.01 ("Common Stock"). Pursuant to the Plan, approximately 296 million shares of Common Stock were issued to settle claims of debt holders, 10 million shares were issued to settle the SEC civil penalty claim and 5.7 million shares were issued to settle the claims of general unsecured creditors. We expect to issue an additional 5.4 million shares of Common Stock to settle the remaining claims of the general unsecured creditors. In addition, approximately 11 million shares of Common Stock were reserved for issuance under the new MCI, Inc. 2003 Management Restricted Stock Plan (of which approximately 8.6 million were issued on the Emergence Date). In addition, the MCI, Inc. 2003 Employee Stock Purchase Plan provides that we may issue approximately 2.2 million shares. These shares may be issued through open market purchases, from treasury shares or from authorized but unissued shares.

Dividends

Pursuant to Section 5.07 of our Plan, on August 5, 2004, the Board of Directors declared the amount of excess cash to be $2.2 billion. On the same date, the Board of Directors declared a cash dividend of $0.40 per share as a return of this shareholder capital. On September 15, 2004, the Company paid $127 million to shareholders of record on September 1, 2004. On October 15, 2004, the Board of Directors authorized another return of shareholder capital distribution in the form of a cash dividend of $0.40 per share. The Company paid the dividend of $127 million on December 15, 2004 to shareholders of record on December 1, 2004. On February 11, 2005, the Board of Directors approved a $0.40 per share dividend payment on March 15, 2005 to shareholders of record as of March 1, 2005.

Pursuant to the terms of the Company's Merger Agreement with Verizon, shareholders will receive a special cash dividend in the amount of $4.10 per share (less the per share amount of any dividend declared by us during the period beginning on February 14, 2005 and ending on the closing date of the merger) after the Merger Agreement is approved by the shareholders.

Securities Authorized For Issuance under Equity Compensation Plans

Pursuant to our Certificate of Incorporation, we are prohibited from issuing stock options for a period of five years from the Emergence Date. As of December 31, 2004, we had 3,358,222 shares common stock available for issuance as restricted stock awards pursuant to the MCI, Inc. 2003 Management Restricted Stock Plan. The MCI, Inc. 2003 Management Restricted Stock Plan was approved pursuant to the plan of reorganization and as such, did not require the approval of the security holders. On February 28, 2005, we granted 3,333,767 shares of restricted stock awards pursuant to the MCI, Inc. 2003 Management Restricted Stock Plan.

ITEM 6. *SELECTED FINANCIAL DATA*

We derived the selected historical consolidated financial data presented below as of and for each of the five years in the period ended December 31, 2004 from our audited consolidated financial statements and related notes thereto included elsewhere in this Annual Report on Form 10–K except for (i) Other Data: "Number of Employees" and year–end stock price, and (ii) the summarized statements of operations for the years ended December 31, 2001 and 2000 and balance sheet data as of December 31, 2002, 2001 and 2000, which were derived from our audited consolidated financial statements not included herein, as adjusted for discontinued operations. You should refer to "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7 of this Annual Report on Form 10–K and the notes to our consolidated financial statements for additional information regarding the financial data presented below, including matters that might cause this data not to be indicative of our future financial condition or results of operations. In addition, readers should note the following information regarding the selected historical consolidated financial data presented below.

- On July 21, 2002, we and substantially all of our direct and indirect domestic subsidiaries filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code. Our plan of reorganization was confirmed by the Bankruptcy Court on October 31, 2003. From the Petition Date to December 31, 2003, our consolidated financial statements were prepared in accordance with SOP 90–7. The consolidated balance sheet as of December 31, 2002 segregates pre–petition liabilities subject to compromise from those pre–petition liabilities that are not subject to compromise and also from post–petition liabilities. Unless otherwise settled, liabilities subject to compromise are reported at the amounts expected to be allowed, even if they may be settled for lesser amounts. Liabilities not subject to compromise are separately classified as current and non–current. Our statements of operations for the years ended December 31, 2004, 2003 and 2002 do not include interest expense on debt subject to compromise subsequent to the Petition Date. Reorganization items include the expenses, realized gains and losses and provisions for losses resulting from our reorganization under the Bankruptcy Code, and are reported separately as reorganization items in our consolidated statements of operations for the years ended December 31, 2003 and 2002. In addition, cash used for reorganization items is disclosed separately in the consolidated statements of cash flows for the years ended December 31, 2003 and 2002. During 2004, we made cash payments of $1.4 billion and issued 5.7 million shares to general unsecured creditors for the settlement of liabilities subject to compromise.

- We restated our previously reported consolidated financial statements for the fiscal years ended December 31, 2001 and 2000. The restatement adjustments (including impairment charges) resulted in reductions of $17.1 billion and $53.1 billion in previously reported net income for the years ended December 31, 2001 and 2000, respectively, and a net reduction of $0.8 billion to shareholders' equity at January 1, 2000. The selected historical consolidated financial data presented below includes all such restatements.

- The selected historical consolidated financial data presented below only includes loss per share information for the year ended December 31, 2004, which is the period subsequent to our adoption of fresh–start reporting and application of a new equity structure. We do not believe that any historical earnings per share information prior to 2004 is relevant in any material respect to users of our financial statements because all existing equity interests issued prior to emergence were eliminated (without a distribution) upon the consummation of our confirmed plan of reorganization. In addition, the creation of the two class common stock structure (WorldCom group common stock and MCI group common stock) in July 2001 would require a separate determination of net income or loss generated by the WorldCom group and MCI group in order to present earnings (loss) per share information. Primarily as a result of the extensive recreation of many of our historical financial entries that was required in order to complete our restatement process, many revenue and expense items cannot be allocated to the appropriate group, making a determination of separate net income or loss information for each group impracticable.

- Included in our net loss for 2004 are pre–tax property, plant and equipment and intangible asset impairment charges of $3.5 billion (after–tax $3.4 billion). Given the market, business and regulatory

conditions, we reevaluated our financial forecasts and strategy in the third quarter of 2004 when it became apparent that these trends would continue into the future. Refer to *"Item 7—Management's Discussion and Analysis of Financial Condition and Results of Operations—Impairment Charges"* for additional discussion.

- During 2004, we identified certain non-core assets to be disposed of under SFAS No. 144, *"Accounting for the Impairment or Disposal of Long-Lived Assets,"* ("SFAS No. 144") which included: (1) our 19% equity interest in Embratel Participações S.A. and subsidiaries ("Embratel"), (2) Proceda Tecnologia e Informatica S.A. ("Proceda"), an information technology outsourcing company in Brazil, and (3) OzEmail Pty. Ltd ("OzEmail"), an Internet service provider providing dial-up, broadband and wireless products to Australian consumers and small business enterprises. On July 23, 2004, we completed the divestiture of our interest in Embratel and received $400 million, recognizing a small gain on the sale within discontinued operations in our consolidated statement of operations. On December 2, 2004, we completed the divestiture of Proceda for $3 million. On February 28, 2005, we completed the divestiture of OzEmail for approximately $86 million and will record a gain of approximately $80 million in discontinued operations in our 2005 consolidated statement of operations. In accordance with SFAS No. 144 for all three of these operations, we reclassified revenue of $3.0 billion, $3.7 billion, $4.7 billion and $4.8 billion for the years ended December 31, 2003, 2002, 2001, and 2000, respectively, and increased (decreased) our loss from discontinued operations in our consolidated statements of operations by $25 million, $57 million, $1.1 billion and $(3) million for the years ended December 31, 2003, 2002, 2001, and 2000, respectively. Additionally, as a result of the sale of Embratel and Proceda, we removed approximately $3.8 billion of assets, approximately $2.3 billion of liabilities, and approximately $1.1 billion in minority interest from our consolidated balance sheet as of the date of disposal.

- In June 2003, we decided and received bankruptcy approval to dispose of our MMDS business. MMDS included network equipment, licenses and leases utilized for the provision of wireless telecommunications services via Multichannel Multipoint Distribution Service. As a result, we reclassified to discontinued operations under SFAS No. 144 revenue of $13 million, $60 million and $93 million for the years ended December 31, 2002, 2001, and 2000, respectively, and increased our loss from discontinued operations in the consolidated statements of operations from MMDS by $55 million, $1.2 billion and $130 million for the years ended December 31, 2002, 2001, and 2000, respectively. We completed the sale in May 2004 and received $144 million in cash for the assets, which was equal to their carrying value.

- Included in our net loss for 2002, 2001 and 2000 are property, plant and equipment and goodwill and other intangible asset impairment charges of $5.0 billion, $12.8 billion and $47.2 billion, respectively. These charges were recorded as a result of experiencing continued significant decreases in projected revenue and operating profit and significant weakness in the business climate over this three-year period. We performed impairment analyses and calculated the fair value of our long-lived assets with the assistance of an independent third party valuation specialist using a combination of discounted cash flows and market valuation models based on competitors' multiples of revenue, gross profit and other financial ratios. These impairment charges are shown separately as a component of operating loss within the consolidated statements of operations, excluding $1.6 billion, $1.2 billion and $249 million impairment charges for Embratel, MMDS and our wireless business, respectively, in 2001 which are included in discontinued operations.

- On July 1, 2001, we acquired Intermedia for approximately $3.9 billion, including the assumption of approximately $2.0 billion of Intermedia's long-term debt, pursuant to a merger transaction in which Intermedia became one of our subsidiaries. The results of Intermedia's operations have been included in our consolidated statements of operations from the acquisition date. As part of the acquisition, we recorded $4.2 billion in goodwill, which we subsequently determined was impaired in 2001. Accordingly, as part of our impairment analysis and included in the amounts discussed above, we reduced the carrying value of goodwill associated with the Intermedia acquisition to zero. Included in the 2001 goodwill impairment charge was $1.5 billion related to our majority interest in Digex, acquired as part of our acquisition of Intermedia.

We adopted fresh-start reporting under the provisions of SOP 90-7 as of December 31, 2003. Upon adoption, our reorganization value was $14.5 billion and was allocated to our assets and liabilities. Our assets were stated at fair value in accordance with SFAS No. 141 and liabilities were recorded at the present value of amounts estimated to be paid. In addition, our accumulated deficit was eliminated, and our new debt and equity were recorded in accordance with distributions pursuant to the Plan. The adoption of fresh-start reporting had a material effect on our consolidated financial statements. As a result, our consolidated balance sheet as of December 31, 2003 and 2004 included in this Annual Report on Form 10-K and our consolidated financial statements published for periods following December 31, 2003 will not be comparable with those published before such date.

	Successor Company	Predecessor Company			
	As of or for the Year Ended December 31,				
	2004	2003	2002	2001	2000
	(Dollars in Millions, except per share amount)				
Results of Operations[1]:					
Revenues	$20,690	$24,266	$ 28,493	$ 32,913	$ 34,417
Other operating expenses	20,368	23,606	27,818	31,544	36,530
Impairment charges	3,513	—	4,999	9,855	47,180
Operating (loss) income	(3,191)	660	(4,324)	(8,486)	(49,293)
(Loss) income from continuing operations	(4,028)	22,469[3]	(8,939)	(11,902)	(47,228)[6]
Net income (loss) from discontinued operations	26	(43)	(202)	(3,696)	(574)
Net (loss) income attributable to common shareholders	(4,002)	22,211	(9,192)	(15,616)	(47,802)[6]
Loss from continuing operations per common share:					
Basic	(12.56)				
Diluted	(12.56)				
Other Data:					
Number of employees at year-end[2]	40,400	56,600	62,700	87,800	97,600
Cash dividends declared per common share	$ 0.80	$ —	$ —	$ 1.80	$ —
Year-end stock price per share[5]	20.16	23.55	N/A	N/A	N/A

	Successor Company	Predecessor Company			
	As of December 31,				
	2004	2003[4]	2002	2001	2000
	(In Millions)				
Financial Position:					
Cash and cash equivalents	$ 4,449	$ 6,178	$ 2,820	$ 1,290	$ 382
Marketable securities	1,055	15	40	18	2
Property, plant and equipment, net	6,259	11,538	14,190	21,486	24,477
Total assets	17,060	27,470	26,762	33,706	44,188
Long-term debt, excluding current portion	5,909	7,117	1,046	29,310	17,184
Liabilities subject to compromise	—	—	37,154	—	—
Minority interests and preferred stock subject to compromise	—	—	1,904	—	—
Mandatorily redeemable preferred securities	—	—	—	1,855	752
Shareholders' equity (deficit)	4,230	8,472	(22,295)	(12,941)	1,792

(1) Reflects the reclassification of Embratel, Proceda and OzEmail to discontinued operations in 2001, 2002, and 2003. In 2000, the results of Embratel and Proceda were reclassified to discontinued operations, however, the results of OzEmail were not reclassified as we have determined that it is impracticable to do so.

(2) Excludes Embratel employees for all periods presented

(3) Income from continuing operations for 2003 includes a $22.3 billion reorganization gain due to the effects of our Plan upon the adoption of fresh-start reporting as of December 31, 2003. Refer to Note 5 to our consolidated financial statements included elsewhere in this Annual Report on Form 10-K for a description of the components of the gain.

(4) The consolidated balance sheet as of December 31, 2003 gives effect to the application of fresh-start reporting. Refer to Note 4 to our consolidated financial statements included elsewhere in this Annual Report on Form 10-K for the adjustments recorded upon adoption.

(5) Includes only the year-end price for new MCI common stock issued on the Emergence Date based on NASDAQ as of December 31, 2004 and on a "when issued" basis as of December 31, 2003.

(6) In 2004, we estimated the effects of amending our federal income tax returns for 1999 through 2003 to reflect the impact of the restatement of our previously issued consolidated financial statements. In connection with this work, an adjustment of $1.1 billion was identified that increased income tax expense and income tax benefit for the years ended December 31, 1999 and December 31, 2000, respectively. The additional tax benefit for the year ended December 31, 2000 has been reflected in the table above. Shareholders' equity at December 31, 2000 was not impacted.

ITEM 7. *MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS*

The information in this Management's Discussion and Analysis and elsewhere in this document contains certain forward–looking statements, which reflect our current view with respect to future events and financial performance. Wherever used, the words "believes," "estimates," "expects," "plans," "anticipates" and similar expressions identify forward–looking statements. Any such forward–looking statements are subject to risks and uncertainties that could cause our actual results of operations to differ materially from historical results or current expectations. See "Cautionary Statement Regarding Forward–Looking Statements" on page 1 and "Item 1—Business—Risk Factors."

Business Overview

We are one of the world's leading global communication companies, providing a broad range of services in over 200 countries on six continents. Each day, we provide Internet, data and voice communication services for thousands of businesses and government entities throughout the world and millions of consumer customers in the United States. We operate one of the most extensive communications networks in the world, comprising approximately 100,000 route miles of network connections linking metropolitan centers and various regions across North America, Europe, Asia, Latin America, the Middle East, Africa and Australia. In addition to transporting customer traffic over our network, we provide value–added services that make communications more secure, reliable and efficient, and we provide managed network services for customers that outsource all or portions of their communications and information processing operations.

Since April 2003, we have conducted our business primarily using the brand name "MCI." As part of our financial reorganization, our predecessor company, WorldCom, was merged with and into MCI in April 2004. References herein to MCI, we, our and us are to MCI, Inc. and its subsidiaries and the Predecessor Company unless the context otherwise requires.

In March 2004, we realigned our operations into three new business segments and began operating under these segments in the second quarter of 2004. Effective with the realignment, our business segments are as follows:

- **Enterprise Markets** serves Global Accounts, Government Markets, and System Integrators. Global Accounts provides communications and network solutions to large multinational corporations requiring complex international network services. Government Accounts provides similar services to various government agencies. System Integrators serve customers through partnerships with third–party network solutions providers. In all cases, these services include local–to–global business data, Internet, voice services and managed network services.

- **U.S. Sales & Service** serves small, mid–sized and corporate customers. In addition, U.S. Sales & Service comprises MCI's consumer operation which includes telemarketing, customer service and direct response marketing.

- **International & Wholesale Markets** serves businesses, government entities and telecommunications carriers outside the United States as well as the wholesale accounts previously included in Business Markets.

On February 14, 2005, Verizon, MCI and a wholly–owned subsidiary of Verizon entered into an Agreement and Plan of Merger. The Merger Agreement provides that, upon the terms and subject to the conditions set forth in the Merger Agreement, MCI will merge with and into the Verizon subsidiary, with Merger Sub continuing as the surviving person (or, in certain situations, as provided in the Merger Agreement, a wholly–owned corporate subsidiary of Verizon will merge with and into MCI, with MCI as the surviving person.)

At the effective time and as a result of the Merger, MCI will become a wholly–owned subsidiary of Verizon and each share of MCI common stock will be converted into the right to receive (x) 0.4062 shares of Verizon common stock and (y) cash in the amount of $1.50 per share, which amount of cash and number of shares may be reduced pursuant to a purchase price adjustment based on MCI's bankruptcy claims and for certain tax liabilities, on the terms specified in the Merger Agreement. The Merger Agreement also provides for payment of a special cash dividend in the amount of $4.10 per share (less the per share amount of any dividend declared by the Company during the period beginning February 14, 2005 and ending on the closing date of the merger) of MCI common stock after the Merger Agreement is approved by the shareholders. All outstanding MCI stock–based awards at the effective time will be replaced by a grant of Verizon stock–based awards.

Consummation of the Merger is subject to customary conditions, including (i) approval of the shareholders of MCI, (ii) expiration or termination of the applicable Hart–Scott–Rodino waiting period and receipt of certain other federal, state or international regulatory approvals, (iii) absence of any law or order prohibiting the closing, (iv) subject to certain exceptions, the accuracy of representations and warranties and the absence of any Material Adverse Effect (as defined in the Merger Agreement) with respect to each party's business. In addition, Verizon's obligation to close is subject to other conditions, including (i) absence of any pending U.S. governmental litigation with a reasonable likelihood of success seeking to prohibit the closing or to impose certain limitations, (ii) receipt of a bankruptcy order issued by the Unites States Bankruptcy Court for the Southern District allowing for the substitution of shares of Verizon common stock for shares of MCI common stock to satisfy certain bankruptcy–related claims, and (iii) receipt of an order issued by the United States District Court for the Southern District of New York relating to MCI's Corporate Monitor and certain affirmative obligations imposed by prior order of the United States District Court for the Southern District of New York. The Merger Agreement contains certain termination rights for both MCI and Verizon, and further provides that, upon termination of the Merger Agreement under specified circumstances, MCI may be required to pay Verizon a termination fee of $200 million.

Consummation of the Merger will constitute a "Change of Control" under MCI's outstanding Senior Notes, which will obligate the surviving person to make an offer to purchase such Notes within 30 days after the effective time at a purchase price equal to 101% of principal amount plus accrued interest.

The communications industry has undergone significant changes in recent years, including severe price competition resulting in part from excess network capacity due to overbuilding and the substitution of email, instant messaging and wireless telephone service for traditional wireline voice communications. Other important changes in our industry are the entry of new competitors, such as Verizon and the other RBOCs into the long distance market, and cable television and other companies into the consumer telephony business. Also, there have been regulatory changes making it more difficult for competitive local exchange carriers like us to provide traditional telephone service, particularly to consumer customers, in competition with the RBOCs and other incumbent local exchange carriers. At the same time, technology changes are enabling the development of advanced networking services primarily based on IP communications and customer demand is increasing for such value–added services, including network monitoring, traffic analysis and management and comprehensive security solutions. MCI believes that consummation of the merger transaction will add new strength to the telecommunications services both companies provide and help the combined company better face these changing conditions. The merger will ensure that consumers and businesses will have a supplier with the financial strength to maintain and improve MCI's Internet backbone network and will mean better service for enterprise customers by enhancing the combined company's ability to compete for and serve large–business and government customers with a complete range of services, including wireless and the most sophisticated IP based services. See *"Item 1—Risk Factors—The merger with Verizon may not occur or, if it does, may not provide all the anticipated benefits."*

On February 24, 2005, we received a revised proposal from Qwest Communications International, Inc. to acquire us. Our board of directors announced that it would conduct a thorough review of the Qwest proposal. On March 2, 2005, we announced our intention to engage with Qwest to review its February 24, 2005 proposal. This decision was made with the concurrence of Verizon. Subsequently, MCI and Qwest have been in ongoing discussions regarding Qwest's proposal. These discussions are continuing as of the date of filing of this Annual Report on Form 10–K.

Voluntary Reorganization under Chapter 11, Restatements, Reclassifications and Adjustments to Previously Issued Consolidated Financial Statements

On the Petition Date, WorldCom, Inc. and substantially all of its direct and indirect domestic subsidiaries filed voluntary petitions for relief in Bankruptcy Court under Chapter 11. On November 8, 2002, WorldCom filed bankruptcy petitions for an additional 43 of its domestic subsidiaries, most of which were effectively inactive and none of which had significant debt. Between the Petition Date and the Emergence Date, the Debtors continued to operate their businesses and manage their properties as debtors–in–possession. In addition, most litigation against the Debtors was stayed. We emerged from bankruptcy on April 20, 2004.

In June 2002, we announced that, as a result of an internal audit of our capital expenditure accounting, it was determined that certain transfers from line cost expenses (also referred to as access cost expenses) to capital accounts during 2001 and the first quarter of 2002 were not made in accordance with GAAP. We promptly notified Andersen, which had been our external auditor until May 2002, had audited our consolidated financial statements for 2001 and 2000, and had reviewed our interim condensed financial statements for the first quarter of 2002. On June 24, 2002, Andersen advised us that, in light of the inappropriate capitalization of access costs, Andersen's audit report on our consolidated financial statements for 2001 and its review of our interim condensed consolidated financial statements for the first quarter of 2002 could not be relied upon. We also promptly notified KPMG, who had been retained in May 2002 as our external auditor, and engaged them to audit the consolidated financial statements for the years ended December 31, 2001 and 2000.

In conjunction with our restatement and through December 31, 2002 a number of balances or entries recorded in the historical accounting records could not be supported or their propriety otherwise determined. Because there was no documentary support related to these items we were unable to determine the appropriate statement of operations line item to which such amounts should be applied. As a result, these amounts have been included within operating expense and noted as "Unclassified, net" in the consolidated statement of operations for the year ended December 31, 2002.

During 2004, we determined that we had recorded in error a restatement entry which had the effect of reducing accounts receivable by $301 million through a charge to expense in the year ended December 31, 2000. The reported 2000 net loss of $48.9 billion should have been $48.6 billion, or 0.5% lower, and our assets of $44.2 billion should have been $44.5 billion, or 0.6% higher. In 2001, $35 million of the amount reversed and left a remaining $266 million understatement of accounts receivable as of December 31, 2001. This situation remained unchanged until, as a result of the application of fresh–start reporting as of December 31, 2003, the previously expensed $266 million was reversed in our statement of operations as a component of the $22.3 billion reorganization gain. Without this expense reversal, our 2003 net income of $22.2 billion would have been $21.9 billion, or 1.2% lower. As a result of the reversal of the expense in 2003, the cumulative impact to our December 31, 2003 consolidated retained earnings was zero. We assessed the impact on the 2000, 2001 and 2003 statements of operations as well as the consolidated balance sheets as of December 31, 2000, 2001, 2002 and 2003, and determined that the impact was not material to any period.

The impact of this reduction of accounts receivable in the consolidated balance sheet as of December 31, 2003 resulted in a misclassification of $266 million between accounts receivable and long–lived assets in our allocation of reorganization value under fresh–start reporting. To properly reflect the allocation of reorganization value as of December 31, 2003, we have reflected a reclassification entry in our consolidated balance sheet as of December 31, 2003, as presented herein, to reflect an increase of $266 million to our accounts receivable balance and reductions in our property, plant and equipment and intangible assets.

The adjustment of this item also resulted in a decrease to our long–term deferred tax liability by $6 million which has been reflected in the consolidated balance sheet as of December 31, 2003.

Impairment Charges

We assess recoverability of our indefinite–lived and long–lived assets to be held and used whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. Impairment analyses of long–lived and indefinite–lived assets are performed in accordance with SFAS No. 144, and SFAS No. 142, *"Goodwill and Other Intangible Assets"* ("SFAS No. 142"). Impairment evaluations are performed at the lowest asset or asset group level for which identifiable cash flows are largely independent of the cash flows of other assets or asset groups. We generate most of our cash flows from products and services that are principally delivered to customers over our integrated telecommunications network and related intangible assets. Therefore, evaluations are performed at the entity level, excluding discontinued operations and assets held for sale, as a single group.

The industry is in a state of transition where traditional business lines are facing significant overcapacity in the marketplace, pricing pressures, changes in product mix, and customers' continued efforts to reconfigure and consolidate their networks in order to achieve lower overall costs and improved efficiencies. Concurrently, the industry is migrating to more advanced network technologies and primarily focused around IP based platforms, and customers are requiring more advanced network services including network monitoring, traffic analysis, and comprehensive security solutions. The industry has also seen a general migration of customers from dial–up services to broadband and various wireless services. Additionally, our regulatory climate deteriorated due to a decision by the D.C. Circuit that invalidated the FCC's February 2003 *Triennial Review Order* local competition rules, which set prices that incumbent providers could charge competitive providers such as the Company for UNE–P, an essential component of our Mass Market local phone service. Although several petitions were filed at the Supreme Court seeking review of the D.C. Circuit's decision, the Solicitor General and the FCC declined to seek such review, and the Supreme Court subsequently denied the petitions. As of the date of our impairment test, the FCC had adopted interim unbundling rules (effective September 13, 2004) to maintain certain ILEC unbundling obligations under interconnection agreements as they existed prior to the D.C Circuit's mandate. As a result, our costs for providing this service were expected to increase significantly in 2005. Some of our competitors announced their intentions to exit from this market, and the cost increases may force us to reduce efforts to acquire new customers and withdraw from certain markets. We therefore anticipated that revenues from that segment would continue to decline.

Given the market, business and regulatory conditions, we reevaluated our financial forecasts and strategy in the third quarter of 2004 when it became apparent that these trends would continue into the future. Updated cash flow and profitability projections and forecasts were developed taking into account both the 2004 changes in the competitive landscape and the regulatory issues facing us. Our executives reviewed these projections with the Audit Committee of the Board of Directors during the third quarter.

Based on the revised projections, we determined that an impairment analysis of our indefinite–lived and long–lived assets was required during the third quarter of 2004. In connection with this analysis, we evaluated our property, plant and equipment and definite and indefinite–lived intangible assets, including customer lists. We developed estimates of future undiscounted cash flows to test the recoverability of our long–lived and indefinite–lived assets. These estimates were compared to the carrying values of the assets, which resulted in the conclusion that we could not recover our carrying values through projected future operations. With the assistance of an independent third party valuation specialist, we further calculated the fair value of our long–lived and indefinite–lived assets based on the discounted cash flow analyses that utilized the revised management projections of revenues and profitability from September 1, 2004 through 2009. These projections were used in various scenarios utilizing a weighted average cost of capital between 10%–14%, a 2% terminal growth rate, certain working capital assumptions and total entity value assumptions.

We concluded that the carrying values of our definite–lived assets exceeded their estimated fair values by approximately $3.3 billion ($2.8 billion related to property, plant and equipment and $478 million related to definite–lived intangible assets) and the carrying value of an indefinite–lived asset exceeded its estimated fair

value by approximately $260 million. These amounts represented the difference between the calculated fair values of the assets and their associated carrying values, and were recorded as a separate component of operating expenses in 2004. Our management reviewed the results of the impairment analysis with the Board of Directors, and the Board of Directors approved the impairment charges on October 15, 2004.

As a result of the impairment charge of approximately $260 million to an indefinite–lived intangible asset, we recognized a $99 million tax benefit which reduced our long–term deferred tax liability as the impairment reduced the difference between the book and tax basis. The impairment charges, after taxes, contributed approximately $3.4 billion to our 2004 net loss (loss per share of $(10.64)).

Discussion of Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in conformity with GAAP. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. We evaluate our assumptions and estimates on an ongoing basis and may employ outside experts to assist in our evaluations. We believe that the estimates we use are reasonable; however, actual results could differ from those estimates. Our significant accounting policies are described in Note 2 to the consolidated financial statements included elsewhere in this Annual Report on Form 10–K. The following describes our most critical accounting policies:

Accounting and Reporting During Reorganization

We operated as debtors–in–possession from July 21, 2002 to the Emergence Date and adopted the provisions of SOP 90–7 upon commencement of our Bankruptcy Court proceedings. Our consolidated financial statements for the periods from July 21, 2002 through December 31, 2002 and from January 1, 2003 through December 31, 2003 have been prepared in accordance with the provisions of SOP 90–7. Interest was not accrued on debt subject to compromise subsequent to the Petition Date. Reorganization items include the expenses, realized gains and losses, and provisions for losses resulting from the reorganization under the Bankruptcy Code, and they are reported separately as reorganization items in our consolidated statements of operations.

We adopted fresh–start reporting under the provisions of SOP 90–7 as of December 31, 2003 and, accordingly, our reorganization value was allocated to our assets. Our assets were stated at fair value in accordance with SFAS No. 141 and liabilities were recorded at the present value of amounts estimated to be paid. Included in the allocation were estimates based on various assumptions and reflects our judgment based upon our prior pre–petition claims settlement history and the terms of our plan of reorganization and, if these assumptions prove incorrect, actual payments could differ from the estimated amounts. Changes in estimates and preconfirmation contingencies are reflected in the statements of operations as they are determined, whereas changes in the allocation of fair values resulted in adjustments to the assets and liabilities. In addition, our accumulated deficit was eliminated, and our new debt and equity were recorded in accordance with distributions pursuant to the Plan. The adoption of fresh–start reporting has had a material effect on our consolidated financial statements. See Notes 4 and 5 to our consolidated financial statements included elsewhere in this Annual Report on Form 10–K for further discussion of the provisions of SOP 90–7.

Revenue and Associated Allowances for Revenue Adjustments and Doubtful Accounts

We recognize revenue when a sales arrangement exists, delivery has occurred or services have been rendered, the sale price is fixed and determinable, and collectibility is reasonably assured. The preparation of our consolidated financial statements requires us to make estimates and assumptions that affect the reported amount of revenues and expenses for the periods presented. Specifically, management makes estimates of future customer credits through the analysis of historical trends and known events. Significant management judgments and estimates must be made and used in connection with establishing the revenue allowances associated with discounts earned on certain customer agreements, billing allowances for pricing changes and customer disputes.

The provisions for revenue adjustments are recorded as a reduction of revenue when incurred or ratably over a contract period. Since the revenue allowances are recorded as an offset to revenue, any future increases or decreases in the allowances will positively or negatively impact revenue by the same amount.

Similarly, our management must make estimates regarding the collectibility of our accounts receivable. Management specifically analyzes accounts receivable, including historical bad debts, customer concentrations, customer creditworthiness and current economic trends, when evaluating the adequacy of the allowance for doubtful accounts. Increases or decreases in our allowance for doubtful accounts will impact our selling, general and administrative expenses.

Access Costs

Access costs are costs incurred for transmission of voice and data over other carriers' networks. These costs consist of both fixed payments and variable amounts based on actual usage and negotiated or regulated contract rates. We expense access costs as incurred. Accordingly, at each balance sheet date, we record our best estimate of the access costs incurred but not yet billed based on internal usage reports. Once we receive an invoice from a carrier, a process of reconciling that carrier's invoice to our internal usage reports begins. In certain cases, this reconciliation process can take several months to complete. Once the reconciliation is complete, we agree with the carrier on the final amount due. In most cases, this process does not result in significant adjustments to our estimates. Accordingly, at each balance sheet date, we accrue access costs for estimated expenses that have not yet been billed by other carriers and for amounts for which the reconciliation of the carriers' invoices to our internal usage reports has not been completed. Due to the complexity of the systems that capture usage information and the number of different negotiated and regulated rates, accounting for access costs requires a significant amount of estimation.

Valuation and Recoverability of Long-lived Assets

As of December 31, 2004, property, plant and equipment represented $6.3 billion and intangible assets represented $1.0 billion of our $17.1 billion in total assets. Accounting for our long-lived assets requires certain significant estimates regarding their expected useful lives and recoverability.

We record at cost our purchases of property, plant and equipment and other long-lived assets and those improvements that extend the useful life or functionality of the underlying assets. We depreciate those assets on a straight-line basis over their estimated useful lives. The estimated useful lives for transmission equipment is four to 30 years, five to nine years for telecommunications equipment, four to 39 years for furniture, fixtures, buildings and other property, plant and equipment, and three to six years for software. These useful lives are determined based on historical usage with consideration given to technological changes and trends that could impact our network architecture and asset utilization. Accordingly, in making these assessments, we consider the views of internal and outside experts regarding the impact of technological advances and trends on the value and useful lives of our network assets. We periodically reassess the remaining useful lives of our assets and make adjustments as necessary. When such an adjustment is required, we depreciate the remaining book value over the updated remaining useful life. Any increases or decreases in the remaining useful lives of our assets could have a significant effect on our consolidated results of operations in the future.

We review our indefinite-lived intangibles for impairment annually or whenever events or circumstances indicate that the carrying amount may not be recoverable. Property, plant and equipment and other definite-lived intangibles are evaluated for recovery under the provisions of SFAS No. 144. We operate an integrated telecommunications network. All assets comprising this network, related intangible assets, and the related cash flows are aggregated for the purpose of the impairment review because this aggregated level is the lowest level at which identifiable cash flows are largely independent of the cash flows of other groups of assets. This review requires us to make significant assumptions and estimates about the extent and timing of future cash flows, remaining useful lives, discount rates and growth rates. The cash flows are estimated over a significant future

period of time, which makes those estimates and assumptions subject to a high degree of uncertainty. We also utilize market valuation models and other financial ratios which require us to make certain assumptions and estimates regarding the applicability of those models to our assets and businesses. In addition, we engage independent third party valuation specialists to assist us in our determination of estimated fair values of our assets.

Accounting for Income Taxes

We recognize deferred income tax assets and liabilities for the expected future tax consequences of transactions and events. Under this method, deferred income tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. If necessary, deferred income tax assets are reduced by a valuation allowance to an amount that is determined to be more likely than not recoverable. We must make significant estimates and assumptions about future taxable income and future tax consequences when determining the amount of the valuation allowance. In addition, tax reserves are based on significant estimates and assumptions as to the relative filing positions and potential audit and litigation exposures related thereto.

Consolidated Results of Operations

Our industry continues to go through a state of rapid transition with excess capacity and technological change placing pricing pressures on traditional business lines. At the same time, advanced networking capabilities primarily focused on IP platforms are creating new services around network design, monitoring and comprehensive security solutions. Prior to 2002, our business was significantly expanded through numerous acquisitions and large capital expenditure programs which contributed to a sharp increase in our outstanding debt. In 2002, we filed for reorganization under the U.S. bankruptcy laws. As a result, we undertook various initiatives to lower our operating costs, including the reduction of headcount of approximately 47,000 from the end of 2001 to the end of 2004, the elimination of excess facilities, investment in automation, and billing platform integrations. In addition, we undertook various initiatives with the near–term objective of minimizing further decreases in our revenues, including focusing on the acquisition and retention of enterprise customers and continuing to invest in new products and services. We believe that the cumulative effects of our cost reduction efforts and the successful execution of our business strategy should enable us to improve our consolidated operating results.

As a result of the FCC's new unbundling rules on remand from the D.C. Circuit in the *Triennial Review Order* proceedings, we have been forced to raise residential phone services prices in some markets and may be forced to pull out of others, and have reduced our sales efforts pending clarity on our future pricing structure. We may take more significant action once state proceedings, and appeals on the matter have been completed.

We expect revenues to continue to decline in 2005. The most significant portion of the decline will be in our Mass Markets business within our U.S. Sales & Service segment, which still faces intense regulatory and competitive pressures. We may also experience declines in our wholesale business within our International & Wholesale Markets segment as we continue to strive to achieve higher margins in this business.

Through July, 2004, we also owned approximately a 19% economic interest and a 52% voting interest in Embratel, which is a Brazilian voice and data communications company that is operated by its own management and employees. During 2004, we sold our interest in Embratel and received $0.4 billion. We also sold Proceda, our information technology outsourcing company in Brazil, during 2004. In July 2004, we began to market OzEmail, an Internet service provider providing dial–up, broadband and wireless products to Australian consumers and small business enterprises, for sale. On February 28, 2005, we completed the divestiture of OzEmail for approximately $86 million. For 2004, 2003, and 2002, all of the results of operations of Embratel and associated Latin American operations, Proceda, and OzEmail that were previously included in our consolidated results from continuing operations were reclassified to discontinued operations.

Our 2003 and 2002 consolidated financial statements have been prepared in accordance with SOP 90–7, which requires an entity's statement of operations to portray the results of operations of the reporting entity during Chapter 11 proceedings. As a result, any revenues, expenses, realized gains and losses, and provisions resulting from our reorganization are reported separately as reorganization items, except those required to be reported as discontinued operations in conformity with SFAS No. 144.

The following table sets forth, for the periods indicated, our consolidated statements of operations (in millions):

	Successor Company	Predecessor Company	
	Year Ended December 31,		
	2004	2003	2002
Revenues:			
Voice	$12,663	$14,634	$15,994
Data	5,372	6,481	7,939
Internet	2,655	3,151	4,560
Total revenues	20,690	24,266	28,493
Operating expenses:			
Access costs	10,719	11,997	13,304
Costs of services and products (excluding depreciation and amortization included below of $1,436, $1,938 and $2,356 in 2004, 2003 and 2002, respectively)	2,506	2,771	3,461
Selling, general and administrative	5,220	6,479	8,062
Depreciation and amortization	1,924	2,316	2,903
Unclassified, net	—	—	(35)
(Gain) loss on property dispositions	(1)	43	123
Impairment charges related to property, plant and equipment	2,775	—	4,599
Impairment charges related to intangible assets	738	—	400
Total	23,881	23,606	32,817
Operating (loss) income	(3,191)	660	(4,324)
Other income (expense), net:			
Interest expense (contractual interest of $2,425 in 2003 and $2,360 in 2002)	(402)	(105)	(1,354)
Miscellaneous income (expense), net (includes a $2,250 SEC fine in 2002)	85	136	(2,221)
Reorganization items, net	—	22,087	(802)
(Loss) income from continuing operations before income taxes, minority interests and cumulative effects of changes in accounting principles	(3,508)	22,778	(8,701)
Income tax expense	520	313	258
Minority interests, net of tax	—	(4)	(20)
(Loss) income from continuing operations before cumulative effects of changes in accounting principles	(4,028)	22,469	(8,939)
Net income (loss) from discontinued operations	26	(43)	(202)
(Loss) income before cumulative effects of changes in accounting principles	(4,002)	22,426	(9,141)
Cumulative effects of changes in accounting principles	—	(215)	(32)
Net (loss) income	(4,002)	22,211	(9,173)
Distributions on preferred securities (contractual distributions of $31 in 2003 and $35 in 2002)	—	—	(19)
Net (loss) income attributable to common shareholders	$(4,002)	$22,211	$(9,192)

The following is a discussion of our consolidated results of operations for 2004, 2003 and 2002.

Revenues. Revenues are comprised of long distance voice, local voice, data and Internet services, as well as network technology solutions. We provide local, long distance and international voice communication services to our business customers. High–volume customers are connected to our global voice network through dedicated access lines, while lower volume customers are connected through switched access provided either by us or an ILEC. We also provide calling cards, voice messaging, speed dialing, and information service access to our business customers, as well as other value–added voice communication services such as VoIP. To our residential customers, we offer not only long distance, local, and high–speed Internet access services, but also bundled packages such as "the Neighborhood", and various transaction services such as 1–800–COLLECT. Revenues derived from long distance and local voice services are recognized at the time of customer usage, and are based upon minutes of traffic carried and upon tariff or contracted fee schedules.

Data services include utilization of our frame relay, asynchronous transfer mode and IP networks to provide high bandwidth data transmission services over both public and private networks. Revenues from data services are recorded at the time service is provided based on monthly service fees. Internet services include access services built around our global Internet backbone, Internet–based virtual private networks ("IP VPN"), PIP networks, and web hosting services. Revenue derived from Internet services is recognized at the time the service is provided.

We also derive a portion of our revenues from the sale and installation of telecommunications equipment, including central office based remote access equipment.

During 2004, revenues decreased by $3.6 billion as compared to 2003. Voice services decreased $2.0 billion in 2004 as compared to 2003. Long distance voice revenues declined $2.1 billion, primarily driven by lower rates and volumes which impacted revenues by $1.1 billion and $1.0 billion, respectively. Long distance revenues continue to be impacted by segment mix. While overall long distance volumes declined by approximately 5%, segment mix was negatively impacted by a 23% decline in Mass Markets, driven by our decision to close selected call centers. Local voice revenues increased $0.1 billion, primarily due to growth in our Mass Markets customer base during the first half of 2004. Due to recent regulatory decisions impacting our consumer business, we will be forced to raise residential local phone service prices in some markets in 2005 and may be forced to pull out of others. Data services revenues decreased $1.1 billion, mainly due to continued rate pressure and technology substitution to IP services. Internet services decreased $0.5 billion, mainly due to the general migration of customers from dial–up services to broadband services. Included in our revenue declines were increases of $0.3 billion and $0.1 billion ($66 million in the fourth quarter) attributable to changes in foreign currency exchange rates and changes in estimates and other items, respectively.

During 2003, revenues decreased by $4.2 billion as compared to 2002. Voice services declined $1.4 billion reflecting lower retail and wholesale price levels from our business customers, which primarily resulted from the entrance of RBOCs into the long distance market, and lower rates in our consumer markets, which were due to product substitution to wireless phones, e–mail and prepaid cards, increased competition, and customer migration to lower–priced calling plans. We also experienced lower volumes in our subscription services, offset by higher wholesale volumes, and higher local volumes in our consumer market. The local volumes increased as we added customers while expanding the area in which we offer local services through using unbundled network elements in an increasing number of states. Data services revenues declined $1.4 billion primarily due to price decreases resulting from excess capacity in the marketplace and lower volumes due to weak market demand. Internet revenues decreased $1.4 billion mainly due to the general migration of customers from dial–up to broadband services, industry competition and pricing pressures negatively impacting both our wholesale and retail Internet services revenue.

Operating Expenses

Access costs. Access costs include costs incurred for the transmission of voice and data traffic over domestic and international networks that we do not own. Access costs also include contributions to the Universal

Service Fund ("USF") which are paid to a government–established agency, passed on to our customers and included in our revenues. Access costs as a percentage of revenues were 52% for 2004 as compared to 49% for 2003 and 47% for 2002. Access costs as a percentage of revenues increased in 2004 as compared to 2003, as declines in revenue driven by competitive rate pressure exceeded access cost reductions. In an effort to mitigate negative pricing trends, we continue to focus on an array of access cost reduction programs including circuit optimization and converting more traffic to our own network.

The decrease in access costs of $1.3 billion during 2004 as compared to 2003 was driven in part by an 11% decline in domestic long distance volumes offset by increased outbound international volumes of 12% as well as increased international traffic outside of the U.S. of 7%. We have experienced a positive trend in data and Internet circuit installs for the latter half of 2004, although associated access costs have declined by $0.5 billion as compared to 2003. Access cost reductions in 2004 were achieved by reducing special access circuit mileage costs, converting switched and dedicated traffic to our own network facilities, and by optimizing our international network. These 2004 cost savings initiatives were integral in reducing the average transmission costs per circuit from 2003 levels. Access costs were also reduced due to our restructuring efforts and contract rejections during our bankruptcy by $0.2 billion during the year. USF contributions decreased by $0.3 billion during 2004 as compared to 2003, which included the recognition in 2004 of a $68 million benefit regarding prior year contributions to the USF fund.

The decrease in access costs of $1.3 billion during 2003 as compared to 2002 was partially due to our contract renegotiations as a result of our restructuring efforts and contract rejections during our bankruptcy that reduced access costs by $0.6 billion. Access costs were further impacted by an approximately $0.7 billion decrease in access charges associated with our data, Internet and long distance voice business in the U.S., partially offset by a $0.3 billion increase in access charges associated with our local voice services. Other access cost changes included a $0.2 billion decrease in connection charges for international voice and data traffic originating in the U.S. and lower USF contributions of $0.1 billion. These access cost decreases were partially offset by changes in foreign currency exchange rates.

We expect our access costs will continue to decline due to our continued cost containment initiatives. These reductions will be partially offset by increased access costs for our local voice service, as the decision of the D.C. Circuit on the Triennial Review Order and the FCC's rules on remand from that decision, combined with recent PUC mandated rate increases, will impact access costs in future quarters.

Costs of services and products. Costs of services and products ("COSP") include the expenses associated with operating and maintaining our telecommunications networks, expenditures to support our outsourcing contracts, technical facilities expenses and other service related costs. COSP as a percentage of total revenue was 12% for the year ended December 31, 2004 as compared to 11% for 2003 and 12% for 2002.

The decrease in COSP of $0.3 billion in 2004 as compared to 2003 was primarily attributable to our continued focus on reducing our costs in line with our revenues. As a result, we experienced a decrease in outside services, repair and maintenance, and facility expenses totaling $0.1 billion, and a decrease of $0.1 billion in salary expense due to force reductions, net of severance expense. In addition, our expenses declined by approximately $0.1 billion due to various other cost–cutting efforts.

The decrease in COSP of $0.7 billion in 2003 as compared to 2002 was primarily attributable to initiatives to improve efficiency and better align our costs with our revenue levels. These initiatives resulted in decreased facility expenses of $0.1 billion, lower payments to marketing partners for customer awards and benefits of $0.1 billion as a result of lower total revenues, and a $0.3 billion reduction in personnel related costs and other general operating costs. COSP also decreased $0.2 billion due to reduced equipment sales.

Selling, general and administrative expenses. Selling, general and administrative ("SG&A") expenses include sales, customer service and marketing expenses, information services costs, bad debt expense, and corporate administrative costs, such as finance, legal and human resources.

We continued to incur reorganization items during 2004 and will incur reorganization items in 2005 for professional fees and other bankruptcy costs, although at lower levels than in 2003. As we adopted the provisions of fresh–start reporting on December 31, 2003, for accounting purposes, reorganization expenses and changes in estimates of reorganization items previously accrued have been included in our 2004 SG&A expense. These expenses totaled $36 million for 2004 and were primarily related to professional services related to our bankruptcy proceedings.

The reduction in expense of $1.3 billion in 2004 as compared to 2003 was primarily related to changes in our business strategy, as well as continued cost–cutting and process improvement initiatives. During 2004, we reduced our advertising costs by $0.4 billion due to changes in our marketing strategy. We improved our collections of receivables from historical levels which resulted in a reduction in the estimate for bad debt expense. In addition, lower revenues and rate declines contributed to the lower bad debt expense of $0.3 billion during 2004. Compensation expense declined $0.3 billion during 2004, reflecting our force reductions and lower commission expenses. We experienced a decrease of $0.1 billion in outside services mainly due to the significant accounting fees that were incurred during 2003 to assist with our restatement efforts. During 2004, we recognized a $38 million benefit from international tax settlements, and in the fourth quarter, we recognized a $91 million gain on bankruptcy settlements and the adjustment of related reserves and realized benefits of $42 million for value added tax settlements. These decreases in expense were partially offset by increased severance expenses during 2004 of $0.1 billion related to our force reductions.

The reduction in expense of $1.6 billion in 2003 as compared to 2002 was primarily due to lower personnel related costs of $0.6 billion reflecting a 3,700 decrease in the number of our employees engaged in sales support and other administrative activities, as well as improvement in bad debt expense of $0.7 billion. The improvement in bad debt expense resulted from improved credit management efforts during 2003 and a charge in 2002 to bad debt expense related to the loan to our former chief executive officer Bernard Ebbers. SG&A expenses were also reduced as a result of our restructuring efforts that led to an improvement of $0.1 billion in facility costs, our lower revenue volumes that resulted in a reduction of $0.1 billion in billing expenses, and other operational improvements. These reductions in SG&A expenses were partially offset by increased advertising of $0.1 billion to support our Mass Markets business and increased professional services fees of $0.3 billion related to the engagement of several professional services firms to assist in our financial restatement efforts.

Depreciation and amortization. Depreciation and amortization expense is primarily affected by the carrying value of our assets, which is directly impacted by our capital expenditure program and impairment charges.

Depreciation and amortization expense decreased by $0.4 billion during 2004 as compared to 2003. The decrease in expense was primarily due to a reduction in our asset carrying values related to pre–tax impairment charges of $3.5 billion recorded in 2004. The impact of our impairment charges on depreciation and amortization expense was a reduction of approximately $0.3 billion, primarily realized during the fourth quarter of 2004. Additionally, lives of certain assets were shortened during 2003 for their expected early disposal which increased the expense associated with these assets in 2003 and resulted in a reduction of depreciation expense in 2004 by $0.1 billion as compared to 2003. As a result of the implementation of fresh–start reporting as of December 31, 2003, fair values of our definite–lived intangibles such as customer lists increased, and the carrying values of our long–lived assets decreased, resulting in an increase in amortization expense of $0.1 billion in 2004 as compared to 2003, directly offset by a decrease in depreciation expense of $0.1 billion in 2004 as compared to 2003.

The decrease in depreciation and amortization expense of $0.6 billion during 2003 was principally due to the recognition of long–lived asset impairment charges of $5.0 billion in 2002, which reduced the asset carrying values.

Depreciation expenses are also affected by the level of our capital expenditures, which were $1.0 billion, $0.8 billion, and $1.0 billion for 2004, 2003 and 2002, respectively. Our reduced capital expenditures during these periods reflect reduced requirements for capacity and operating constraints resulting from bankruptcy. We

expect 2005 capital expenditures to be consistent with 2004 levels even as we accelerate our investment in new products and services and continue to improve the efficiency, functionality and reliability of our network as well as make other operational improvements.

Impairment charges. During 2004, we recorded impairment charges of approximately $3.5 billion to adjust the carrying values of our long–lived assets and indefinite–lived intangible assets. Refer to "*Management's Discussion and Analysis of Financial Condition and Results of Operations—Impairment Charges*" for additional details of the impairment charges. During 2002, we recorded impairment charges of $5.0 billion to adjust the carrying values of our long–lived assets and indefinite–lived intangible assets, consisting of $4.6 billion related to property, plant and equipment and $0.4 billion related to goodwill and intangibles. The decline in value for 2002 was driven by our pending bankruptcy filing, our disclosure of accounting and reporting irregularities and the resignation of senior officers. These events precipitated a lack of access to the capital markets and, therefore, a decrease in future projected cash flows.

Operating (loss) income. For 2004, our operating loss was $3.2 billion on revenues of $20.7 billion, a decrease of $3.9 billion from operating income of $0.7 billion on revenues of $24.3 billion in 2003. The principal factors underlying this decrease of $3.9 billion were impairment charges of $3.5 billion and lower operating income of $0.4 billion as the reduction in revenue of $3.6 billion was greater than the $3.2 billion reduction in our operational expenses.

For 2003, our operating income was $0.7 billion on revenues of $24.3 billion, an improvement of $5.0 billion from an operating loss of $4.3 billion on revenues of $28.5 billion in 2002. The principal factors underlying this improvement include a decrease in impairment charges of $5.0 billion, a decrease of $1.6 billion in SG&A expenses, a decrease in access cost expenses of $1.3 billion, a decrease of $0.7 billion in COSP expenses and a decrease in depreciation and amortization expenses of $0.6 billion, partially offset by a decrease in revenue of $4.2 billion.

Interest expense. Interest expense increased $0.3 billion to $0.4 billion in 2004 from $0.1 billion in 2003, and decreased $1.3 billion to $0.1 billion in 2003 from $1.4 billion in 2002.

This increase in 2004 as compared to 2003 relates to the recognition of interest expense on our Senior Notes that were issued on the Emergence Date as well as the $114 million in non–cash interest expense related to the accretion of the discount on these Senior Notes recognized from January 1, 2004 through the Emergence Date. No interest expense was paid or recognized in 2003 on our outstanding long–term debt during our bankruptcy. However, we continued to pay interest on our capital leases during 2003.

The decrease in 2003 as compared to 2002 reflects approximately $2.2 billion that was not paid or accrued on our $30.7 billion of outstanding debt that was subject to compromise as a result of our bankruptcy filing on July 21, 2002.

Miscellaneous income, net. Miscellaneous income includes: interest income, results of our equity investments, and foreign currency translation gains and losses. In 2004 and 2003, miscellaneous income was $0.1 billion and was an expense of $2.2 billion in 2002. In 2004, interest income and foreign currency gains were offset by losses from our equity investments, while 2003 included income from our equity interests and foreign currency translation gains. In 2002, we recognized $2.3 billion for an SEC civil penalty claim which was settled upon our emergence from bankruptcy for a cash consideration of $500 million and the issuance of common stock with an assigned value of $250 million.

Reorganization items. From the Petition Date to our adoption of fresh–start reporting as of December 31, 2003, we classified certain expenses as reorganization items in accordance with SOP 90–7. Reorganization items do not include any revenues or expenses that must be reported as related to discontinued operations. In the years ended December 31, 2003 and 2002, we recorded reorganization items which totaled $22.1 billion of income and $0.8 billion of expenses, respectively. The following table sets forth the components of these items (in millions):

	Predecessor Company	
	Year Ended December 31,	
	2003	2002
Contract rejections	$ (237)	$ (363)
Write–off of debt issuance costs and original issue discounts	—	(200)
Employee retention, severance and benefits	(121)	(97)
Loss on disposal of assets	(22)	(56)
Lease terminations	(178)	(64)
Professional fees	(125)	(43)
Gains on settlements with creditors	56	14
Effects of the plan of reorganization and fresh–start reporting	22,324	—
Increase to fresh–start basis of assets and liabilities	350	—
Interest earned by debtor entities during reorganization	40	7
Income (expense) from reorganization items, net	$22,087	$ (802)

Contract rejection and lease termination expenses resulted from the rejection of executory contracts and leases as part of our financial reorganization under the bankruptcy laws. Employee retention and severance costs were incurred in connection with either retaining certain employees in order to complete our financial reorganization or reducing personnel levels as part of the restructuring of our business operations. These expenses were partially offset by interest income earned on our accumulated cash balances.

The costs included in reorganization items reflect the cash and non–cash expenses recognized by us in connection with our reorganization and are separately reported on the face of our consolidated statements of operations as required by SOP 90–7. The cash expenditures for reorganization items in 2003 and 2002 totaled $204 million and $114 million, respectively.

In our 2003 consolidated statement of operations, we recognized a gain of approximately $22.3 billion resulting from the difference between the amounts distributed to creditors pursuant to our Plan and our carrying value. See *"Discussion of Critical Accounting Policies—Accounting and Reporting During Reorganization"* above and Notes 4 and 5 to our 2004 consolidated financial statements included elsewhere in this Annual Report on Form 10–K. The gain from the effects of the Plan and the application of fresh–start reporting was calculated as follows (in millions):

	Predecessor Company
	Year Ended December 31, 2003
Discharge of liabilities subject to compromise	$ 37,532
Discharge of preferred stock subject to compromise	436
Issuance of new common stock	(8,472)
Issuance of new debt, net of a $114 discount	(5,552)
Accrual of amounts to be settled in cash	(1,620)
Gain from the effects of the Plan	$ 22,324

Income tax expense. Income tax expense was $0.5 billion in 2004, and $0.3 billion in 2003 and 2002. During 2004, we recognized $0.6 billion in income tax expense primarily comprised of a $0.3 billion change in estimate related to our income tax contingencies as well as state income taxes, foreign income taxes, interest, and changes to foreign tax reserves from the effects of foreign currency exchange rates. Our 2004 federal income tax expense of $0.1 billion, generated as a result of impairment charges that are not currently deductible and certain limitations on our ability to use our net operating loss carryforwards, was entirely offset by a benefit from changes in our deferred tax balances. Offsetting our income tax expense was a benefit of $0.1 billion which resulted from our impairment charge to reduce the carrying value of our indefinite-lived intangible assets recorded in the third quarter. In addition, due to certain attribute reduction rules, we have reduced the tax basis of certain current assets by $1.5 billion, which will increase our current income tax expense as such assets are disposed.

The provisions for income taxes in 2003 and 2002 were primarily attributable to taxes on the income of our international subsidiaries and the establishment of reserves for tax contingencies which resulted in a current period tax expense. Additionally, certain expenses in our consolidated statements of operations are not deductible for income tax purposes. In 2003, the recognition of the gain on reorganization resulted in a reduction of our valuation allowance from limitations of certain tax attributes resulting in the establishment of a long-term deferred income tax liability, and did not impact income tax expense for 2003.

Income (loss) from discontinued operations. Discontinued operations reflected the operating results of our Wireless, MMDS, Embratel, and Proceda businesses which were all sold prior to December 31, 2004, as well as OzEmail, which we sold on February 28, 2005. In 2004, income from discontinued operations primarily reflected the income from our OzEmail operations and the gain on sale of Embratel. In 2003 and 2002, the loss from discontinued operations resulted primarily from our investment in Embratel.

Cumulative effects of changes in accounting principles. In 2003, we recorded a charge of $0.2 billion upon the adoption of SFAS No. 143, *"Accounting for Asset Retirement Obligations* ("SFAS No. 143"). In 2002, we recorded a charge related to the impairment of SkyTel's channel rights upon the adoption of SFAS No. 142.

Net (loss) income. For 2004, our net loss was $4.0 billion, a decrease of $26.2 billion from net income of $22.2 billion in 2003. This decrease primarily resulted from the $3.9 billion decrease in operating loss discussed above, a $22.1 billion gain from reorganization items related to our application of fresh-start reporting in 2003, a $0.3 billion increase in interest expense, and a $0.2 billion increase in income tax expense offset by income in 2004 from discontinued operations as compared to a loss in 2003 and the $0.2 billion cumulative effect of a change in accounting principle recorded in 2003.

For 2003, our net income was $22.2 billion, a $31.4 billion change from a net loss of $9.2 billion in 2002. This change primarily resulted from a $22.9 billion change in reorganization items, a $5.0 billion improvement in operating income (loss), a $2.4 billion change in miscellaneous income (expense) and a decrease in interest expense of $1.3 billion.

Segment Results of Operations

In March 2004, we changed our segment reporting by realigning our previous business segments into three new business segments: Enterprise Markets, U.S. Sales & Service, and International & Wholesale Markets. Enterprise Markets serves the following customers which had been served by Business Markets in the past: global accounts, government accounts, MCI Solutions and Conferencing. U.S. Sales & Service serves the previous Mass Markets accounts and certain commercial accounts. International & Wholesale Markets serves customers internationally, as well as our wholesale accounts that were previously included in Business Markets. We began operating under these new segments during the second quarter of 2004.

In addition, we developed methodologies to fully allocate indirect costs that were previously reported in Corporate and Other to the new business segments. These costs include expenses associated with the operation of our network, access costs and cost of services and products, indirect selling, general and administrative expenses, depreciation and amortization, impairment charges, and corporate functions. The allocation methodologies are based on statistical and operational data that is generated from our continuing operations. These amounts can fluctuate based upon the performance of the individual segments.

We have changed the way we manage our business to utilize operating income (loss) information to evaluate the performance of our business segments and to allocate resources to them. Accordingly, we have restated our results of segment operations data for 2003 into the new business segments for comparability with the current presentation. However, we determined that it was impracticable to restate our 2002 results into the new business segment structure. As such, we have only included discussion on segment data for 2004 and 2003 under the new segment structure.

All revenues are generated through external customers from three main product and service categories: Voice, Data, and Internet.

Our impairment charges recorded in 2004 were allocated to each of our business segments based on the same methodology used to allocate depreciation and amortization expense. Refer to "*Management's Discussion and Analysis of Financial Condition and Results of Operations—Impairment Charges*" for additional details of the impairment charges.

Financial information for each of our reportable business segments and revenue product lines is as follows:

Enterprise Markets

This segment includes Global Accounts, Government Markets, and System Integrators. Global Accounts provides communications and network solutions to large multinational corporations requiring complex international network services. Government Accounts provides similar services to various government agencies. System Integrators serves customers through partnerships with third–party network solutions providers. In all cases, these services include local–to–global business data, Internet, voice services and managed network services.

For 2004 and 2003, the operating (loss) income of our Enterprise Markets segment was as follows (in millions):

	Successor Company	Predecessor Company
	Year Ended December 31,	
	2004	2003
Revenues:		
Voice	$1,830	$ 1,893
Data	2,316	2,577
Internet	665	859
Total revenues	4,811	5,329
Costs of sales and services	2,950	3,201
Selling, general and administrative	1,028	1,123
Depreciation and amortization	460	649
Loss on property dispositions	3	15
Impairment charges	870	—
Operating (loss) income	$ (500)	$ 341

Revenues. For 2004, Enterprise Markets revenues were 23% of our consolidated revenues as compared to 22% in 2003. Voice services revenues decreased due to rate declines across our entire voice business. Voice services revenues declined $63 million or 3% during 2004 as compared to 2003, driven primarily by market pricing pressures and customer contract rate changes in our long distance business which were centered in the Global and System Integrator channels. These declines were partially offset by growth in revenue from our local services. Global and System Integrators voice revenues declined by $36 million and $29 million, respectively, during 2004 as compared to 2003, while Government voice revenues were stable. In 2004, voice pricing trends in the Global market showed signs of greater stability, a trend we expect to continue in 2005.

Data services revenues declined $0.3 billion or 10% during 2004 as compared to 2003. The decrease was driven by price erosion and product migration from traditional data to more efficient IP based technology. During 2004, revenue for traditional data services, which includes frame relay and point–to–point private line, declined by $0.2 billion or 12% as compared to 2003. In 2004, data pricing in the Global market showed signs of increasing stability, a trend we expect to continue in 2005.

Internet services revenue declined $0.2 billion or 23% during 2004 as compared to 2003, primarily due to declines in the Global business, reflecting the general migration of customers from dial–up to broadband services. Internet revenue from dial–access technologies declined by $0.1 billion while revenue from PIP services and IP VPN increased by $34 million as compared to 2003.

The Enterprise Market segment continues to focus on providing customer solutions with emphasis on local and wide area network management, integrating contact centers, hosting and comprehensive security services supporting our overall movement to IP–based platforms. Revenues in this portfolio increased by $39 million in 2004 as compared to 2003. These revenues are spread across the voice, data and Internet categories identified above.

Costs of sales and services. Costs of sales and services were 61% and 60% of segment revenues for 2004 and 2003, respectively. The increase in costs as a percentage of revenue is driven by rate declines in our system integrators business. Actual expenses decreased by $0.3 billion during 2004 as compared to 2003, primarily due to force reductions and lower volumes.

Selling, general and administrative expenses. SG&A expenses decreased by $0.1 billion during 2004 as compared to 2003, primarily due to force reductions.

Operating (loss) income. For the year ended December 31, 2004, Enterprise Markets had an operating loss of $0.5 billion as compared to an operating income of $0.3 billion for 2003. The operating loss was primarily attributable to $0.9 billion of impairment charges recorded during 2004, while decreased revenue was partially offset by lower costs.

U.S. Sales & Service

This segment serves our Mass Markets business, which includes subscription–based residential and certain small business accounts, and transactional products including 10–10–987, 10–10–220, 1–800–COLLECT, MCI Prepaid card, and our Commercial Accounts business, which serves small to medium–size business accounts. Commercial Accounts also includes our SkyTel business, which provides wireless email, interactive two–way messaging, wireless telemetry services and traditional text and numeric paging to customers throughout the United States.

For 2004 and 2003, the operating (loss) income of our U.S. Sales & Service segment was as follows (in millions):

	Successor Company	Predecessor Company
	Year Ended December 31,	
	2004	2003
Revenues:		
Voice	$ 6,728	$ 8,354
Data	1,610	2,012
Internet	738	749
Total revenues	9,076	11,115
Costs of sales and services	4,910	5,755
Selling, general and administrative	3,007	3,887
Depreciation and amortization	841	821
(Gain) loss on property dispositions	(3)	16
Impairment charges	1,627	—
Operating (loss) income	$(1,306)	$ 636

Revenues. For 2004, U.S. Sales & Service revenues were 44% of our consolidated revenues as compared to 46% in 2003.

Mass Markets. During 2004, Mass Markets revenues were 56% of our total segment revenues, as compared to 57% in 2003. For 2004 and 2003, the amounts of product line revenues of our Mass Markets business were as follows (in millions):

	Successor Company	Predecessor Company
	Year Ended December 31,	
	2004	2003
Subscription services		
Long distance voice services	$2,497	$ 3,642
Local voice services	1,850	1,627
Other services (includes data and Internet)	32	24
Total subscription services	4,379	5,293
Transaction services	709	1,085
Total Mass Markets Revenues	$5,088	$ 6,378

The decline in subscription service revenues of 17% during 2004 was primarily the result of continued long distance volume declines of $0.8 billion during 2004 as compared to 2003, which was driven by customer loss. The average number of residential and small business long distance subscribers, which includes local customers who subscribe to long distance services, declined approximately 25% during 2004, as compared to 2003. Subscriber losses were driven by a decrease in sales attributed to the ongoing impact of "Do Not Call" regulations, heavy RBOC competition, and reduced advertising. The combined residential and small business long distance subscriber count at the end of 2004 was approximately 8.4 million. Rate declines totaling $0.3 billion also contributed to the decrease in long distance revenue during 2004 as compared to 2003. Rate declines were driven by increased competition and the continual migration of customers to new, lower-priced calling plans.

Partially offsetting the declines in our long distance business were increases in local voice services revenues of $0.2 billion during 2004, driven by local subscriber growth in the first half of the year. On average, residential

and small business local customers increased by approximately 10% during 2004, as compared to 2003. We do not expect local customer growth to continue in the future as customer declines in the second half of 2004 as well as anticipated future declines due to an unfavorable regulatory environment, which is expected to drive costs and prices up, will likely drive down local customer levels in the future. The combined residential and small business local subscriber count at the end of 2004 was approximately 3.3 million.

Our transaction services business is comprised of a dial–around product suite (1–800–COLLECT, 10–10–321, 10–10–220, 10–10–987) and prepaid card services. The decline of $0.4 billion during 2004 as compared to 2003 was mainly driven by volume declines in both our dial–around and prepaid business. These volume declines contributed $0.3 billion, and were a direct result of significant reductions in advertising spending and the continued declines in the overall wire–line long distance market. The remaining $0.1 billion in revenue declines can be attributed to average rate decreases, driven by product mix.

In 2004, we continued to actively market local products where it was profitable. We are engaged in an ongoing evaluation of how the anticipated rise in UNE–P access costs will impact our future ability to profitably provide Mass Markets local subscription services. These cost increases may force us to withdraw UNE–P–based services from certain markets in 2005. As a result, new local service account installs and revenue may decrease from current levels in future periods. To mitigate the expected UNE–P access cost increases to our local subscription base, we are exploring alternatives to UNE–P through commercial agreements. Two such agreements were signed in 2004.

Commercial Accounts. During 2004, Commercial Accounts revenues were 44% of our total segment revenues, as compared to 43% in 2003. For the years ended December 31, 2004 and 2003, the amounts of product line revenues of our Commercial Accounts business were as follows (in millions):

	Successor Company	Predecessor Company
	Year Ended December 31,	
	2004	2003
Voice	$1,672	$ 2,000
Data	1,593	1,991
Internet	723	746
Total Commercial Accounts Revenues	$3,988	$ 4,737

Voice service revenues decreased $0.3 billion during 2004 as compared to 2003, primarily driven by a 9% reduction in long distance usage. Reduced usage was primarily a result of customer downsizing and consolidation, as well as product substitution. Rate erosion has also contributed to the decline in long distance revenues, where we have seen aggressive pricing in the marketplace, especially with the RBOCs in the mid and small–sized business markets.

Data services revenues decreased $0.4 billion during 2004 as compared to 2003, primarily due to rate declines as a result of market pricing pressure and product substitution as customers moved from Frame to PIP networks.

Internet services revenues declined slightly during 2004 as compared to 2003 due to rate compression and the migration from dial–up to broadband services. The decline was partially offset by the continued growth in our existing customer base, as well as the introduction of new products to both new and existing customers.

We are beginning to see a growing trend for business customers converting their traditional frame and ATM networks to IP centric service, resulting in revenue growth of our IP VPN and PIP solutions, which increased revenue by $82 million during 2004 as compared to 2003.

The Commercial Accounts segment is expected to benefit from a growing focus on delivering solutions to customers in the areas of hosting, managed network services, security and contact center services.

Costs of sales and services. Costs of sales and services were 54% and 52% of segment revenues for 2004 and 2003, respectively. The increase in costs as a percentage of revenue was driven by rate declines and change in product mix. Actual expenses decreased by $0.8 billion for 2004 as compared to 2003. The decrease was due to lower access costs, lower payments to marketing partners for customer awards, and force reductions.

Selling, general and administrative expenses. SG&A expenses decreased by $0.9 billion for 2004 as compared to 2003. Our SG&A costs have decreased due to lower advertising costs, headcount reductions in our call centers and support functions, and lower billing costs due to the increasing mix of direct-billed customers. During 2004, SG&A was also impacted by lower bad debt expense, primarily resulting from lower revenues.

Operating (loss) income. For the year ended December 31, 2004, U.S. Sales & Service had an operating loss of $1.3 billion as compared to operating income of $0.6 billion for 2003. The operating loss was primarily attributable to approximately $1.6 billion of impairment charges recorded in 2004. In addition, U.S. Sales & Service experienced lower revenues due to changes in product mix and rate compression, but these lower revenues were only partially offset by decreases in costs of sales and services and selling, general, and administrative expenses.

International & Wholesale Markets

This segment serves our domestic and international wholesale accounts, as well as retail business customers in Europe, the Middle East and Africa (collectively "EMEA"), the Asia Pacific region, Latin America and Canada. The segment provides telecommunications services, which include voice, data services, Internet and managed network services.

For 2004 and 2003, the operating loss of our International & Wholesale Markets segment was as follows (in millions):

	Successor Company	Predecessor Company
	Year Ended December 31,	
	2004	2003
Revenues:		
Voice	$ 4,105	$ 4,387
Data	1,446	1,892
Internet	1,252	1,543
Total revenues	6,803	7,822
Costs of sales and services	5,365	5,812
Selling, general and administrative	1,185	1,469
Depreciation and amortization	623	846
(Gain) loss on property dispositions	(1)	12
Impairment charges	1,016	—
Operating loss	$(1,385)	$ (317)

Revenues. For 2004, International & Wholesale Markets revenues were 33% of our consolidated revenues, as compared to 32% in 2003. For 2004 and 2003, the amounts of product line revenues of our International and Wholesale business were as follows (in millions):

	Successor Company	Predecessor Company
	Year Ended December 31,	
	2004	2003
International:		
Voice	$2,496	$ 2,435
Data	320	378
Internet	860	943
Total International Revenues	3,676	3,756
Wholesale:		
Voice	1,609	1,952
Data	1,126	1,514
Internet	392	600
Total Wholesale Revenues	3,127	4,066
Total International & Wholesale Markets Revenues	$6,803	$ 7,822

International Revenues. During 2004, International revenues were 54% of our total segment revenues, as compared to 48% in 2003. We experienced rate declines in each product area during 2004, which were offset by favorable foreign exchange rate movements of $0.3 billion, resulting in an overall International revenue decline of $0.1 billion in 2004 as compared to 2003.

International voice services revenues increased $0.1 billion during 2004 as compared to 2003. In the International segment, average U.S. dollar equivalent billing rates for voice were stable in 2004 as compared to 2003 due primarily to the impact of foreign exchange rates, which increased the average billing rate by 7%. Excluding the impact of foreign exchange rates, average voice rates declined 8% in 2004 as compared to 2003. This decline was offset by higher voice volumes, which increased 3% or 1.5 billion minutes during 2004 as compared to 2003. In addition, voice revenues were positively impacted by an increase in higher rate mobile traffic and sales in countries with higher rate structures, primarily in the first quarter of 2004.

International data and Internet services revenues each decreased $0.1 billion during 2004 as compared to 2003 as a result of rate compression and the general migration of customers from dedicated–access and dial–up Internet access services to DSL–type access services. Competition and pricing pressures continued to negatively impact data and Internet revenues during 2004.

Approximately 81% of our revenue in EMEA is focused in the United Kingdom, Germany, France, Belgium, the Netherlands and Sweden. In Asia, revenues are heavily concentrated in Australia, Hong Kong, Japan, Singapore and India. During 2004, we implemented agreements to provide enhanced Internet related services with key suppliers in China and India.

We expect pricing and margin pressure to continue. Price competition from the local incumbent carriers has intensified during 2004. To react to these conditions, we are focusing our emphasis on large retail customers with global communications needs.

Wholesale Revenues. Wholesale revenues relate to domestic wholesale services, which include all wholesale traffic sold in the United States, as well as traffic that originates in the United States and terminates in a different country. During 2004, Wholesale revenues were 46% of our total segment revenues, as compared to 52% in 2003. Wholesale revenues decreased $0.9 billion during 2004 as compared to 2003. This decrease was the result of pricing pressures, overcapacity, continued industry bankruptcies, and the elimination of certain incentive discounts.

Wholesale voice services revenues decreased $0.3 billion during 2004 as compared to 2003, primarily as a result of pricing pressures. Volumes were down 3% in 2004 as compared to 2003, mainly due to several customers who migrated traffic to their own networks. Declines in our local dial tone service business also contributed to our overall decreases in voice revenues.

Wholesale data services revenues decreased $0.4 billion during 2004 as compared to 2003, primarily due to continued price compression as a result of overcapacity in the marketplace, migration of carriers to their own networks and overall lower demand levels. Additionally, as some of our customers experienced financial difficulties, they reduced their demand for network capacity.

Due to a general industry shift from dial–up Internet access to broadband services, wholesale Internet services revenues decreased $0.2 billion during 2004 as compared to 2003. Volume decreased by 19% while rates continued to decline as a result of contract renegotiations.

Costs of sales and services. Costs of sales and services were 79% and 74% of segment revenues for 2004 and 2003, respectively. Costs decreased by $0.4 billion during 2004 primarily due to lower revenues. Wholesale access expense across the segment increased as a percentage of segment revenues due to product mix and rate pressures. Reducing the high cost of International access continued to be a challenge in 2004, as we continued to rely on dominant, incumbent carriers for local loop access. Our costs also decreased due to force reductions and lower repairs and maintenance expense, which were partially offset by severance expenses. International costs were also affected by changes in foreign currency exchange rates that increased U.S. dollar equivalent costs by approximately $0.2 billion for 2004.

Selling, general and administrative expenses. SG&A expenses decreased by $0.3 billion for 2004, as compared to 2003. This decrease was a result of management actions to gain efficiencies through lower headcount as well as reduced bad debt expense, resulting from lower revenues and successful collection efforts. In addition, the International business received a benefit from favorable consumption tax settlements during 2004. These decreases were offset by severance expenses incurred as a result of our force reductions and changes in foreign currency exchange rates that increased U.S. dollar equivalent costs by approximately $0.1 billion for 2004.

Operating loss. For the year ended December 31, 2004, International & Wholesale Markets had an operating loss of $1.4 billion as compared to $0.3 billion for 2003. The operating loss for 2004 was primarily attributable to approximately $1.0 billion of impairment charges recorded in 2004. Additionally, increases in operating loss were driven by lower revenues that were not fully offset by reductions in costs of sales and services and SG&A expenses. Similarly, the operating loss for the year 2003 was attributable to revenues declining faster than costs, primarily due to rate compression across all products.

Financial Condition

As a result of our business activities through 2004, including our emergence from bankruptcy and significant payments to settle bankruptcy claims, divestiture of non–core assets, and the recording of impairment charges, our consolidated balance sheet has significantly changed since year–end 2003. Included in the 2004

change was the removal of Embratel's assets and liabilities upon disposition. The components of Embratel's balance sheet as of December 31, 2003 are identified in Note 17 to our consolidated financial statements included elsewhere in this Annual Report on Form 10–K. The following table sets forth the consolidated balance sheet as of the dates indicated (in millions):

	Successor Company	
	As of December 31,	
	2004	2003
Assets:		
Cash and cash equivalents	$ 4,449	$ 6,178
Marketable securities	1,055	15
Other current assets	3,589	6,335
Long–term assets	7,967	14,942
	$ 17,060	$ 27,470
Liabilities and Shareholders' Equity:		
Current liabilities	$ 6,203	$ 8,810
Long–term debt, excluding current portion	5,909	7,117
Other long–term liabilities	718	3,071
Shareholders' equity	4,230	8,472
	$ 17,060	$ 27,470

Cash and cash equivalents. Cash and cash equivalents decreased by $1.7 billion from December 31, 2003, primarily due to a net $1.0 billion of marketable securities that were purchased during 2004. Cash and cash equivalents also declined due to payments of bankruptcy claims since our Emergence Date in the amount of $1.4 billion, capital expenditures of $1.0 billion, removal of Embratel's cash balance (approximately $0.6 billion as of December 31, 2003) and payments of dividends and interest of approximately $0.5 billion, partially offset by the collection of $0.6 billion from the sale of assets and $0.8 billion from cash flows from operations during 2004, which is net of the payment of $1.4 billion in bankruptcy claim payments in 2004. Refer to "*Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources*" for further details.

Marketable Securities. Marketable securities increased by $1.0 billion from December 31, 2003 as we sought to increase the rate of return on our invested cash through direct investments in government securities, commercial paper, corporate bonds and certificates of deposit.

Other current assets. Other current assets decreased by approximately $2.7 billion from December 31, 2003, primarily due to a decrease in net accounts receivable of approximately $1.5 billion (including the elimination of Embratel's accounts receivable balance which was approximately $0.6 billion as of December 31, 2003) from better collections and lower revenues, a reduction of $1.0 billion in deferred income taxes from changes in our federal and state tax provisions, and a decrease of $0.2 billion from sales of non–core assets included as assets held for sale as of December 31, 2003.

Long–term assets. Long–term assets, primarily property, plant, and equipment and intangibles, decreased by approximately $7.0 billion from December 31, 2003 due to impairment charges of approximately $3.5 billion recorded in 2004, the elimination of Embratel's long–term assets (approximately $2.9 billion at December 31, 2003), depreciation and amortization expense of $1.9 billion and a decrease in other assets of $0.2 billion net of Embratel's balance. These decreases were offset by capital expenditures of approximately $1.0 billion in 2004 and an increase in our long–term deferred income tax asset of $0.5 billion.

Current liabilities. Current liabilities decreased by approximately $2.6 billion from December 31, 2003, due to the elimination of Embratel's liabilities (approximately $1.2 billion as of December 31, 2003) and a decrease

of approximately $1.4 billion in our liabilities. Our decrease was primarily due to payments of approximately $1.4 billion to creditors and $1.1 billion in other reductions of accrued expenses from lower operating expenses, which were offset by increases of $0.5 billion for accrued taxes related to contingencies and federal, state, and international tax provisions and $0.6 billion relating to current deferred income tax liabilities.

Long–term debt. Long–term debt decreased by approximately $1.2 billion from December 31, 2003, primarily due to the removal of Embratel's debt obligations from our consolidated balance sheet.

Other long–term liabilities. Other long–term liabilities decreased by approximately $2.4 billion from December 31, 2003, primarily due to the elimination of Embratel's minority interest (approximately $1.2 billion as of December 31, 2003) and a $1.2 billion decrease in deferred tax liabilities for changes in our federal and state tax provisions.

Liquidity and Capital Resources

Current Liquidity

The table below is a summary of our cash, cash equivalents and marketable securities as of December 31, 2004, 2003, and 2002 (in millions):

	Successor Company		Predecessor Company
	As of December 31,		
	2004	2003	2002
Without Embratel	$4,449	$5,583	$ 2,569
Embratel cash and cash equivalents balance	—	595	251
Total cash and cash equivalents	4,449	6,178	2,820
Marketable securities	1,055	15	40
Total cash, cash equivalents, and marketable securities	$5,504	$6,193	$ 2,860

The table above shows Embratel's cash and cash equivalents as of December 31, 2003 and 2002 included in our consolidated balance sheet. Throughout the period of our ownership of an equity interest in Embratel, it was not a wholly–owned subsidiary and was operated by its own management and employees. Consequently, our ability to access Embratel's cash and cash equivalents for our corporate purposes was significantly limited. On July 23, 2004, we completed the sale of our 19% economic interest and 52% voting interest in Embratel, and realized proceeds of approximately $0.4 billion.

During 2004, we purchased approximately $1.1 billion in marketable securities, which were classified in our consolidated balance sheet as current assets. These securities include commercial paper, certificates of deposit, U.S. government securities, and corporate bonds. We expect to continue to increase these amounts during 2005 to achieve higher returns on our available funds.

Our principal cash needs consist of capital expenditures, debt service, dividends, acquisitions, and payments made pursuant to the plan of reorganization. The Plan included the payment of approximately $2.6 billion in cash to settle certain creditor claims. Some payments were made prior to our emergence from bankruptcy and some expected payments will not be made as a result of some claims being reduced since the Plan was confirmed. As of December 31, 2004, our estimated remaining cash payments to settle pre–petition creditor claims were approximately $0.8 billion.

Section 5.07 of the Plan required the Board of Directors to conduct a review of our cash needs, including amounts that may be necessary to satisfy all claims to be paid in cash pursuant to the Plan, and that any excess cash be utilized in accordance with our best business judgment to maximize shareholder value. On August 5, 2004, the Board of Directors completed its review and declared the amount of excess cash to be $2.2 billion. The Board of Directors decided to distribute a portion of the excess cash through a return of capital and declared cash dividends of $0.40 per share payable on September 15, 2004 and December 15, 2004, resulting in total payments of $0.3 billion of dividends on our common stock during 2004. On February 11, 2005, the Board of Directors approved a quarterly dividend of $.40 per share payable on March 15, 2005 to shareholders of record as of March 1, 2005. Shareholders will receive a special cash dividend in the amount of $4.10 per share (less the per share amount of any dividend declared by us during the period beginning on February 14, 2005 and ending on the closing date of the merger) after the Merger Agreement is approved by the shareholders.

Our capital expenditures were $1.0 billion in 2004 and we expect our capital expenditures to be approximately $1.0 billion in 2005. Our expenditures will focus on enhancements to the efficiency, functionality and reliability of our network operations, improvements in customer service and the development of additional value–added services. Included in our capital expenditures will be investments in building next–generation services and achieving IP leadership. These objectives will be achieved by beginning deployment of a new IP core and multi–service edge which enables migration of services to a common IP Core; converged packet access which enables logical / automated service provisioning and enables Telco access cost reductions; ultra long haul technology which provides more cost effective transmission by reducing the number of network elements by 70 percent and also enables the wavelength services product; and enhancing our data center architecture with utility and grid computing capability. Additionally, we may expend capital for acquisitions of businesses or technology that will enhance our products or services. On January 20, 2005, we announced the acquisition of NetSec, for approximately $105 million in cash and completed the acquisition on February 25, 2005.

In 2004, our debt service obligations primarily consisted of interest payments on the $5.7 billion principal amount of Senior Notes that were issued upon our emergence from bankruptcy. Interest on the Senior Notes is payable semi–annually on May 1 and November 1, beginning November 1, 2004, with interest accruing contractually from April 20, 2004. On November 1, 2004, we made the first interest payment of approximately $0.2 billion on the Senior Notes. The Senior Notes consist of three separate issues with maturities of three, five and ten years.

The interest rates on the Senior Notes were subject to adjustment depending upon the ratings assigned to the Senior Notes by Moody's Investor Service, Inc. ("Moody's") and Standard & Poor's Corporation ("S&P") as set forth in the indentures under which the Senior Notes were issued. In December 2004, Moody's issued a B2 rating and S&P issued a B+ rating on the Senior Notes. As a result, the interest rate on the obligations was raised by 1% effective December 15, 2004 which will result in an additional $57 million of interest expense in 2005. The current weighted average interest rate on the Senior Notes is 7.7%, resulting in annual interest payments of approximately $0.4 billion.

The Senior Notes are subject to covenants that limit our ability to make certain cash distributions based on our cumulative net income or loss since the Issue Date. The impairment charges recorded during the third quarter of 2004 will not affect our ability or our current plans to continue to distribute excess cash pursuant to Section 5.07 of the plan of reorganization to our shareholders in the form of quarterly dividends until such excess cash is fully utilized. In addition, if the excess cash is fully paid out to shareholders, any further dividends will be limited by the covenants in the indentures for the Senior Notes, which generally restrict dividends and certain other payments to an amount equal to 50% of cumulative adjusted net income since April 2004 (or minus 100% of cumulative losses) plus proceeds of equity offerings. Consequently, further dividends may not be possible as long as the Senior Notes or other debt instruments with similar covenants remain outstanding. As of December 31, 2004, we did not have any retained earnings available for distribution. Pursuant to the terms of our Merger Agreement with Verizon, shareholders will receive a special cash dividend in the amount of $4.10 per share (less the per share amount of any dividend declared by us during the period beginning on February 14, 2005 and ending on the closing date of the merger) after the Merger Agreement is approved by the shareholders.

We believe that our principal source of funds will be cash generated from our operating activities despite anticipated declines in revenues. In addition, we expect to continue the process of divesting non–core investments and other assets.

We believe that our available cash and marketable securities, together with cash generated from operating activities and asset sales, will be more than sufficient to meet our liquidity requirements through at least 2006.

Bank Facilities

As an additional source of liquidity during our bankruptcy, we entered into a Senior Secured Debtor–in–Possession Credit Facility (the "DIP Facility"). On the Emergence Date, there were no outstanding advances under the DIP Facility. We did have letters of credit outstanding under the DIP Facility.

On the Emergence Date, the DIP Facility was terminated. Approximately $100 million in letters of credit were rolled over to new letter of credit facilities entered into with JPMorgan Chase Bank, Citibank, N.A. and Bank of America, N.A. (the "Letter of Credit Facilities"). On October 12, 2004, the Commitment under the Letter of Credit Facilities was increased from $150 million to $300 million. None of the additional amount has been used as of the date of this filing. In addition, we pay a facility fee under the Letter of Credit Facilities equal to .05% per annum of the amount of the Commitment (whether used or unused). If any fee or other amount payable under any Letter of Credit Facility is not paid when due, additional interest equal to 2% per annum plus the federal funds rate (determined in accordance with such Letter of Credit Facility) will be incurred on the overdue amount. The Letter of Credit Facilities mature in April 2005. As of December 31, 2004, under the Letter of Credit Facilities, we had $137 million in letters of credit outstanding, $162 million in availability, and $1 million reserved for issuance. As of December 31, 2004, $144 million in cash has been pledged as collateral for our outstanding letters of credit and this cash has been classified as restricted cash in other current assets in the consolidated balance sheet.

We may arrange a revolving credit facility to support our letter of credit requirements and as an additional source of liquidity. The revolving credit facility would replace the Letter of Credit Facilities.

Historical Cash Flows

During 2004, 2003 and 2002, our cash flows were as follows (in millions):

	Successor Company	Predecessor Company	
	Year Ended December 31,		
	2004	2003	2002
Provided by (used in):			
Operating activities	$ 792	$3,528	$ (102)
Investing activities	(1,366)	(530)	(147)
Financing activities	(553)	19	1,626
Net change in cash and cash equivalents from discontinued operations	(602)	341	153
Net (decrease) increase in cash and cash equivalents	$(1,729)	$3,358	$ 1,530

The following discussion of cash flows provided by (used in) operating, investing, and financing activities excludes the impact of discontinued operations which is discussed separately.

Net Cash Flows Provided by (Used in) Operating Activities

For the years ended December 31, 2004, 2003 and 2002, net cash provided by (used in) operating activities was $0.8 billion, $3.5 billion, and $(0.1) billion, respectively, and was comprised of the following (in millions):

	Successor Company	Predecessor Company	
	Year Ended December 31,		
	2004	2003	2002
OPERATING ACTIVITIES			
Net (loss) income	$(4,002)	$ 22,211	$ (9,173)
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:			
Depreciation and amortization	1,924	2,316	2,903
Impairment charges related to property, plant and equipment, goodwill and intangible assets	3,513	—	4,999
Impairment charges related to investments	1	12	25
Cumulative effects of changes in accounting principles	—	215	32
Minority interests, net of tax	—	(4)	(20)
Net realized gain on sale of investments	(10)	(2)	(24)
(Gain) loss on sale of property, plant and equipment	(1)	43	123
Bad debt provision	554	880	1,271
Deferred income tax (benefit) expense	(84)	(26)	95
Reserve for employee loan	—	—	332
Effect of the plan of reorganization and revaluation of assets and liabilities	—	(22,674)	—
Non-cash reorganization items, net	—	383	688
Accretion expense related to SFAS No. 143 liability	27	21	—
Amortization of debt discount	114	—	—
Other	12	264	121
Changes in assets and liabilities, net of acquisitions:			
Accounts receivable	377	(169)	(3,061)
Other current assets	118	96	407
Non-current assets	13	277	—
Accounts payable and accrued access costs	(1,053)	(151)	(1,015)
Other current liabilities	(762)	(360)	(867)
Other liabilities	51	196	3,062
Net cash provided by (used in) operating activities	$ 792	$ 3,528	$ (102)

Further, the following table identifies significant net changes in our working capital displayed above during the years ended December 31, 2004 and 2003, but excludes data for 2002, the development of which, was determined to be impracticable (in millions):

	Successor Company	Predecessor Company
	Year Ended December 31,	
	2004	2003
Cash Provided By (Used In):		
Accounts receivable		
Decrease in accounts receivable, excluding the effect of bad debt provision	$ 931	$ 711
Increase in allowance for doubtful accounts for the effect of bad debt provision	(554)	(880)
Decrease (increase) in accounts receivable	377	(169)
Other current assets		
Decrease in non–trade and other receivables	54	100
Decrease in prepaid expenses	29	79
Other decreases (increases)	35	(83)
Decrease in other current assets	118	96
Decrease in non–current assets	13	277
Total decrease in assets	$ 508	$ 204
Accounts payable and accrued access costs		
Decrease in accounts payable	$ (909)	$ (141)
Decrease in accrued access costs	(144)	(10)
Decrease in accounts payable and accrued access costs	(1,053)	(151)
Other current liabilities		
Payment of SEC penalty	(500)	—
Increase (decrease) in accrued interest	67	(10)
Increase in income taxes payable	495	242
Decrease in other taxes	(101)	(52)
(Decease) increase in accrued reorganization expenses	(147)	106
Decrease in advance billings and deferred revenue	(125)	(228)
Other decreases	(451)	(418)
Decrease in other current liabilities	(762)	(360)
Increase in other non–current liabilities	51	196
Total decrease in liabilities	$ (1,764)	$ (315)

For 2004, we generated $0.8 billion in cash from operations. We had a net loss of $3.9 billion, which included non–cash charges for impairment of approximately $3.5 billion, depreciation and amortization of $1.9 billion, and a bad debt provision of $0.6 billion. Cash from operations was negatively affected by decreases in our liabilities totaling $1.8 billion which were partially offset by decreases in our assets totaling $0.5 billion. Additionally, cash from operations was lower than 2003 due to lower revenues that were not fully offset by reductions in operating expenses.

Our liabilities decreased $1.8 billion as compared to 2003. The decrease was attributable to a decrease in our accounts payable and accrued access costs of $1.1 billion during 2004 due to lower accruals for reduced spending on certain operating expenses such as advertising and professional fees. Force reductions during 2004 reduced accruals for salary and benefit expenses, and cost–cutting initiatives reduced access costs and related accruals. Additionally, liabilities decreased from an SEC penalty payment of $0.5 billion and from the reduction of $0.8 billion from other accruals primarily resulting from our bankruptcy settlement payments. These decreases were offset by the increase in accrued interest and income taxes payable of $0.6 billion. Interest expense for our Senior Notes was recognized and accrued in 2004, but not in 2003. Accrued income taxes increased for higher tax exposures related to liabilities for certain tax contingencies.

Offsetting the cash used for liabilities was a decrease in our assets from cash collections. Our accounts receivable decreased $0.9 billion during the year ended December 31, 2004 primarily due to improved collection efforts, including the collection of $0.3 billion for the settlement of disputes related to fees earned from third party companies for calls that terminated on our network and reduced billings due to lower revenues. Additionally, a decrease of $0.1 billion in other receivables, prepaid expenses, and other current assets from lower prepayments and collection of notes receivable had a positive effect on cash from operations.

For 2003, we generated approximately $3.5 billion in cash from operations. The generation of cash from operations was primarily the result of our net income of $22.2 billion which included non–cash benefits related to the plan of reorganization and the revaluation of assets and liabilities of $22.7 billion. Partially offsetting these benefits were non–cash charges for depreciation and amortization of approximately $2.3 billion, a bad debt provision of $0.9 billion, the cumulative effect of a change in accounting principle of $0.2 billion, and reorganization items of $0.4 billion. Cash flows from operations during this period were negatively affected by decreases in our liabilities totaling $0.3 billion which were mostly offset by decreases in our assets totaling $0.2 billion.

Our liabilities decreased $0.3 billion as compared to 2002. The decrease was attributable to a decrease in our accounts payable and accrued access costs of $0.2 billion during 2003 due primarily to lower accruals for reduced compensation and bad debt expense. Additionally, the reduction of other accruals of $0.6 billion reflects lower expenses from our cost containment and restructuring initiatives during 2003. These declines were offset by the increase in accrued income taxes of $0.2 billion, accrued reorganization expenses of $0.1 billion, and other accruals of $0.2 billion.

Offsetting the cash used for liabilities in 2003 was a decrease in our assets from cash collections of $0.2 billion. Our accounts receivable decreased $0.7 billion during the year ended December 31, 2003 due to a combination of lower revenues and improved cash collections, and we recorded $0.9 billion in bad debt expense. Additionally, a net decrease of $0.4 billion in other receivables, prepaid expenses, and other assets resulting from lower operating expenses and cash collections had a positive effect on cash from operations.

For 2002, we used $0.1 billion in cash for operating activities. We had a net loss of $9.2 billion, which included non–cash charges for impairment of approximately $5.0 billion, depreciation and amortization of $2.9 billion, a bad debt provision of $1.6 billion and reorganization items of $0.7 billion. Our cash flows from operating activities were negatively impacted by an increase in accounts receivable of approximately $3.1 billion, primarily resulting from the termination of our accounts receivable securitization facility and a slowing of our collections following our bankruptcy filing in July 2002. This decrease was partially offset by an increase in our liabilities as the result of lower payments of expenses during our bankruptcy period.

Net Cash Flows Used in Investing Activities

For 2004, net cash used by investing activities was approximately $1.4 billion. Capital expenditures for property, plant and equipment were approximately $1.0 billion. Investing activities also included the purchase of approximately $1.1 billion in marketable securities, offset by $0.7 billion in receipts from the sale of non–core assets primarily including approximately $0.1 billion for the sale of MMDS, $0.4 billion from our sale of Embratel and approximately $0.1 billion from the sale of Douglas Lake and other surplus properties. For 2003, net cash used by investing activities was approximately $0.5 billion. Capital expenditures of $0.8 billion were the primary use of cash and were partially offset by approximately $0.3 billion in proceeds from the sale of property, plant and equipment. For 2002, net cash used in investing activities was approximately $0.1 billion. Capital expenditures for property, plant and equipment were approximately $1.0 billion, offset by sale proceeds of investments and other assets of approximately $0.9 billion.

Net Cash Flows Used in (Provided by) Financing Activities

For 2004, net cash used in financing activities was approximately $0.6 billion and consisted primarily of $0.3 billion in dividend payments and approximately $0.1 billion in cash collateral posted for the Letter of Credit

Facilities. For 2003, net cash provided by financing activities consisted primarily of payments on capital leases, offset by other financing activities. In 2002, cash provided by financing activities was approximately $1.6 billion, primarily due to approximately $2.9 billion of debt obligation borrowings and repayments of approximately $1.0 billion which were completed prior to our bankruptcy filing, offset by the payment of $0.2 billion in dividends and $0.1 billion of debt issuance costs.

Net Change in Cash from Discontinued Operations

Net change in cash from discontinued operations for 2004 was approximately $0.6 billion and was primarily attributable to Embratel, which had a balance of approximately $0.6 billion as of December 31, 2003 that was removed from our consolidated balance sheet upon the consummation of the sale in July 2004. The increase of approximately $0.3 billion and $0.2 billion in 2003 and 2002, respectively, primarily represented the change in cash and cash equivalents from Embratel.

Contractual Obligations and Commitments

The following table represents our consolidated contractual obligations and commercial commitments as of December 31, 2004 (in millions):

	Payments due by period				
	Total	Less than 1 year	1–3 years	3–5 years	More than 5 years
Contractual obligations:					
Liabilities subject to compromise and tax claims[1]	$ 777	$ 777	$ —	$ —	$ —
Long-term debt	5,665	—	1,983	1,983	1,699
Capital leases	268	24	52	51	141
Interest on debt and capital lease obligations	2,521	462	831	528	700
Operating leases and commitments	4,186	1,125	1,691	482	888
Purchase commitments[2]	137	51	50	36	—
Other long-term liabilities	128	40	16	12	60
Total contractual cash obligations	$13,682	$ 2,479	$4,623	$3,092	$ 3,488

(1) Reflects the estimated remaining cash payments as of December 31, 2004 that are expected to be due upon final settlements (including interest on tax obligations of bankruptcy claims). All other non-cash distributions as contemplated by the Plan were distributed through the issuance of new common stock or new debt as described in *"Item 7—Management Discussion and Analysis of Financial Condition and Results of Operations—Voluntary Reorganization Under Chapter 11."* This estimate is based on various assumptions and reflects our judgment based upon our prior pre-petition claims settlement history and the terms of our plan of reorganization and, if these assumptions prove incorrect, actual payments could differ from the estimated amounts. Additionally, it is possible that some settlements may not be completed, and some cash payments may not be made, in less than one year. In addition, we have other tax contingencies described in our consolidated financial statements not reflected in this table.

(2) Reflects commitments related to vendors where we have contractual obligations which require minimum payments regardless of our performance under these contracts.

We have contractual obligations to utilize network facilities from local exchange carriers with terms greater than one year. We assess our minimum exposure based on penalties to exit the contracts, and as of December 31, 2004, the obligation associated with this liability is estimated to be approximately $1.4 billion and has been excluded from the table above.

We are obligated to pay a portion of maintenance and repair costs for certain cable systems which we use to transmit voice, data and Internet traffic. As no minimum obligation is identified under these agreements, we have excluded these obligations from the contractual obligations table above. However, we estimate these obligations as of December 31, 2004 to be approximately $733 million over the contract period, which can exceed 20 years.

Obligations to Provide Funds to Other Entities

As of December 31, 2004, we did not have any obligations to provide any funding to any entities that are not consolidated in our financial statements.

Off Balance Sheet Arrangements

As of December 31, 2004 and the date of this filing, we did not have any amounts outstanding under off balance sheet arrangements.

New Accounting Standards

In November 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 151, *"Inventory Costs, an amendment of ARB No. 43, Chapter 4"* ("SFAS No. 151"). SFAS No. 151 clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage), and requires that these costs be recognized as current period charges. The provisions of SFAS No. 151 will be effective for inventory costs incurred during fiscal years beginning after June 15, 2005. We have completed our evaluation of the impact of SFAS No. 151, and do not expect any material impact on our consolidated results of operations, financial condition and cash flows.

In December 2004, the FASB issued SFAS No. 153, *"Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29"* ("SFAS No. 153"). SFAS No. 153 addresses the measurement of exchanges of nonmonetary assets in eliminating the exception from fair value measurement for nonmonetary exchanges of similar productive assets and replacing it with an exception for exchanges that do not have commercial substance. SFAS No. 153 indicates a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The provisions of SFAS No. 153 will be effective for nonmonetary asset exchanges in fiscal years beginning after June 15, 2005, with earlier application permitted.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), *"Accounting for Stock–Based Compensation"* ("SFAS No. 123 (R)"). SFAS No. 123, *"Accounting for Stock–Based Compensation,"* focuses primarily on accounting for transactions in which an employee is compensated for services through share–based payment transactions. SFAS No. 123 (R) requires the cost of employee services received in exchange for an award of equity instruments to be measured based on the grant–date fair value of the award. The provisions of SFAS No. 123 (R) are effective as of the beginning of the first interim or annual reporting period that begins after June 15, 2005. We have not completed evaluating the impact of SFAS No. 123 (R), but do not expect any material impact on our consolidated results of operations, financial condition and cash flows.

ITEM 7A. ***QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK***

Interest Rate Risk

We are subject to market risk from exposure to changes in interest rates. As of December 31, 2004, our Senior Notes had an outstanding balance of $5.7 billion and a fair market value of $5.9 billion. While changes in market interest rates affect the fair market value of this debt, there is no impact to earnings or cash flows unless we redeem the Senior Notes before their maturity dates. We would redeem the Senior Notes only if market conditions, our financial structure or other conditions make such redemptions appropriate. The initial interest rates of the 2007, 2009, and 2014 Senior Notes were 5.908%, 6.688% and 7.735%, respectively, and were subject to reset after we applied for and received ratings from Moody's and S&P. In December 2004, we received B2 and B+ ratings from Moody's and S&P, respectively. As such, the initial interest rates on the Senior Notes were each increased by 1% effective December 15, 2004. The expected increase in interest expense for 2005 as a result of the change in interest rates on the Senior Notes is $57 million. We do not currently hedge our exposure

to this market risk through interest rate swaps. However, we may engage in hedging transactions to mitigate interest rate risk in the future should we change the structure of our debt.

Foreign Exchange Risk

We are subject to market risk from exposure to changes in foreign exchange rates when transactions are denominated in a currency other than our functional currency (the U.S. dollar). Because differing portions of our revenues and costs are denominated in foreign currencies, movements could impact our margins by, for example, decreasing our foreign revenues when the dollar strengthens and not correspondingly decreasing our expenses in the same proportion.

We generated 19% of our revenues from international operations during 2004, and the impact of foreign exchange increased our revenues by $0.3 billion with a slightly lower increase to our expenses. Future fluctuations in foreign currency exchange rates will impact line components of our consolidated statement of operations, and increases or decreases in these currency exchange rates could have a material impact on our consolidated net income or loss if our revenues and expenses do not fluctuate proportionately.

We do not currently hedge our currency exposures. However, we may engage in hedging transactions to mitigate foreign exchange risk in the future should such risk become significant.

Equity Risk

We are subject to market risk from exposure to changes in the market value of our investment securities. Our portfolio of investment securities includes available–for–sale securities, equity and cost method investments, and derivative instruments.

As of December 31, 2004 and 2003, available–for–sale securities were $1.1 billion and $15 million, respectively, and were comprised of fixed income and investment grade securities. The fixed–income portfolio consists primarily of relatively short–term investments to minimize interest rate risk. Investment grade securities include those issued by banks and trust companies that have long–term debt rated "A–3", "A" or higher according to Moody's or S&P, respectively. Investments in commercial paper issued by corporations are rated "P–1" or "A–1" or higher according to Moody's and S&P, respectively. As of December 31, 2004 and 2003, the fair value of available–for–sale securities approximated the cost of such investments. In 2003, prior to the investment of our cash and cash equivalents into available–for–sale securities, we managed our cash in a manner designed to maintain a $1.00 per share market value. As such, we did not experience any material changes in market value. The potential loss in fair value resulting from a hypothetical increase of 1% in interest rates on our available–for–sale debt securities as of December 31, 2004 would be approximately $11 million. A hypothetical decrease of 1% in interest rates would increase the fair value of our available–for–sale securities by $11 million.

As of December 31, 2004 and 2003, long–term investments (including long–term available–for–sale securities, equity and cost method investments and derivative instruments) totaled $116 million and $238 million, respectively. To the extent that our investments continue to have value, we typically do not attempt to reduce or eliminate our market exposure.

We periodically review investments and record impairment to these investments whenever we determine that a loss in market value is other–than–temporary. In recent years, we have experienced significant declines in the value of certain investments. In 2004, 2003 and 2002, we determined that the carrying value of certain cost method investments exceeded their fair value and were impaired. As such, we reduced the carrying value of our cost method investments in 2004, 2003 and 2002 by $1 million, $12 million and $8 million, respectively. In addition, in 2002, we determined that the carrying value of certain available–for–sale investments exceeded their fair values and were impaired, and reduced the carrying value of these investments by $17 million.

ITEM 8. ***CONSOLIDATED FINANCIAL STATEMENTS***

Our Consolidated Financial Statements and notes thereto are included elsewhere in this Annual Report on Form 10–K as described in Item 15.

ITEM 9. ***CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE***

None

ITEM 9A. ***CONTROLS AND PROCEDURES***

1. Management's Report on Internal Control over Financial Reporting

The management of MCI, Inc. and subsidiaries ("MCI" or the "Company") is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a–15(f) of the Exchange Act. MCI's internal control system was designed to provide reasonable assurance to the Company's management and board of directors regarding the preparation and fair presentation of published financial statements in accordance with U.S. generally accepted accounting principles.

As part of MCI's compliance efforts relative to Section 404 of the Sarbanes–Oxley Act of 2002, MCI management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2004. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control–Integrated Framework. Based on that assessment, management identified a material weakness in the Company's internal control over accounting for income taxes. The material weakness in internal control related to a lack of personnel with adequate expertise in income tax accounting matters, a lack of documentation, insufficient historical analysis and ineffective reconciliation procedures. These deficiencies represent a material weakness in internal control over financial reporting on the basis that there is more than a remote likelihood that a material misstatement in the Company's interim or annual financial statements due to errors in accounting for income taxes could occur and would not be prevented or detected by its internal control over financial reporting. Because of this material weakness in internal control over financial reporting, management concluded that, as of December 31, 2004, the Company's internal control over financial reporting was not effective based on the criteria set forth by COSO.

MCI's independent auditors, KPMG LLP, an independent registered public accounting firm, have issued an audit report on our assessment of the Company's internal control over financial reporting. This report appears on page F–4.

2. Management's Discussion on Income Tax Material Weakness

MCI's income tax accounting in 2004 had significant complexity due to fresh start accounting, impairment of assets, cancellation of indebtedness, a significant reduction in the number of subsidiary legal entities and various tax contingencies described in Note 20 to the consolidated financial statements.

To address this complexity, the Company instituted other procedures, hired additional tax accounting staff and outsourced the more complex areas of its income tax work to third party tax service providers.

While these steps have helped address some of the internal control deficiencies noted above, they have not been sufficient to conclude that the Company's internal control over accounting for income taxes was effective as

of December 31, 2004. Accordingly, the Company has, and will continue to, conduct significant remediation activity including:

- the hiring, in March 2005, of a new Vice President of Tax;
- hiring of additional full time tax accounting staff;
- increased use of third party tax service providers for the more complex areas of the Company's income tax accounting; and
- increased formality and rigor of controls and procedures over accounting for income taxes.

As a consequence of the material weakness noted above, the Company applied other procedures designed to improve the reliability of its accounting for income taxes. Based on these other procedures, management believes that the consolidated financial statements included in this report, as well as the Company's financial statements for each quarter in 2004, as previously reported, are fairly stated in all material respects.

3. Changes in Internal Control over Financial Reporting

In 2003, MCI concluded that its internal control over financial reporting was not effective. Accordingly, the Company applied other procedures to improve the reliability of its financial reporting processes.

Significant efforts were made to establish a framework to improve our internal control over financial reporting during 2004. We committed considerable resources to the design, implementation, documentation and testing of the key internal controls of the Company. Additional efforts were required to remediate and retest certain internal control deficiencies. Management believes that these efforts have improved the Company's internal control over financial reporting. While our internal control over financial reporting is significantly improved, management has identified certain areas (in addition to accounting for income taxes) that it believes should be further enhanced. With respect to these areas, the Company has implemented compensating controls and procedures that are designed to prevent a material misstatement of the Company's consolidated financial statements as of December 31, 2004. Nevertheless, management intends to continue improving the Company's internal control over financial reporting. Initiatives the Company has implemented to improve the Company's internal control over financial reporting in 2004 include, but are not limited to the following:

- increased the number and quality of our accounting personnel;
- increased the formality and rigor around the operation of key controls;
- documentation of all key financial procedures;
- implemented more stringent policies and procedures around our processes over accounting estimates; and
- increased security surrounding, and limited access rights to, the most significant financial systems.

Initiatives the Company will implement to further enhance the Company's internal control over financial reporting in 2005 (in addition to those previously discussed relating to income taxes) include, but are not limited to, the following:

- continue to recruit and train finance and accounting personnel;
- automate certain controls that are currently performed manually;
- simplify our back office systems; and
- expand our introduction of increased security and limiting access rights to financial systems of lesser significance.

4. Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report, we conducted an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to the Securities Exchange Act Rules of 1934 (the Exchange Act) 13a–15(e) and 15d–15(e). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective as of December 31, 2004, due to the material weakness discussed under the heading, *"Management's Report on Internal Control over Financial Reporting."* Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and completely and accurately reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

5. Limitations on the Effectiveness of Controls

The effectiveness of any system of internal control over financial reporting, including our own, is subject to certain inherent limitations, including the exercise of judgment in designing, implementing, operating, and evaluating the controls and procedures, and the inability to eliminate misconduct completely. Accordingly, any system of internal control over financial reporting, including ours, can only provide reasonable, not absolute, assurances. In addition, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

ITEM 9B. ***OTHER INFORMATION***

None

PART III

ITEM 10. *DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT*

Contained below is a listing of our current directors and executive officers.

Name	Age	Position
Michael Capellas	50	President and Chief Executive Officer, Director
Robert T. Blakely	63	Executive Vice President and Chief Financial Officer
Fred M. Briggs II	56	President of Operations and Technology
Daniel Casaccia	55	Executive Vice President, Human Resources
Jonathan C. Crane	55	Executive Vice President of Strategy and Corporate Development
Daniel E. Crawford	65	Acting President, International and Wholesale Markets
Nancy Gofus	51	Senior Vice President of Marketing and Chief Marketing Officer
Elizabeth Hackenson	44	Executive Vice President and Chief Information Officer
Victoria Harker	40	Senior Vice President and Treasurer
Nancy Higgins	53	Executive Vice President of Ethics and Business Conduct
Wayne Huyard	45	President, U.S. Sales and Service
Anastasia Kelly	55	Executive Vice President and General Counsel
Eric Slusser	44	Senior Vice President and Controller
Grace Chen Trent	35	Senior Vice President of Communications and Chief of Staff
Nicholas deB. Katzenbach	83	Director, Chairman of the Board
Dennis Beresford	66	Director
W. Grant Gregory	64	Director
Judith Haberkorn	58	Director
Laurence E. Harris	69	Director
Eric Holder	54	Director
Mark Neporent	47	Director
C.B. Rogers, Jr.	75	Director

Additional information required by this Item will be provided in our definitive proxy statement for our 2005 annual meeting of shareholders, which definitive proxy statement will be filed pursuant to Regulation 14A not later than 120 days following our fiscal year ended December 31, 2004, and is incorporated herein by this reference.

ITEM 11. *EXECUTIVE COMPENSATION*

The information required by this Item will be provided in our definitive proxy statement for our 2005 annual meeting of shareholders, which definitive proxy statement will be filed pursuant to Regulation 14A not later than 120 days following our fiscal year ended December 31, 2004, and is incorporated herein by this reference.

ITEM 12. *SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS*

The information required by this Item will be provided in our definitive proxy statement for our 2005 annual meeting of shareholders, which definitive proxy statement will be filed pursuant to Regulation 14A not later than 120 days following our fiscal year ended December 31, 2004, and is incorporated herein by this reference.

ITEM 13. *CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS*

The information required by this Item will be provided in our definitive proxy statement for our 2005 annual meeting of shareholders, which definitive proxy statement will be filed pursuant to Regulation 14A not later than 120 days following our fiscal year ended December 31, 2004, and is incorporated herein by this reference.

ITEM 14. *PRINCIPAL ACCOUNTANT FEES AND SERVICES*

Pre–Approval Policies and Procedures

The Audit Committee of our Board of Directors is responsible for the appointment, evaluation, compensation and oversight of our independent auditor. Pursuant to the Audit Committee's charter and SEC rules effective as of May 6, 2003, our Audit Committee must review and pre–approve all auditing and permitted non–auditing services (including the fees and terms thereof) provided by our independent auditor. Under the Audit Committee charter, the approval may be given as part of the Audit Committee's approval of the scope of the engagement of our independent auditor or on an individual basis. The pre–approval of certain services may be delegated to the Chair of the Audit Committee, but the decision must be presented to the full Audit Committee at its next scheduled meeting. Since the effective date of these rules, all of the services performed by KPMG described below were approved in advance by our Audit Committee. Other pre–approvals will be disclosed, as appropriate, in our periodic public filings. Our independent auditor may not be retained to perform the non–auditing services specified in Section 10A(g) of the Exchange Act.

Fees Paid to the Independent Auditor

Set forth in the table below are the aggregate amount of fees billed to us by KPMG for professional accounting services during 2004 and 2003, except for audit fees which for 2004, represents the aggregate amount of fees incurred through February 2005 related to the auditing of our consolidated financial statements for the fiscal year ended December 31, 2004 (in millions):

	2004	2003[5]
Audit Fees[1]	$42.2	$54.7
Audit–Related Fees[2]	1.2	0.2
Total audit and audit–related fees	$43.4	$54.9
Tax Fees[3]	8.7	14.8
All Other Fees[4]	0.7	0.1
Total Fees	$52.8	$69.8

(1) *Audit Fees.* These are fees for professional services provided for the audit of our annual consolidated financial statements, the audit of our internal controls assessment under the Sarbanes–Oxley Act of 2002, and reviews of our condensed consolidated quarterly financial statements, services that are normally provided by our independent accountant in connection with statutory and regulatory engagements and services generally only our independent accountant reasonably can provide, such as statutory audits required internationally, attest services, consents and assistance with and review of documents filed with the SEC. Included in the Audit Fees category are fees incurred for audits of the financial statements of certain of our subsidiaries performed in compliance with such subsidiaries' independent legal reporting obligations.

(2) *Audit–Related Fees.* These are fees for assurance and related services that are reasonably related to performance of audit services and traditionally are performed by our independent accountant. More specifically, these include: employee benefit plan audits and consultation concerning financial accounting and reporting standards.

(3) *Tax Fees.* These are fees for professional services rendered by our independent accountant's tax professionals except those related to the audit of our consolidated financial statements. Services included tax compliance, tax advice, and tax planning. Tax compliance involves preparation of original and amended tax returns and refund claims. Tax planning and tax advice included assistance with tax audits, requests for rulings, technical advice on bankruptcy matters, restructurings and transactions with foreign affiliates.

(4) *All Other Fees.* These are fees for all other products and services provided by our independent accountant that do not fall within the previous categories. Such fees relate to reimbursement of time and expenses incurred to produce information in response to third party requests.

(5) Reflects an additional $20.8 million in fees above those reported in our 2003 Annual Report on Form 10–K, to adjust estimated amounts to actual billings.

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

Financial Statements

Report of Independent Registered Public Accounting Firm	F–2
Report of Independent Registered Public Accounting Firm	F–4
Report of Independent Registered Public Accounting Firm—Embratel Participações S.A.	F–6
Consolidated statements of operations for each of the years in the period ended December 31, 2004 (Successor), 2003 and 2002 (Predecessor)	F–7
Consolidated balance sheets as of December 31, 2004 and 2003 (Successor)	F–8
Consolidated statements of changes in shareholders' equity (deficit) and comprehensive (loss) income for each of the years in the period ended December 31, 2004 (Successor), 2003 and 2002 (Predecessor)	F–9
Consolidated statements of cash flows for each of the years in the period ended December 31, 2004 (Successor), 2003 and 2002 (Predecessor)	F–10
Notes to consolidated financial statements	F–11

Exhibits

2.1 Modified Amended Second Joint Plan of Reorganization for WorldCom, Inc. (incorporated herein by reference to Exhibit 2.1 to WorldCom's Current Report on Form 8–K dated October 31, 2003 (filed November 18, 2003))

2.2 Offer to Purchase for Cash All Outstanding Shares of Class A Common Stock of Digex, Incorporated by WorldCom, Inc., dated August 27, 2003, as amended September 23, 2003 (filed as Exhibit 99(a)(1) to WorldCom's Schedule TO–T/A, dated September 23, 2003, and incorporated herein by reference)

2.3* Agreement and Plan of Merger between WorldCom, Wildcat Acquisition Corp. and Intermedia Communications Inc. dated as amended May 14, 2001 (filed as Annex A to WorldCom's Registration Statement on Form S–4, Registration No. 333–60482 and incorporated herein by reference)

2.4 Stock Purchase Agreement dated as of March 12, 2004 between Telefonos de Mexico, S.A. de C.V., WorldCom, Inc., MCI International, Inc., MCI WORLDCOM International, Inc. and MCI WorldCom Brazil, LLC (incorporated herein by reference to Exhibit 99.2 to WorldCom's Current Report on Form 8–K dated March 12, 2004 (filed March 18, 2004) (File No. 001–10415))

2.5 First Amendment to Stock Purchase Agreement dated as of April 7, 2004, by and among Telefonos de Mexico, S.A. de C.V., MCI, Inc., MCI International, Inc., MCI WorldCom International, Inc., and MCI WorldCom Brazil LLC (incorporated herein by reference to Exhibit 99.1 to MCI, Inc.'s Current Report on Form 8–K dated April 22, 2004 (filed April 23, 2004) (File No. 001–10415))

2.6 Second Amendment, dated as of April 20, 2004, by and among Telefonos de Mexico, S.A. de C.V., MCI, Inc., MCI International, Inc., MCI WorldCom International, Inc., and MCI WorldCom Brazil LLC (incorporated herein by reference to Exhibit 99.2 to MCI, Inc.'s Current Report on Form 8–K dated April 22, 2004 (filed April 23, 2004) (File No. 001–10415))

2.7 Merger Agreement dated as of February 14, 2005 among Verizon Communications, Inc., Eli Acquisition, LLC and MCI, Inc. (incorporated by reference to Exhibit 99.1 to MCI, Inc. Current Report on Form 8–K dated February 14, 2005 (filed February 17, 2005) (File No. 001–10415))

3.1 Amended and Restated Certificate of Incorporation of MCI, Inc. (incorporated herein by reference to Exhibit 3.1 to MCI's Form 8–A dated April 20, 2004 (File No. 000–11258))

3.2 Bylaws of MCI, Inc. incorporated herein by reference to Exhibit 3.2 to MCI's Form 8–A dated April 20, 2004 (File No. 000–11258)

4.1 Indenture between MCI, Inc., and Citibank, N.A., as trustee, dated as of April 20, 2004, for Senior Notes due 2007 (incorporated by reference to Exhibit 4.2 to MCI's Annual Report on Form 10–K for the year ended December 31, 2003 (filed April 29, 2004) (File No. 001–10415))

4.2 Indenture between MCI, Inc., and Citibank, N.A., as trustee, dated as of April 20, 2004, for Senior Notes due 2009 (incorporated by reference to Exhibit 4.3 to MCI's Annual Report on Form 10–K for the year ended December 31, 2003 (filed April 29, 2004) (File No. 001–10415))

4.3 Indenture between MCI, Inc., and Citibank, N.A., as trustee, dated as of April 20, 2004, for Senior Notes due 2014 (incorporated by reference to Exhibit 4.4 to MCI's Annual Report on Form 10–K for the year ended December 31, 2003 (filed April 29, 2004) (File No. 001–10415))

4.4	Rights Agreement between MCI, Inc. and The Bank of New York, as Rights Agent, dated as of April 20, 2004 incorporated herein by reference to Exhibit 4.1 to MCI's Form 8–A dated April 20, 2004 (File No. 000–11258)
4.5	Registration Rights Agreement, dated as of April 20, 2004, among MCI, Inc. and the security holders named therein (incorporated herein by reference to Exhibit 4.6 to MCI's Annual Report on Form 10–K for the year ended December 31, 2003 (filed April 29, 2004) (File No. 001–10415))
10.1	MCI, Inc. 2003 Employee Stock Purchase Plan (incorporated herein by reference to Exhibit 10.64 to MCI's Annual Report on Form 10–K for the year ended December 31, 2003 (filed April 29, 2004) (File No. 001–10415))
10.2	MCI, Inc. 2003 Management Restricted Stock Plan (incorporated herein by reference to Exhibit 10.65 to MCI's Annual Report on Form 10–K for the year ended December 31, 2003 (filed April 29, 2004) (File No. 001–10415))
10.3	MCI, Inc. Deferred Stock Unit Plan (incorporated herein by reference to Exhibit 10.66 to MCI's Annual Report on Form 10–K for the year ended December 31, 2003 (filed April 29, 2004) (File No. 001–10415))
*10.4	Form of Employment Agreement between MCI, Inc. and Michael Capellas (incorporated herein by reference to Exhibit 10.67 to MCI's Annual Report on Form 10–K for the year ended December 31, 2003 (filed April 29, 2004) (File No. 001–10415))
*10.5	Employment Agreement between MCI, Inc. and Robert T. Blakely
*10.6	Employment Agreement between MCI, Inc. and Jonathan Crane
*10.7	Employment Agreement between MCI, Inc. and Wayne E. Huyard
*10.8	Employment Agreement between MCI, Inc. and Anastasia Kelly
*10.9	Form of Employment Agreement between MCI, Inc. and Richard R. Roscitt (incorporated herein by reference to Exhibit 10.68 to MCI's Annual Report on Form 10–K for the year ended December 31, 2003 (filed April 29, 2004) (File No. 001–10415))
10.10	Supplemental Appendix to Employment Agreement of Richard R. Roscitt (incorporated herein by reference to Exhibit 10.69 to MCI's Annual Report on Form 10–K for the year ended December 31, 2003 (filed April 29, 2004) (File No. 001–10415))
10.11	Separation Agreement between Richard R. Roscitt and WorldCom, Inc. dated March 24, 2004 (incorporated herein by reference to Exhibit 10.70 to MCI's Quarterly Report on Form 10–Q for the quarter ended March 31, 2004 (filed May 10, 2004) (File No. 001–10415))
10.12	MCI, Inc. Corporate Valuable Pay Plan, as amended and restated effective February 11, 2005
10.13	Amendment No. 1 to the MCI, Inc. 2003 Employee Stock Purchase Plan
10.14	Amendment No. 2 to the MCI, Inc. 2003 Employee Stock Purchase Plan
10.15	Amendment No. 3 to the MCI, Inc. 2003 Employee Stock Purchase Plan
14.1	MCI, Inc.'s Code of Ethics and Business Conduct, "The Way We Work." (incorporated herein by reference to Exhibit 14.1 to MCI's Annual Report on Form 10–K for the year ended December 31, 2003 (filed April 29, 2004) (File No. 001–10415))
21.1	Subsidiaries of MCI, Inc.
23.1	Consent of Independent Registered Public Accounting Firm
23.2	Consent of Independent Registered Public Accounting Firm
31.1	Chief Executive Officer Certification
31.2	Chief Financial Officer Certification
32.1	Certification pursuant to 18. U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes–Oxley Act of 2002

* The registrant hereby agrees to furnish supplementally a copy of any omitted schedules/appendices to this Agreement to the SEC upon request.

SIGNATURES

Pursuant to the requirements of Section 13 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.

MCI, INC.

/s/ Robert T. Blakely

Robert T. Blakely
Chief Financial Officer

Date: March 16, 2005

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Name	Title	Date
/s/ Michael D. Capellas **Michael D. Capellas**	Director, President and Chief Executive Officer (Principal Executive Officer)	March 16, 2005
/s/ Robert T. Blakely **Robert T. Blakely**	Chief Financial Officer (Principal Financial Officer)	March 16, 2005
/s/ Eric R. Slusser **Eric R. Slusser**	Senior Vice President, Controller	March 16, 2005
/s/ Nicholas deB. Katzenbach **Nicholas deB. Katzenbach**	Chairman of the Board	March 16, 2005
/s/ Dennis R. Beresford **Dennis R. Beresford**	Director	March 16, 2005
/s/ W. Grant Gregory **W. Grant Gregory**	Director	March 16, 2005
/s/ Judith R. Haberkorn **Judith R. Haberkorn**	Director	March 16, 2005
/s/ Laurence E. Harris **Laurence E. Harris**	Director	March 16, 2005
/s/ Eric H. Holder **Eric H. Holder**	Director	March 16, 2005
/s/ Mark A. Neporent **Mark A. Neporent**	Director	March 16, 2005
/s/ C.B. Rogers, Jr. **C.B. Rogers, Jr.**	Director	March 16, 2005

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	Page
MCI, Inc. and subsidiaries	
Report of Independent Registered Public Accounting Firm	F–2
Report of Independent Registered Public Accounting Firm	F–4
Report of Independent Registered Public Accounting Firm—Embratel Participações S.A.	F–6
Consolidated statements of operations for each of the years in the period ended December 31, 2004 (Successor), 2003 and 2002 (Predecessor)	F–7
Consolidated balance sheets as of December 31, 2004 and 2003 (Successor)	F–8
Consolidated statements of changes in shareholders' equity (deficit) and comprehensive (loss) income for each of the years in the period ended December 31, 2004 (Successor), 2003 and 2002 (Predecessor)	F–9
Consolidated statements of cash flows for each of the years in the period ended December 31, 2004 (Successor), 2003 and 2002 (Predecessor)	F–10
Notes to consolidated financial statements	F–11

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
MCI, Inc.:

We have audited the accompanying consolidated balance sheets of MCI, Inc. and subsidiaries as of December 31, 2004 and 2003 (Successor Company), and the related consolidated statements of operations, changes in shareholders' equity (deficit) and comprehensive (loss) income and cash flows for the years ended December 31, 2004 (Successor Company), 2003 and 2002 (Predecessor Company) (collectively, the Company). These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the consolidated financial statements of Embratel Participações S.A. and subsidiaries ("Embratel"), a partially–owned subsidiary until July 2004, which statements reported in Brazilian Reals (R$) reflect total assets of R$13.7 billion (US$4.7 billion) as of December 31, 2003. Embratel's net income (loss) of R$382 million (US$125 million) and R$(678) million (US$(226) million) in 2003 and 2002, respectively, are included within discontinued operations for those years. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Embratel Participações S.A. and subsidiaries for 2003 and 2002, is based solely on the report of the other auditors.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The Company's consolidated financial statements do not disclose earnings (loss) per common share information allocated between the Company's two series of separately traded tracking stocks for the years ended December 31, 2003 and 2002. Earnings per share information is required by Statement of Financial Accounting Standards No. 128, *Earnings Per Share*. In our opinion, disclosure of this information is required by U.S. generally accepted accounting principles.

In our opinion, except for the omission of the information discussed in the preceding paragraph, based on our audits and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of MCI, Inc. and subsidiaries as of December 31, 2004 and 2003 (Successor Company), and the results of their operations and their cash flows for the years ended December 31, 2004 (Successor Company), 2003 and 2002 (Predecessor Company), in conformity with U.S. generally accepted accounting principles.

As discussed in Note 5 to the consolidated financial statements, on October 31, 2003, the United States Bankruptcy Court for the Southern District of New York confirmed the Company's Plan of Reorganization (the Plan). The Plan became effective on April 20, 2004 and the Company emerged from Chapter 11 of Title 11 of the U.S. Bankruptcy Code (Chapter 11). In connection with its emergence from Chapter 11, the Company adopted fresh–start reporting pursuant to American Institute of Certified Public Accountants Statement of Position 90–7, *Financial Reporting by Entities in Reorganization Under the Bankruptcy Code,* as of December 31, 2003 as further described in Note 4 to the consolidated financial statements. As a result, the consolidated financial statements of the Successor Company are presented on a different basis than those of the Predecessor Company and, therefore, are not comparable in all respects.

As discussed in Note 2 to the accompanying consolidated financial statements, effective January 1, 2003, the Company adopted Statement of Financial Accounting Standards No. 143, *Accounting for Asset Retirement*

Obligations. Also, as discussed in Note 2, effective January 1, 2002, the Company adopted Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*, and Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long–Lived Assets*.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2004, based on the criteria established in *Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)*, and our report dated March 15, 2005, expressed an unqualified opinion on management's assessment of, and an adverse opinion on the effective operation of, internal control over financial reporting.

KPMG LLP

McLean, Virginia

March 15, 2005

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
MCI, Inc.:

We have audited management's assessment, included in *Management's Report on Internal Control over Financial Reporting* at Item 9A.1., that MCI, Inc. and subsidiaries (the Company) did not maintain effective internal control over financial reporting as of December 31, 2004, because of the effect of the material weakness identified in management's assessment that the Company's controls and procedures over accounting for income taxes were ineffective, based on the criteria established in *Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)*. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weakness has been identified and included in management's assessment: In its assessment as of December 31, 2004, management identified that the Company had a material weakness in its internal control over accounting for income taxes due to a lack of personnel with adequate expertise in income tax accounting matters, a lack of documentation, insufficient historical analysis and ineffective reconciliation procedures. Because of these deficiencies, there is more than a remote likelihood that a material misstatement in the Company's annual or interim financial statements due to errors in accounting for income taxes could occur and not be prevented or detected by its internal control over financial reporting.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of MCI, Inc. and subsidiaries as of December 31, 2004 and 2003

(Successor Company), and the related consolidated statements of operations, changes in shareholders' equity (deficit) and comprehensive (loss) income, and cash flows for the years ended December 31, 2004 (Successor Company), and 2003 and 2002 (Predecessor Company) (collectively, the Company). The aforementioned material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2004 consolidated financial statements, and this report does not affect our report dated March 15, 2005, which expressed a qualified opinion on those consolidated financial statements due to the absence of earnings per share information for 2003 and 2002.

In our opinion, management's assessment that MCI, Inc. and subsidiaries did not maintain effective internal control over financial reporting as of December 31, 2004, is fairly stated, in all material respects, based on the criteria established in *Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).* Also, in our opinion, because of the effect of the material weakness described above on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of December 31, 2004, based on the criteria established in *Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).*

We do not express an opinion or any other form of assurance on *Management's Discussion on Income Tax Material Weakness* at Item 9A.2. or other matters included at Items 9A.3., 4., and 5.

KPMG LLP

McLean, Virginia

March 15, 2005

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
Embratel Participações S.A.
Rio de Janeiro–RJ, Brazil

We have audited the accompanying consolidated balance sheets of Embratel Participações S.A. and subsidiaries as of December 31, 2003 and the consolidated statements of operations, changes in shareholders' equity and changes in financial position for each of the two years in the period ended December 31, 2003, all expressed in Brazilian Reais. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

Our audits were conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Embratel Participações S.A. and subsidiaries as of December 31, 2003, and the results of their operations, the changes in shareholders' equity and the changes in their financial position for each of the two years in the period ended December 31, 2003, in conformity with accounting practices adopted in Brazil.

Accounting practices adopted in Brazil vary in certain respects from accounting principles generally accepted in the United States of America. Application of accounting principles generally accepted in the United States of America would have affected shareholders' equity as of December 31, 2003 and the results of operations for each of the two years in the period ended December 31, 2003, to the extent summarized in Note 30 to the consolidated financial statements.

DELOITTE TOUCHE TOHMATSU

Rio de Janeiro, Brazil

March 17, 2004 (except with respect to the matters discussed in Note 30, as to which the date is April 6, 2004)

MCI, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
(In Millions, Except Per Share Data)

	Successor Company	Predecessor Company	
	Year Ended December 31,		
	2004	2003	2002
Revenues	$20,690	$24,266	$28,493
Operating expenses:			
Access costs	10,719	11,997	13,304
Costs of services and products (excluding depreciation and amortization included below of $1,436, $1,938 and $2,356 in 2004, 2003 and 2002, respectively)	2,506	2,771	3,461
Selling, general and administrative	5,220	6,479	8,062
Depreciation and amortization	1,924	2,316	2,903
Unclassified, net	—	—	(35)
(Gain) loss on property dispositions	(1)	43	123
Impairment charges related to property, plant and equipment	2,775	—	4,599
Impairment charges related to intangible assets	738	—	400
Total operating expenses	23,881	23,606	32,817
Operating (loss) income	(3,191)	660	(4,324)
Other income (expense), net:			
Interest expense (contractual interest of $2,425 in 2003 and $2,360 in 2002)	(402)	(105)	(1,354)
Miscellaneous income (expense), net (includes a $2,250 SEC fine in 2002)	85	136	(2,221)
Reorganization items, net	—	22,087	(802)
(Loss) income from continuing operations before income taxes, minority interests and cumulative effects of changes in accounting principles	(3,508)	22,778	(8,701)
Income tax expense	520	313	258
Minority interests, net of tax	—	(4)	(20)
(Loss) income from continuing operations before cumulative effects of changes in accounting principles	(4,028)	22,469	(8,939)
Net income (loss) from discontinued operations	26	(43)	(202)
(Loss) income before cumulative effects of changes in accounting principles	(4,002)	22,426	(9,141)
Cumulative effects of changes in accounting principles	—	(215)	(32)
Net (loss) income	(4,002)	22,211	(9,173)
Distributions on preferred securities (contractual distributions of $31 in 2003 and $35 in 2002)	—	—	(19)
Net (loss) income attributable to common shareholders	$(4,002)	$22,211	$(9,192)
Basic and diluted (loss) income per share:			
Continuing operations	$(12.56)		
Discontinued operations	0.08		
Loss per share	$(12.48)		
Basic and diluted shares used in calculation	320.8		

See accompanying notes to consolidated financial statements.

MCI, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(In Millions, Except Share Data)

	Successor Company	
	As of December 31,	
	2004	2003
ASSETS		
Current assets		
Cash and cash equivalents	$ 4,449	$ 6,178
Marketable securities	1,055	15
Accounts receivable, net of allowance for doubtful accounts of $729 for 2004 and $1,762 for 2003	2,855	4,348
Prepaid expenses	287	377
Deferred income taxes	—	990
Other current assets	437	444
Assets held for sale	10	176
Total current assets	9,093	12,528
Property, plant and equipment, net	6,259	11,538
Investments	116	238
Intangible assets, net	991	2,085
Deferred income taxes	456	608
Other assets	145	473
	$17,060	$27,470
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 784	$ 1,722
Accrued access costs	1,491	2,349
Current portion of long-term debt	24	330
Accrued interest	93	25
Deferred income taxes	598	—
Other current liabilities	3,198	4,361
Liabilities of assets held for sale	15	23
Total current liabilities	6,203	8,810
Long-term debt, excluding current portion	5,909	7,117
Deferred income taxes	18	1,207
Other liabilities	700	714
Commitments and contingencies (Notes 18 and 19)		
Minority interests	—	1,150
Shareholders' equity:		
MCI common stock, par value $0.01 per share; authorized: 3,000,000,000 shares in 2004 and 2003; issued and outstanding: 319,557,905 shares for 2004 and 314,856,250 shares for 2003	3	3
Additional paid-in capital	8,365	8,639
Deferred stock-based compensation	(114)	(170)
Accumulated deficit	(4,002)	—
Accumulated other comprehensive loss	(22)	—
Total shareholders' equity	4,230	8,472
	$17,060	$27,470

See accompanying notes to consolidated financial statements.

MCI, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (DEFICIT) AND COMPREHENSIVE (LOSS) INCOME
For Each of the Years in the Three–Year Period Ended December 31, 2004
(In Millions)

	Common Stock	Additional Paid–In Capital	Deferred Stock–Based Compensation	Accumulated Deficit	Treasury Stock	Accumulated Other Comprehensive (Loss) Income	Total Shareholders' Equity (Deficit)
Balance at January 1, 2002 (Predecessor Company)	$ 31	$ 56,330	$ —	$ (68,975)	$ (185)	$ (142)	$ (12,941)
Net loss				(9,173)			(9,173)
Currency translation adjustments						(156)	(156)
Unrealized loss on marketable securities						(3)	(3)
Reclassification adjustment for gains included in net loss						(19)	(19)
Minimum pension liability adjustment						(38)	(38)
Comprehensive loss							(9,389)
Distributions on preferred securities				(19)			(19)
Issuance of common stock for preferred dividends		9					9
Exercise of stock options		15					15
Conversion of preferred stock to common		28					28
Other		2					2
Balance at December 31, 2002 (Predecessor Company)	31	56,384	—	(78,167)	(185)	(358)	(22,295)
Net income				22,211			22,211
Currency translation adjustments						15	15
Unrealized gains on marketable securities						12	12
Reclassification adjustment for gains included in net income						(5)	(5)
Comprehensive income							22,233
Conversion of preferred stock to common		58					58
Other		2					2
Application of fresh–start reporting (Note 4):							
Cancellation of Predecessor common stock	(31)	(56,444)			185		(56,290)
Elimination of Predecessor accumulated deficit and accumulated other comprehensive loss				55,956		336	56,292
Issuance of MCI common stock	3	8,639	(170)				8,472
Balance at December 31, 2003 (Successor Company)	3	8,639	(170)	—	—	—	8,472
Net loss				(4,002)			(4,002)
Currency translation adjustments						(18)	(18)
Reclassification of foreign currency translation gains included in net loss						17	17
Unrealized gains on marketable securities						2	2
Minimum pension liability						(23)	(23)
Comprehensive loss							(4,024)
Dividends declared on common stock		(254)					(254)
Amortization of deferred stock–based compensation			36				36
Deferred stock–based compensation forfeited		(20)	20				—
Balance at December 31, 2004 (Successor Company)	$ 3	$ 8,365	$ (114)	$ (4,002)	$ —	$ (22)	$ 4,230

See accompanying notes to consolidated financial statements.

MCI, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Millions)

	Successor Company	Predecessor Company	
	Year Ended December 31,		
	2004	2003	2002
OPERATING ACTIVITIES			
Net (loss) income	$(4,002)	$ 22,211	$(9,173)
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:			
Depreciation and amortization	1,924	2,316	2,903
Impairment charges related to property, plant and equipment, goodwill and intangible assets	3,513	—	4,999
Impairment charges related to investments	1	12	25
Cumulative effects of changes in accounting principles	—	215	32
Minority interests, net of tax	—	(4)	(20)
Net realized gain on sale of investments	(10)	(2)	(24)
(Gain) loss on sale of property, plant and equipment	(1)	43	123
Bad debt provision	554	880	1,271
Deferred income tax (benefit) expense	(84)	(26)	95
Reserve for employee loan	—	—	332
Effect of the plan of reorganization and revaluation of assets and liabilities	—	(22,674)	—
Non-cash reorganization items, net	—	383	688
Accretion expense related to SFAS No. 143 liability	27	21	—
Amortization of debt discount	114	—	—
Other	12	264	121
Changes in assets and liabilities:			
Accounts receivable	377	(169)	(3,061)
Other current assets	118	96	407
Non current assets	13	277	—
Accounts payable and accrued access costs	(1,053)	(151)	(1,015)
Other current liabilities	(762)	(360)	(867)
Other liabilities	51	196	3,062
Net cash provided by (used in) operating activities	792	3,528	(102)
INVESTING ACTIVITIES			
Additions to property, plant and equipment	(982)	(756)	(1,040)
Proceeds from sale of property, plant and equipment	43	257	48
Purchases of investments	(1,055)	—	—
Proceeds from sale of investments	56	8	792
Proceeds from disposition of assets and assets held for sale	585	—	53
Cash paid for acquisitions, net of cash received	(13)	(39)	—
Net cash used in investing activities	(1,366)	(530)	(147)
FINANCING ACTIVITIES			
Principal borrowings on debt	—	—	2,851
Principal repayments on debt	(43)	(93)	(1,031)
Proceeds from exercise of stock options	—	—	15
Dividends paid on common and preferred stock	(254)	—	(159)
Debt issuance costs	—	—	(50)
Cash restricted for letters of credit	(144)	—	—
Other	(112)	112	—
Net cash (used in) provided by financing activities	(553)	19	1,626
Net change in cash and cash equivalents	(1,127)	3,017	1,377
Net change in cash and cash equivalents from discontinued operations	(602)	341	153
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	6,178	2,820	1,290
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 4,449	$ 6,178	$ 2,820
SUPPLEMENTAL CASH FLOW INFORMATION:			
Cash paid (refunds received) for income taxes, net	$ 97	$ 28	$ (471)
Cash paid for interest, net of amounts capitalized	223	178	1,306
Cash paid for reorganization items	—	204	114
Non cash items:			
Conversion of preferred stock to common stock	—	58	28
Minimum pension liability adjustment	23	—	38
Unrealized holding (gain) loss on investments	(2)	(7)	22
Reclassification of pre-petition liabilities to liabilities subject to compromise	—	—	2,890

See accompanying notes to consolidated financial statements.

(1) The Organization and Description of Business

MCI, Inc., a state of Delaware corporation, (formerly known as WorldCom, Inc., (the "Predecessor Company" or "WorldCom") a public corporation organized in 1983 under the laws of Georgia) serves as a holding company for its direct and indirect domestic subsidiaries and foreign affiliates (collectively, the "Company", "Successor Company" or "MCI"). Prior to and including December 31, 2003, all operations of the business resulted from the operations of the Predecessor Company. All conditions required for adoption of fresh–start reporting were met on December 23, 2003 and the Company selected December 31, 2003 as the date to adopt the accounting provisions of fresh–start reporting. As a result, the fair value of the Predecessor Company's assets became the new basis for the Successor Company's consolidated balance sheet as of December 31, 2003, and all results of operations beginning January 1, 2004 are those of the Successor Company.

The Company is one of the world's leading global telecommunications companies, providing a broad range of communication services. The Company serves thousands of businesses and government entities throughout the world and provides voice, data and Internet communication services for millions of consumer customers. The Company operates one of the most extensive telecommunications networks in the world, comprising network connections linking metropolitan centers and various regions across North America, Europe, Asia, Latin America, the Middle East, Africa and Australia. The Company began doing business as MCI in 2003.

In March 2004, the Company realigned its operations into three new business segments and began operating under these segments in the second quarter of 2004. Effective with the realignment, the Company's business segments are as follows:

- **Enterprise Markets** serves Global Accounts, Government Markets, and System Integrators. Global Accounts provides communications and network solutions to large multinational corporations requiring complex international network services. Government Accounts provides similar services to various government agencies. System Integrators serve customers through partnerships with third–party network solutions providers. In all cases, these services include local–to–global business data, Internet, voice services and managed network services.

- **U.S. Sales & Service** serves small, mid–sized and corporate customers. In addition, U.S. Sales & Service comprises the Company's consumer operation which includes telemarketing, customer service and direct response marketing.

- **International & Wholesale Markets** serves businesses, government entities and telecommunications carriers outside the United States as well as wholesale accounts.

The Predecessor Company restated its previously reported consolidated financial statements for the years ended December 31, 2001 and 2000. In conjunction with the Predecessor Company's restatement and through December 31, 2002, a number of balances or entries recorded in the historical accounting records could not be supported or their propriety otherwise determined. Certain accrued liabilities, other liabilities and other asset balances were found to have inadequate support to establish existence of an asset or a liability. Certain intercompany balances could not be reconciled and the propriety of certain entries recorded in consolidation could not be determined due to lack of supporting documentation. As a result of these findings, it was determined that appropriate adjustments should be recorded to properly state the historical accounting records. Because there was no documentary support related to these items, the Predecessor Company was unable to determine the appropriate statement of operations line item to which such amounts should be applied. As a result, 2002 amounts have been included within operating expenses and noted as "Unclassified, net" in the consolidated statement of operations for the year ended December 31, 2002.

On July 21, 2002 (the "Petition Date"), WorldCom, Inc. and substantially all of its domestic subsidiaries ("Debtors") filed voluntary petitions for relief in the U.S. Bankruptcy Court for the Southern District of

New York (the "Bankruptcy Court") under Chapter 11 of Title 11 of the U.S. Bankruptcy Code (the "Bankruptcy Code" or "Chapter 11"). The Debtors continued to operate their businesses and manage their properties as debtors–in–possession through the close of business on April 19, 2004. The Predecessor Company filed a plan of reorganization (the "Plan") with the Bankruptcy Court and, on October 31, 2003, the Bankruptcy Court confirmed the Plan. The Predecessor Company emerged from Chapter 11 on April 20, 2004 (the "Emergence Date") and changed its legal name to MCI.

(2) Summary of Significant Accounting Policies

Use of Estimates

The Company uses estimates and assumptions in the preparation of its consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP"). The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates. Estimates are used when accounting for impairment charges, revenues and related allowances, allowance for doubtful accounts, accrued access costs, depreciation and amortization of property, plant and equipment and intangible assets, income taxes, acquisition related assets and liabilities, accrued and contingent liabilities and fresh–start reporting. The Company evaluates and updates its assumptions and estimates on an ongoing basis and may employ outside experts to assist in its evaluations.

During 2004, the Company recorded benefits for changes in estimates totaling $302 million. The Company recorded $121 million as a reduction to selling, general, and administrative expenses for a change in estimate of $62 million related to its reserve for outstanding claims, which amount was included in total gains on settlements (see Note 5) and a $59 million change in estimate related to bad debt assumptions. Additionally, the Company increased revenue by $86 million for a change in estimate related to its billing adjustment assumptions, and reduced access costs by $95 million (of which $68 million related to 2003) for a change in estimate related to its contributions to the Universal Service Fund. Additionally, the Company recognized an increase to income tax expense of $275 million relating to changes in estimates of U.S. federal, state, and foreign tax contingencies of $210 million and $65 million that reduced the carrying value of the Company's intangible assets during the second quarter of 2004.

Basis of Financial Statement Preparation

For the period subsequent to the Petition Date through December 31, 2003, the accompanying consolidated financial statements have been prepared in accordance with American Institute of Certified Public Accountants Statement of Position ("SOP") 90–7, "*Financial Reporting by Entities in Reorganization Under the Bankruptcy Code*" ("SOP 90–7"). Accordingly, all pre–petition liabilities subject to compromise were adjusted to the estimated amounts of allowable claims prior to the application of fresh–start reporting. Interest has not been accrued on debt subject to compromise subsequent to the Petition Date. Reorganization items include the expenses, realized gains and losses, and provisions for losses resulting from the reorganization under the Bankruptcy Code, and are reported separately as reorganization items in the Predecessor Company's consolidated statements of operations. Cash used for reorganization items is disclosed separately in the consolidated statements of cash flows.

Fresh–Start Reporting

Although the Company emerged from bankruptcy on April 20, 2004, the Predecessor Company adopted fresh–start reporting effective at the close of business on December 31, 2003 under the provisions of SOP 90–7, which resulted in a new reporting entity for accounting purposes (Successor Company). The consolidated balance sheet as of December 31, 2003 gives effect to adjustments to the carrying value of assets or amounts and classifications of liabilities that were necessary when adopting fresh–start reporting. The statements of operations

and cash flows for the two–year period ended December 31, 2003 reflect the operations of the Predecessor Company, which included a gain in 2003 from the application of fresh–start reporting (see Note 4). The adoption of fresh–start reporting had a material effect on the consolidated financial statements as of December 31, 2003. As a result, the consolidated financial statements of the Successor Company are presented on a different basis than those of the Predecessor Company and, therefore, are not comparable in all respects. Changes in estimates and preconfirmation contingencies are reflected in the statements of operations as they are determined, whereas changes in the allocation of fair values resulted in adjustments to the assets and liabilities.

In addition, the Successor Company was required to adopt changes in accounting principles that were required in the consolidated financial statements of the emerging entity within the twelve months following the adoption of fresh–start reporting. The Successor Company completed a review of these accounting pronouncements and there was no material impact on its consolidated results of operations, financial position or cash flows.

In connection with fresh–start reporting, the Successor Company's new debt obligations included in the Successor Company's consolidated balance sheet were adjusted as of December 31, 2003 to a value based on an imputed interest rate. The difference between the December 31, 2003 obligation in the consolidated balance sheet and the face value of the obligations issued on April 20, 2004 was estimated to be $114 million, using an imputed rate of interest of approximately 6.7% which represented the estimated weighted average rate for the debt issued on the Emergence Date. The amount was recorded in the consolidated balance sheet as a discount. The debt obligations were accreted to the face value of the Company's obligations beginning January 1, 2004 through the Emergence Date.

Consolidation

The consolidated financial statements include the accounts of all controlled subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

Foreign Currency Translation

The Company's functional currency is the U.S. dollar. Embratel Participações S.A. and subsidiaries ("Embratel") assets and liabilities included in the consolidated balance sheet as of December 31, 2003 were recorded in Embratel's functional currency, the Brazilian Real, and were translated at the exchange rate as of the balance sheet date. Embratel's revenue and expense accounts included in discontinued operations were translated at a weighted–average exchange rate in effect during the reporting period. Translation adjustments were recorded as a component of accumulated other comprehensive (loss) income within shareholders' equity as of December 31, 2003.

Transaction gains and losses arise from exchange rate fluctuations on transactions denominated in a currency other than an entity's functional currency. The consolidated statements of operations include as a component of miscellaneous income (expense), net foreign currency transaction gains (losses) of $22 million, $15 million and $(146) million for the years ended December 31, 2004, 2003, and 2002, respectively.

Cash and Cash Equivalents

The Company considers all highly liquid investments with maturities of three months or less at the time of purchase to be cash equivalents.

Marketable Securities

All investments in debt and equity securities with readily determinable fair values are recorded as available–for–sale securities. The available–for–sale securities are carried at fair value, with unrealized holding gains or

losses reported in accumulated other comprehensive (loss) income, which is a separate component of shareholders' equity, net of tax. Marketable securities are included in current assets in the consolidated balance sheet as management has identified these securities as available to fund current operations. The Company reviews declines in the fair value of each individual available–for–sale investment security to determine whether the decline is other–than–temporary. The Company considers all available evidence in this decision, including changes in general market conditions, specific industry and individual company data, the length of time and the extent to which the market value has been less than the amortized cost, and the Company's intent and ability to hold the security. The cost basis of the investments in the available–for–sale category is determined using either the specific identification or average cost method.

Property, Plant and Equipment

Property, plant and equipment are stated at cost net of depreciation and impairment. Plant and equipment under capital leases are stated at the present value of minimum lease payments. Depreciation is provided for financial reporting purposes using the straight–line method over the lesser of the estimated useful life of the assets or life of the lease. Useful lives are as follows:

Transmission equipment (including conduit)	4 to 30 years
Telecommunications equipment	5 to 9 years
Furniture, fixtures, buildings and other	4 to 39 years
Software	3 to 6 years

Maintenance and repairs on property and equipment are expensed as incurred. Replacements and betterments which increase the useful lives or functionality of the assets are capitalized. The cost and related accumulated depreciation of assets sold or retired are removed from the accounts, and any resulting gain or loss is reflected as a separate component on the consolidated statements of operations.

The Company constructs certain transmission systems and related facilities for use. Certain costs directly related to the construction of such facilities, including interest and internal labor costs, are capitalized. Such capitalized costs were $51 million (of which $28 million was interest), $2 million (of which none was interest), and $243 million (of which $10 million was interest) for the years ended December 31, 2004, 2003 and 2002, respectively.

Also included in property, plant and equipment are costs incurred to develop software for internal use. Certain direct development costs and software enhancements associated with internal–use software are capitalized, including external direct costs of material and service, and internal labor costs devoted to these software projects under Statement of Position 98–1, *"Accounting for Costs of Computer Software Developed or Obtained for Internal Use."* Costs incurred during the preliminary project stage, as well as maintenance and training costs, are expensed as incurred. Such capitalized costs were $319 million, $314 million and $489 million for the years ended December 31, 2004, 2003 and 2002, respectively.

Asset Retirement Obligations

On January 1, 2003, the Predecessor Company adopted Statement of Financial Accounting Standards ("SFAS") No. 143, *"Accounting for Asset Retirement Obligations"* ("SFAS No. 143"). This standard requires that obligations, which are legally enforceable, unavoidable and associated with the retirement of tangible long–lived assets, be recorded as liabilities when those obligations are incurred, with the amount of the liability initially measured at the estimated fair value. The offset to each initial asset retirement obligation is an increase in the carrying amount of the related long–lived asset and is depreciated over its estimated useful life. The

liability is accreted over time to a projected disposal date. Upon settlement of the liability, the Company will record a gain or loss in its consolidated statement of operations for the difference between the estimate provided and the actual settlement amount to be paid.

The Company evaluated its long–lived assets and determined that legal asset retirement obligations existed for the removal of a limited number of these assets as of January 1, 2003 and recorded the cumulative effect of a change in accounting principle in its 2003 statement of operations of $215 million, which represents the difference between the increase in net asset value of $60 million and the estimated liability of $275 million. The majority of these obligations related to specific lease restoration requirements of leased buildings, obligations related to removal and restoration of international fiber optic cable, towers and antennae, and obligations related to other long–lived assets.

Subsequent to adoption of SFAS No. 143 on January 1, 2003, operating expenses increased as a result of the accretion of the Company's legal asset retirement obligations by approximately $21 million per year and depreciation expense increased by approximately $6 million per year, which in total is approximately $3 million lower than the combined amounts for 2002. These items have no impact on the Company's cash flows until such time as these long–lived assets are retired and the related obligations are settled. See Note 7 for a reconciliation of the beginning and ending aggregate recorded amount of the asset retirement obligations. The following pro forma table illustrates the effect on the Predecessor Company's statements of operations had SFAS No. 143 been applied in 2002 (in millions):

	Predecessor Company
	Year Ended December 31, 2002
Net loss attributable to common shareholders	$ (9,192)
Deduct: Additional accretion and depreciation expense	(30)
Pro forma net loss attributable to common shareholders	$ (9,222)

Intangible Assets

The Company accounts for its indefinite–lived intangible assets in accordance with SFAS No. 142, *"Goodwill and Other Intangible Assets"* ("SFAS No. 142"). Indefinite–lived intangibles are reviewed for impairment using a variety of methods at least annually, and impairments, if any, are charged to the Company's results of operations. The Company has selected an annual impairment test date for these assets of October 1. Intangible assets that have definite lives are amortized over their useful lives which range from three years to 25 years and are reviewed for impairment, as discussed in *"Valuation of Long–Lived Assets"* below.

Upon adoption of SFAS No. 142 on January 1, 2002, the Predecessor Company recognized a cumulative effect of the change in accounting principle of $32 million related to the impairment of indefinite–lived SkyTel Communications, Inc. ("SkyTel") channel rights.

Valuation of Long–Lived Assets

The Company accounts for its definite–lived assets in accordance with SFAS No. 144, *"Accounting for the Impairment or Disposal of Long–Lived Assets,"* ("SFAS No. 144") which requires that long–lived assets be evaluated whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the total of the undiscounted future cash flows is less than the carrying amount of the asset or asset group, an impairment loss is recognized for the difference between the estimated fair value and the carrying value of the asset or asset group.

The Company operates an integrated telecommunications network. All assets comprising the integrated telecommunications network and the related identifiable cash flows are aggregated for the purposes of the impairment review because this aggregated level is the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets and liabilities.

Investments

Investments in entities where the Company's ownership interest exceeds 20 percent or which provide the Company the ability to exercise significant influence over the entity's operations and management functions are accounted for using the equity method. Under the equity method, the original investment is increased (decreased) for the Company's share of the investee's net income (loss), increased by contributions made and reduced by distributions received. The Company records its equity in the income or losses of these investees either in the current month, one month in arrears for some private companies or three months in arrears for some public companies.

All equity investments where the equity securities do not have readily determinable fair values and which do not provide the Company the ability to exercise significant influence over the entity's operations and management functions are accounted for under the cost method. Under the cost method of accounting, private equity investments are carried at cost and are adjusted only for other–than–temporary declines in fair value, dividends received in excess of earnings and additional investments.

The Company periodically reviews its investments to determine if a loss in value which is other–than–temporary has occurred. In these reviews, the Company considers all available information, including the recoverability of its investment, the earnings and near–term prospects of the entity, factors related to the industry, financial and operating conditions of the entity and the Company's ability, if any, to influence the management of the entity.

Acquisition Related Assets and Liabilities

Accounting for the acquisition of a business as a purchase transaction requires an allocation of the purchase price to the assets acquired and the liabilities assumed in the transaction at their respective estimated fair values. The most difficult estimations of individual fair values are those involving properties, equipment and identifiable intangible assets. The Company uses all available information to make these fair value determinations and, for significant business acquisitions, engages independent third–party appraisal firms to assist in the fair value determinations of the acquired long–lived assets.

Assets and Liabilities Held for Sale

The Company classifies and reports separately assets and liabilities of operations held for sale when all of the following conditions are met: a formal plan for disposal has been authorized by management with proper authority, the operations to be disposed of are available for immediate sale in its present condition, an active program to sell the operations at a reasonable price has been initiated, the sale is expected to occur within one year, and it is unlikely that significant changes to the disposition plan will occur. Assets of operations held for sale are not depreciated, are recorded at the lower of their carrying amount or fair value less estimated costs to sell, and are separately presented in the consolidated balance sheet. The operating results of assets held for sale that meet the requirements for discontinued operations presentation are separately reported as discontinued operations in the consolidated statements of operations for all periods presented.

Recognition of Revenues

The Company recognizes revenue when persuasive evidence of a sales arrangement exists, delivery has occurred or services have been rendered, the sales price is fixed or determinable, and collectibility is reasonably assured. The Company records provisions against related revenue for service discounts, promotions, achievement credits and incentives related to telecommunication services. These revenue allowances are based on estimates derived from factors that include, but are not limited to, historical results, analysis of credits issued, current economic trends and changes in demand. The provisions for revenue adjustments are recorded as a reduction of revenue when incurred or ratably over a related contract period.

The Company derives revenue principally from long distance voice, local voice, data services, and Internet services. Long distance voice services are sold to consumer, business, government and wholesale customers. Local voice services consist mostly of local toll and switched access services for residential and business customers. Revenues derived from long distance and local voice services are recognized at the time of customer usage, and are based upon minutes of traffic carried and upon tariff or contracted fee schedules. Data services include domestic private lines, frame relay, and asynchronous transfer mode services. Revenues are recorded at the time service is provided based on monthly service fees. Internet products and services include dedicated Internet access, managed networking services and applications, web hosting and electronic commerce and transaction services. Revenue derived from Internet services is recognized at the time the service is provided. Advanced billings for monthly fees are deferred and recognized as revenue at the time the service is provided.

Additionally, a portion of the Company's revenue is related to the sale and installation of telecommunications equipment, including central office based remote access equipment. Revenue from systems equipment sales is recognized when title, ownership, and risk of loss passes to the customer and other revenue recognition criteria are met.

The Company has certain arrangements where it recognizes revenue in accordance with SEC Staff Accounting Bulletin No. 104, *"Revenue Recognition,"* which requires certain up front non–recurring service activation and installation fee revenue to be deferred over the average customer life. Service activation and installation fee revenues are deferred and amortized over the average customer life, which ranges from one to three years, while costs directly related to these revenues are expensed as incurred.

The Company enters into operating agreements with telecommunications carriers in foreign countries under which international long distance traffic is both delivered and received. The terms of some switched voice operating agreements, as established by Federal Communications Commission ("FCC") policy, require that inbound switched voice traffic from the foreign carrier to the United States be routed to United States international carriers, like MCI, in proportion to the percentage of United States outbound traffic routed by that United States international carrier to the foreign carrier. Mutually exchanged traffic between the Company and foreign carriers is settled in cash through a formal settlement process that generally extends over a three–month or six–month period at an agreed upon settlement rate. International settlements are accounted for as revenue for international in–bound calls terminating on the Company's domestic U.S. facilities and as access cost expense for international out–bound calls originating on the Company's domestic U.S. facilities and terminating on another international carrier's facilities.

Reciprocal compensation is the amount paid by one carrier to complete particular calls on a local exchange carrier's network. Reciprocal compensation paid to and received from other carriers is based on contractual fixed rate per minute charges. The Company recognizes the receipt of reciprocal compensation as revenue and the cost of reciprocal compensation as access cost expense.

The Company enters into contracts with counter parties to provide telecommunications network capacity, and grants rights to capacity on the basis of an indefeasible right of use ("IRU"). An IRU is a right to use a specified amount of capacity for a specified time period. The "indefeasible right" is one that cannot be revoked or voided. An acquirer of an IRU has the exclusive right to use the capacity represented by the IRU. It may use the capacity, leave it idle or allow third parties to use some or all of it in return for payments or otherwise. Upon meeting certain criteria, grants of IRUs of fiber or cable in exchange for cash are accounted for as sales type leases. IRUs that do not meet this criteria, which are the most common, are accounted for as operating leases and the related cash receipt is recognized as revenue over the life of the IRU.

The Company has entered into transactions such as buying, selling, swapping or exchanging capacity to complete and complement its network. In general, these transactions represent the exchange of productive assets not held for sale in the ordinary course of business and, as such, do not result in the culmination of the earnings process. Accordingly, the Company does not recognize any revenue for these types of transactions. The Company accounts for the exchange of a non–monetary asset based on the recorded amount of the non–monetary asset relinquished with no gain or loss recognized.

Primary interexchange carrier charges ("PICC") are local carrier flat rate charges mandated by the FCC to connect the Company's customers to each customer's local carrier facilities. Historically, the local carrier billed PICC directly to the Company who in turn passed the charge on to its customers directly. Effective July 1, 2000, as a result of the FCC's Coalition for Affordable Local and Long Distance Services ("CALLs") order, the PICC fees for residential customers are billed directly to the customer by its local carrier. Subsequent to the CALLs order, the Company does not bill residential or very small business customers for PICC fees, or recognize revenue associated with the charges. The Company does, however, continue to bill PICC fees to business customers.

Allowance for Doubtful Accounts and Revenue Adjustments

The Company's trade receivables are geographically dispersed and include customers in many different industries, but a substantial amount of the Company's revenues is derived from services provided to others in the telecommunications industry, mainly resellers of long distance telecommunications service and Internet online services. The Company performs ongoing credit analysis on its largest customers and, when warranted, requires collateral to support receivables. Collateral generally is given in the form of assignment to the Company of a customer's receivables in the event of nonpayment. The Company is exposed to concentrations of credit risk from customers which are other telecommunications service providers.

The allowance for doubtful accounts reflects management's best estimate of probable losses inherent in the accounts receivable balance from its trade customers. Management primarily determines the allowance based on the aging of accounts receivable balances, historical write–off experience, customer concentrations, customer creditworthiness, and current industry and economic trends. The Company's provisions for uncollectible receivables are included in selling, general and administrative expense in the consolidated statements of operations.

The following tables include the activity related to the Company's allowance for doubtful accounts (in millions):

	Successor Company				
	Balance at Beginning of Period	Additions Charged to Expense	Accounts Written-Off	Other Changes[1]	Balance at End of Period
2004	$1,762	$ 554	$ (920)	$ (667)	$ 729

	Predecessor Company				
	Balance at Beginning of Period	Additions Charged to Expense	Accounts Written-Off	Other Changes[2]	Balance at End of Period
2003	$1,817	$ 880	$ (1,052)	$ 117	$ 1,762
2002	2,023	1,271	(1,723)	246	1,817

(1) Amount represents the reclassification of Embratel's allowance for doubtful accounts to assets "held for sale" in the second quarter of 2004 when the investment qualified for discontinued operations. Ultimately, the amount was removed from the consolidated balance sheet upon the disposal of Embratel (see Note 17).

(2) Reflects the reclassification of bad debt expense from continuing operations to discontinued operations (see Note 17).

Direct Customer and Network Installation Related Costs

Direct customer and network installation related costs generally consist of installation related labor costs and activation fees paid to other telecommunications companies for access to circuits. All direct customer and network installation related costs are expensed as incurred.

Access Costs

Access cost expenses are the costs incurred for the transmission of voice and data over other carriers' networks. These costs consist of both fixed payments and variable amounts based on actual usage and negotiated or regulated contract rates. The Company records access cost expenses as incurred. Accordingly, at each balance sheet date the Company records its best estimate of the access cost expense incurred but not billed based on internal usage reports. Once the Company receives an invoice from a carrier, a process of reconciling that carrier's invoice to the Company's internal usage reports begins. In certain cases, this reconciliation process can take many months to complete. Once the reconciliation is complete, the Company and the carrier agree on the final amount due. In most cases, this process does not result in significant adjustments to the Company's estimates. Accordingly, at each balance sheet date, the Company has accrued access costs for estimated expenses related to amounts that have been billed but are not yet due, amounts that have not yet been billed by the other carriers and amounts for which the reconciliation of the carriers' invoices to the Company's internal usage reports has not been completed.

Advertising and Promotional Costs

The Company expenses the costs of advertising and promotions as incurred and these amounts are reported in selling, general and administrative expenses. Advertising and promotional expenses were $152 million, $579 million and $459 million for the years ended December 31, 2004, 2003, and 2002, respectively.

Income Taxes

The Company recognizes deferred income tax assets and liabilities for the expected future tax consequences of transactions and events. Under this method, deferred income tax assets and liabilities are determined based on

the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Deferred income tax assets are reduced by a valuation allowance to record the deferred income tax assets at an amount expected to be more likely than not recoverable. Deferred income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. In addition, tax reserves are based on significant estimates and assumptions as to the relative filing positions and potential audit and litigation exposures related thereto.

Derivative Instruments

The Company accounts for its derivative instruments under SFAS No. 133, *"Accounting for Derivative Instruments and Hedging Activities,"* as amended by SFAS No. 138, *"Accounting for Certain Derivative Instruments and Certain Hedging Activities"* ("SFAS No. 133"). Derivatives are recognized as either assets or liabilities in the consolidated balance sheet at their fair values. The changes in the fair values of all derivative instruments, including embedded derivatives, are recorded in miscellaneous income (expense) in the consolidated statements of operations as the Company has not sought hedge accounting treatment.

From time to time, the Company may also hold equity warrants in various companies, which meet the definition of a derivative under SFAS No. 133. In addition, the Company may also hold investments in convertible preferred stock which may contain embedded derivatives that need to be bifurcated and carried on the consolidated balance sheet at fair value. Changes in fair value are recorded in miscellaneous income (expense) in the consolidated statements of operations.

Benefit Accounting

The Company maintains various pension and postretirement benefit plans for its employees. Embratel maintained its own benefit and postretirement plans. The Company's plans represent a significant benefit for its employees and a significant expense to the Company. In accordance with SFAS No. 87, *"Employers' Accounting for Pensions,"* and SFAS No. 106, *"Employers' Accounting for Postretirement Benefits Other Than Pensions,"* certain assumptions and estimates must be made in order to determine the costs and future benefit that will be associated with these plans. These assumptions include the estimated long–term rate of return to be earned by plan assets, the estimated discount rate used to value the projected benefit obligations, estimated wage increases and the estimated healthcare cost trend rate. The Company uses a model portfolio of high quality bonds whose expected rate of return will match the plans' expected cash flows as a basis to determine the most appropriate discount rate. For the long–term rate of return, the Company uses a model portfolio based on the Company's targeted asset allocation.

Loss per Share

For 2004, basic loss per share is calculated based on the weighted average shares outstanding during the period, including the weighted average shares contingently issuable to unsecured creditors. Diluted loss per share is calculated based on the basic shares calculation adjusted to include the weighted average shares outstanding of unvested restricted stock and the weighted average shares to be issued under the MCI, Inc. 2003 Employee Stock Purchase Plan ("ESPP") during the period, when the shares do not have an anti–dilutive effect.

For periods prior to 2004, historical earnings (loss) per share information of the Predecessor Company has not been presented. The Company does not believe that this information is relevant in any material respect for users of its financial statements because all existing equity interests, including the interests of both the WorldCom group common stockholders and the MCI group common stockholders, were eliminated (without a distribution) upon the consummation of the plan of reorganization. In addition, the creation of the two class common stock structure (WorldCom group common stock and MCI group common stock) by the Predecessor Company in July 2001 would require it to determine the net income or loss generated by the WorldCom group and MCI group separately in order to present earnings per share information. Primarily as a result of the

extensive recreation of many of the Predecessor Company's historical financial entries that was required in order to complete its restatement process, many of its revenue and expense items cannot be allocated to the appropriate group, making a determination of separate net income or loss information for each group impracticable.

Stock–Based Compensation

The Predecessor Company had various stock–based compensation plans that provide for the granting of stock–based compensation to certain employees and directors. The Predecessor Company accounted for these stock–based compensation plans in accordance with the intrinsic value method of Accounting Principles Board Opinion No. 25, *"Accounting for Stock Issued to Employees,"* ("APB Opinion No. 25") and had adopted the disclosure–only provisions of SFAS No. 123, *"Accounting for Stock–Based Compensation"* ("SFAS No. 123"). Under the intrinsic value method, compensation expense is recorded on the date of grant if the current market price of the underlying stock exceeded the exercise price of the stock–based award.

In December 2002, the Financial Accounting Standards Board ("FASB") issued SFAS No. 148, *"Accounting for Stock–Based Compensation—Transition and Disclosure,"* ("SFAS No. 148") which became effective for fiscal years ended after December 15, 2002. SFAS No. 148 requires that certain pro forma information assuming the Company recognized expense for its stock–based compensation using the fair value method be presented in the summary of significant accounting policies note to the consolidated financial statements. The Predecessor Company did not grant any options in 2003. The fair value of stock–based compensation was estimated at the date of grant using the Black–Scholes option–pricing model and the following assumptions for 2002: volatility of 114%, risk–free interest rate of 4.0%, 5–year expected life and no dividend yield. The fair value of Embratel options was calculated using the assumptions described in Note 15. The fair value of the stock–based compensation for the ESPP (initiated in 2004) was estimated at the beginning of the offering period using the Black–Scholes option–pricing model and the following assumptions: volatility of 55%, risk–free interest rate of 1.79%, 0.41 year expected life and dividend yield of 10.81%. The Company's 2003 Management Restricted Stock Plan ("MRSP") was initiated in 2004 and was not included in the Black–Scholes calculation as the fair value of the compensation expense related to the plan has been expensed in the Company's 2004 consolidated statement of operations.

If compensation costs had been recognized based on the fair value recognition provisions of SFAS No. 123, the pro forma amounts of the Company's net (loss) income attributable to common shareholders for the years ended December 31, 2004, 2003 and 2002 would have been as follows (in millions):

	Successor Company	Predecessor Company	
	Year Ended December 31,		
	2004	2003	2002
Net (loss) income attributable to common shareholders, as reported	$(4,002)	$22,211	$(9,192)
Add: Stock–based employee compensation expense recorded, net of tax	36	2	1
Deduct: Stock–based employee compensation expense determined under the fair value method for all awards, net of tax	(42)	(272)	(304)
Pro forma net (loss) income attributable to common shareholders	$(4,008)	$21,941	$(9,495)
Basic and diluted loss per share:			
As reported	$(12.48)		
Pro forma	$(12.49)		

The Company has not provided pro forma disclosures of income (loss) per share as defined by SFAS No. 148 for 2003 or 2002 as it does not believe that this information for any compensation plan that was terminated on the Emergence Date is relevant in any material respect for users of its consolidated financial statements because all equity interests existing in 2003 and 2002, including the interests of the Predecessor Company's WorldCom group common stockholders and MCI group common stockholders, were eliminated (without a distribution) on the Emergence Date.

Reclassifications

Certain prior year amounts have been reclassified to conform to current year presentation, including marketable securities on the consolidated balance sheets, deferred compensation on the consolidated balance sheets and the statements of shareholders' equity (deficit) and comprehensive (loss) income, and other financing activities on the statements of cash flows.

Adjustment to Previously Issued Financial Statements

During 2004, the Company determined that it had recorded in error a restatement entry which had the effect of reducing accounts receivable by $301 million through a charge to expense in the year ended December 31, 2000. The reported 2000 net loss of $48.9 billion should have been $48.6 billion, or 0.5% lower, and the Company's assets of $44.2 billion should have been $44.5 billion, or 0.6% higher. In 2001, $35 million of the amount reversed and left a remaining $266 million understatement of accounts receivable as of December 31, 2001. This situation remained unchanged until, as a result of the application of fresh-start reporting as of December 31, 2003, the previously expensed $266 million was reversed in the Company's statement of operations as a component of the $22.3 billion reorganization gain (see Note 5). Without this expense reversal, the Company's 2003 net income of $22.2 billion would have been $21.9 billion, or 1.2% lower. As a result of the reversal of the expense in 2003, the cumulative impact to the Company's December 31, 2003 consolidated retained earnings was zero. The Company has assessed the impact on the 2000, 2001 and 2003 statements of operations as well as the consolidated balance sheets as of December 31, 2000, 2001, 2002 and 2003 and determined that the impact was not material to any period.

The impact of this reduction of accounts receivable in the consolidated balance sheet as of December 31, 2003 resulted in a misclassification of $266 million between accounts receivable and long-lived assets in the Company's allocation of reorganization value under fresh-start reporting. To properly reflect the allocation of reorganization value as of December 31, 2003, the Company has reflected a reclassification entry in its consolidated balance sheet as of December 31, 2003, as presented herein, to reflect an increase of $266 million to its accounts receivable balance and reductions in its property, plant and equipment and intangible assets.

The adjustment of this item also resulted in a decrease of $6 million to the Company's long-term deferred tax liability which has been reflected in the consolidated balance sheet as of December 31, 2003.

New Accounting Standards

In November 2004, the FASB issued SFAS No. 151, *"Inventory Costs, an amendment of ARB No. 43, Chapter 4"* ("SFAS No. 151"). SFAS No. 151 clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage), and requires that these costs be recognized as current period charges. The provisions of SFAS No. 151 will be effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company has completed its evaluation of the impact of SFAS No. 151, and does not expect any material impact on its consolidated results of operations, financial condition and cash flows.

In December 2004, the FASB issued SFAS No. 153, *"Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29"* ("SFAS No. 153"). SFAS No. 153 addresses the measurement of exchanges of nonmonetary assets in eliminating the exception from fair value measurement for nonmonetary exchanges of similar productive assets and replacing it with an exception for exchanges that do not have commercial substance. SFAS No. 153 indicates a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The provisions of SFAS No. 153 will be effective for nonmonetary asset exchanges in fiscal years beginning after June 15, 2005, with earlier application permitted.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Accounting for Stock–Based Compensation" ("SFAS No. 123 (R)"). SFAS No. 123 focuses primarily on accounting for transactions in which an employee is compensated for services through share–based payment transactions. SFAS No. 123 (R) requires the cost of employee services received in exchange for an award of equity instruments to be measured based on the grant–date fair value of the award. The provisions of SFAS No. 123 (R) are effective as of the beginning of the first interim or annual reporting period that begins after June 15, 2005. The Company has not completed evaluating the impact of SFAS No. 123 (R), but does not expect any material impact on its consolidated results of operations, financial condition and cash flows.

(3) Impairment Charges

The Company assesses recoverability of its indefinite–lived and long–lived assets to be held and used whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. Impairment analyses of long–lived and indefinite–lived assets are performed in accordance with SFAS Nos. 144 and 142. Impairment evaluations are performed at the lowest asset or asset group level for which identifiable cash flows are largely independent of the cash flows of other assets or asset groups. The Company generates most of its cash flows from products and services that are principally delivered to customers over its integrated telecommunications network ("Integrated Network") and related intangible assets. Therefore, evaluations are performed at the entity level, excluding discontinued operations and assets held for sale, as a single group. During 2003 and 2004, all stand alone entities that were reviewed independently in prior years were integrated into the Company's network and tested for impairment as part of the Integrated Network.

Year Ended December 31, 2004

The industry is in a state of transition where traditional business lines are facing significant overcapacity in the marketplace, pricing pressures, changes in product mix, and customers' continued efforts to reconfigure and consolidate their networks in order to achieve lower overall costs and improved efficiencies. Concurrently, the industry is migrating to more advanced network technologies primarily focused around IP based platforms, and customers are requiring more advanced network services including network monitoring, traffic analysis, and comprehensive security solutions. The industry has also seen a general migration of customers from dial–up services to broadband and various wireless services. Additionally, the Company's regulatory climate deteriorated due to a decision by the U.S. Court of Appeals for the D.C. Circuit ("D.C. Circuit") that invalidated the FCC's February 2003 *Triennial Review Order* local competition rules, which set prices that incumbent providers could charge competitive providers such as the Company for unbundled network element platforms ("UNE–P"), an essential component of the Company's Mass Market local phone service. Although several petitions were filed at the Supreme Court seeking review of the D.C. Circuit's decision, the Solicitor General and the FCC declined to seek such review, and the Supreme Court subsequently denied the petitions. As of the date of the Company's impairment test, the FCC had adopted interim unbundling rules (effective September 13, 2004) to maintain certain incumbent local exchange carrier ("ILEC") unbundling obligations under interconnection agreements as they existed prior to the D.C Circuit's mandate. As a result, the Company's costs for providing

this service was expected to increase significantly in 2005. Some of the Company's competitors announced their intentions to exit from this market, and the cost increases may force the Company to reduce efforts to acquire new customers and withdraw from certain markets. The Company therefore anticipated that revenues from that segment would continue to decline.

Given the market, business and regulatory conditions, the Company reevaluated its financial forecasts and strategy in the third quarter of 2004 when it became apparent that these trends would continue into the future. Updated cash flow and profitability projections and forecasts were developed taking into account both the 2004 changes in the competitive landscape and the regulatory issues facing the Company. The Company's executives reviewed these projections with the Audit Committee of the Board of Directors during the third quarter.

Based on the revised projections, the Company determined that an impairment analysis of its indefinite–lived and long–lived assets was required during the third quarter of 2004. In connection with this analysis, the Company evaluated its property, plant and equipment and definite and indefinite–lived intangible assets, including customer lists. The Company developed estimates of future undiscounted cash flows to test the recoverability of its long–lived and indefinite–lived assets. These estimates were compared to the carrying values of the assets, which resulted in the conclusion that the Company could not recover its carrying values through projected future operations. With the assistance of an independent third party valuation specialist, the Company further calculated the fair value of its long–lived and indefinite–lived assets based on the discounted cash flow analyses that utilized the revised management projections of revenues and profitability from September 1, 2004 through 2009. These projections were used in various scenarios utilizing a weighted average cost of capital between 10%–14%, a 2% terminal growth rate, certain working capital assumptions and total entity value assumptions.

The Company concluded that the carrying values of its long–lived assets exceeded their estimated fair values by approximately $3.3 billion ($2.8 billion related to property, plant and equipment and $478 million related to definite–lived intangible assets) and the carrying value of an indefinite–lived asset exceeded its estimated fair value by approximately $260 million. These amounts represented the difference between the calculated fair values of the assets and their associated carrying values, and were recorded as a separate component of operating expenses in the consolidated statement of operations for the year ended December 31, 2004. The Company's management reviewed the results of the impairment analysis with the Board of Directors, and the Board of Directors approved the impairment charges on October 15, 2004.

As a result of the impairment charge of approximately $260 million to an indefinite–lived intangible asset, the Company recognized a $99 million tax benefit which reduced its long–term deferred tax liability as the impairment reduced the difference between the book and tax bases. The impairment charges, after taxes, contributed approximately $3.4 billion to the Company's net loss for year ended December 31, 2004 (loss per share of $(10.64)).

The impairment recorded in 2004 was calculated as of August 31, 2004. The Company did not identify any additional trigger events, or make any significant changes to the projections used in the impairment test, between August 31 and December 31, 2004. Therefore, the Company concluded that the August impairment test related to its indefinite–lived intangibles served as its annual assessment required to be performed as of October 1 in accordance with its policy.

Year Ended December 31, 2002

Integrated Network and Related Goodwill and Other Intangible Assets

During the second quarter of 2002, impairment indicators occurred, including continued competitive pressures, the discovery of accounting irregularities in June that led to the Predecessor Company's impending

bankruptcy, and the resignation of senior officers. These factors dramatically impaired asset recoverability and the Predecessor Company's ability to finance operations, resulting in a further reduction in projected cash flows. These events precipitated a lack of access to the capital markets, a lack of confidence from its customers and overall uncertainties about the Predecessor Company's economic viability. As a result, the Predecessor Company reviewed its Integrated Network, which had a collective carrying value of $15.9 billion for impairment. Based on the results of an assessment of expected cash flows over a period of 5 years discounted at 14% with a 2% terminal growth rate, and Company comparative market valuation metrics completed with the assistance of an independent third party valuation specialist, the Predecessor Company concluded that the carrying value of the Integrated Network exceeded its estimated fair value by $4.9 billion. Accordingly, the Predecessor Company recorded impairment charges of $45 million for goodwill, comprised primarily of reclassification of definite–lived assets related to the Predecessor Company's workforce, and $353 million for other intangible assets. In addition, a $4.5 billion property, plant and equipment impairment charge was recorded in 2002. As a result of these impairment charges, the carrying value of goodwill associated with the Integrated Network was reduced to zero.

Digex

Digex, Incorporated ("Digex") is a provider of advanced hosting services, including value added products such as monitoring, security, reporting, performance and application hosting for companies conducting business on the Internet. In the second quarter of 2002, Digex performed an undiscounted cash flow analysis related to its long–lived assets. The result of that analysis indicated that an impairment of the carrying value of its property, plant and equipment and other intangible assets existed as of June 30, 2002. Based upon an independent appraisal, the carrying value of the Digex long–lived assets was reduced to fair value. This resulted in the Predecessor Company recording a $2 million and a $55 million impairment charge related to other intangible assets and property, plant and equipment, respectively.

SkyTel

SkyTel is a leading messaging service provider, with products such as traditional one–way paging, two–way paging and wireless email. Upon the adoption of SFAS No. 142 as of January 1, 2002, the Predecessor Company evaluated the indefinite–lived channel rights intangibles of SkyTel and determined that the net book value of $33 million was impaired. Accordingly, the Predecessor Company reduced the carrying value of these intangible assets to their estimated fair value of $1 million. This impairment was recognized as of January 1, 2002 as the cumulative effect of a change in accounting principle in accordance with the provisions of SFAS No. 142.

During 2002, the Predecessor Company determined that it would dispose of SkyTel's operations and engaged an investment banking firm to evaluate and assess the interest of potential buyers. While it was subsequently determined that the Predecessor Company would not dispose of SkyTel, the intent to sell caused the Predecessor Company to evaluate the recoverability of the SkyTel long–lived assets, which had a carrying value of $142 million. The review concluded that SkyTel's long–lived assets were impaired. The assessment resulted in an estimated fair value of $68 million which resulted in the Predecessor Company recording an impairment charge of $74 million to property, plant and equipment.

Impairment charges recorded for the years ended December 31, 2004 and 2002 are as follows (in millions):

	Successor Company	Predecessor Company
	Year Ended December 31,	
	2004	2002
Definite-lived intangible assets:		
Integrated Network	$ 478	$ 353
Digex	—	2
Total definite-lived intangible assets impairment	478	355
Goodwill impairment—Integrated Network	—	45
Indefinite-lived intangibles	260	—
Total goodwill and other intangible assets impairment charges	738	400
Property, plant and equipment:		
Integrated Network	2,775	4,470
SkyTel	—	74
Digex	—	55
Total property, plant and equipment impairment charges	2,775	4,599
Total impairment charges, excluding $32 million of cumulative effect related to adoption of SFAS No. 142 in 2002	$3,513	$ 4,999

(4) Fresh-Start Reporting

In accordance with SOP 90-7, the Predecessor Company adopted fresh-start reporting as of the close of business on December 31, 2003. The consolidated balance sheet as of December 31, 2003 gives effect to allocations to the carrying value of assets or amounts and classifications of liabilities that were necessary when adopting fresh-start reporting. As discussed below, these allocation adjustments recorded to the carrying amounts of assets and liabilities in the December 31, 2003 consolidated balance sheet were subject to adjustment as estimated valuations were finalized.

The following consolidated balance sheet reflects the implementation of the Plan as if the Plan had been effective on December 31, 2003. Reorganization adjustments have been recorded in the consolidated balance sheet to reflect the discharge of debt and the adoption of fresh-start reporting in accordance with SOP 90-7. The Company engaged an independent financial advisor to assist in the determination of the Company's reorganization value as defined in SOP 90-7. In August 2003, the Company determined a reorganization value, together with the financial advisor, using various valuation methods including: (i) publicly traded company analysis, (ii) discounted cash flow analysis, and (iii) precedent transactions analysis. These analyses are necessarily based on a variety of estimates and assumptions which, though considered reasonable by management, may not be realized and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond the Company's control. Changes in these estimates and assumptions may have had a significant effect on the determination of the Company's reorganization value. The assumptions used in the calculations for the discounted cash flow analysis regarding projected revenue, costs, and cash flows, for the period 2003-2005 were provided by the Company's management based on their best estimate at the time the analysis was performed. Management's estimates implicit in the cash flow analysis included increases in net revenue of 1.0% per year over the three-year period. In addition, the analysis included estimated cost reductions, primarily in selling, general and administrative expenses through the Company's plans for headcount reductions and other access cost efficiencies. The analysis also included anticipated levels of reinvestment in the Company's operations through capital expenditures ranging from $1.2 billion to $2.0 billion

per year. The Company did not include in its estimates the potential effects of litigation, either on the Company or the industry. The foregoing estimates and assumptions were inherently subject to uncertainties and contingencies beyond the control of the Company. Accordingly, there could be no assurance that the estimates, assumptions, and values reflected in the valuations would be realized, and actual results did vary materially from those estimates and assumptions resulting in the Company recording impairment charges in its 2004 consolidated statement of operations (see Note 3).

The enterprise value of the Company was calculated to be within an approximate range of $10.0 billion to $12.9 billion. The Company selected the midpoint of the range, $11.4 billion, to be used in the determination of reorganization value. Such value was confirmed by the Bankruptcy Court and the Creditors Committee on the confirmation date. The enterprise value of the Successor Company was increased to $14.5 billion to reflect the expected increase in the Predecessor Company's cash balances in excess of requirements to fund claims, increase in working capital, and increase for certain previously excluded non–core assets expected to be sold for $520 million. The equity value of $8.5 billion represented the reorganization value of $14.5 billion less $6.0 billion of post–emergence debt (including capital leases of approximately $314 million and excluding Embratel's $1.6 billion of debt).

Fresh–start adjustments reflected the allocation of fair value to the Successor Company's long–lived assets and the present value of liabilities to be paid as calculated with the assistance of an independent third party valuation specialist. The Company's property, plant and equipment and software were valued based on a combination of the cost or market approach, depending on whether market data was available. Also considered were technical, functional, and economic obsolescence, including network utilization factors inherent in the Company's assets. Key assumptions used in the valuation to determine the fair value of the Company's long–lived assets for the allocation included: (i) an income tax rate of 38.2%, (ii) a weighted average cost of capital of 13.5% based on a ratio of debt (30%) to equity (70%), and (iii) an obsolescence factor on property, plant and equipment ranging from 0% to 60%. Certain indefinite–lived assets were valued using a relief from royalty methodology. Certain intangible assets were subject to sensitive business factors of which only a portion were within control of the Company's management.

These estimates of fair value were reflected in the Successor Company's consolidated balance sheet as of December 31, 2003. During 2004, the Company adjusted the carrying value of certain assets and liabilities from the previously estimated values as appraisals and valuations were completed. As these adjustments were recorded in each quarter, associated year–to–date depreciation and amortization expense amounts were also adjusted for the effects of the changes in carrying values. As of September 30, 2004, the Company completed its assessment of the fair values of its assets and liabilities.

In applying fresh–start reporting as of December 31, 2003, the Company followed these principles:

- The reorganization value of the entity was allocated to the entity's assets in conformity with the procedures specified by SFAS No. 141, *"Business Combinations."* The sum of the amounts assigned to assets and liabilities exceeded the reorganization value. This excess was allocated as a pro rata reduction of the amounts that otherwise would have been assigned to the Successor Company's long–lived assets.

- Each liability existing as of the fresh–start reporting date, other than deferred taxes, was stated at the present value of the amounts to be paid, determined at appropriate current interest rates. Deferred revenue was adjusted to reflect the fair value of future costs of contractual performance obligations plus a normal profit margin.

- Deferred taxes were reported in conformity with applicable income tax accounting standards, principally SFAS No. 109, *"Accounting for Income Taxes"* ("SFAS No. 109"). Deferred tax assets and liabilities were recognized for differences between the assigned values and the tax basis of the recognized assets and liabilities (see Note 20).

- Changes in existing accounting principles that otherwise would have been required in the consolidated financial statements of the emerging entity within the twelve months following the adoption of fresh–start reporting were adopted at the time fresh–start reporting was adopted.

- Reversal of all items included in accumulated other comprehensive loss, including the recognition of the Predecessor Company's minimum pension liability, reflecting all unrealized losses from available for sale securities under SFAS No. 115, *"Accounting for Certain Investments in Debt and Equity Securities,"* to the underlying asset balances, and recognition of all previously unrecognized cumulative translation adjustments (see Note 13).

- Resetting property, plant and equipment assets and other long–lived assets to fair value and eliminating all of the accumulated depreciation and amortization.

- Adjustment of the Company's pension plans to their projected benefit obligation by recognition of all previously unamortized actuarial gains and losses.

During 2004, the Company determined that approximately $132 million of property tax liabilities and $110 million of other liabilities that should not have been adjusted in fresh–start reporting were reduced by approximately $152 million in the Company's application of fresh–start reporting as of December 31, 2003. Due to the application of fresh–start reporting, these errors were offset by fresh–start adjustments and therefore had no impact on the Company's 2003 net income. However, these errors caused both accounts payable and long–lived assets to be understated by approximately $152 million, representing 0.5% of the Company's total assets of $27.5 billion and approximately 0.8% of its $19.0 billion total liabilities as of December 31, 2003, which it determined to be immaterial to its 2003 consolidated balance sheet. The Company's December 31, 2004 consolidated balance sheet reflects the correction of these immaterial errors. In the fourth quarter of 2004, the Company identified errors primarily related to the application of the effects of the Plan (not in the fair values assigned to its assets) totaling $38 million and therefore reduced the value assigned to tangible and intangible assets. Additionally, the Company cumulatively adjusted depreciation and amortization expense in its 2004 consolidated statement of operations. The Company expects that no further adjustments will be recorded, except for adjustments that may be related to deferred tax assets and contingencies as discussed below. Refer to the pro forma table below for the impact of these items.

As of December 31, 2004, the Company had various net deferred tax assets which remain unresolved. Benefits realized from pre–confirmation net operating loss carryforwards will be adjusted to intangible assets, until exhausted, and then to additional paid–in–capital and not through income.

The estimates and assumptions used in the valuations are inherently subject to uncertainties and contingencies beyond the control of the Company. Accordingly, there can be no assurance that the estimates, assumptions, and values reflected in the valuations will be realized, and actual results could vary materially.

The following table identifies the adjustments recorded to the Predecessor Company's December 31, 2003 consolidated balance sheet as a result of implementing the Plan and applying fresh-start reporting. Additionally, it includes a pro forma disclosure which includes the impact of 2004 adjustments to the 2003 estimated valuations upon their completion during 2004 (in millions):

	Predecessor Company December 31, 2003	Effects of Plan	Fresh-Start Valuation[e]	2004 Fresh-Start Valuation Adjustments[o]	Pro Forma Successor Company December 31, 2003[p]
ASSETS					
Current assets:					
Cash and cash equivalents	$ 6,178	$ —	$ —	$ —	$ 6,178
Accounts receivable, net	4,348	—	—	—	4,348
Deferred income taxes	119	921[a]	(50)[f]	—	990
Other current assets	1,029	—	(17)[f]	(15)[q]	997
Total current assets	11,674	921	(67)	(15)	12,513
Property, plant and equipment, net	12,277	—	(739)[g]	150[r]	11,688
Intangible assets, net	1,229	—	856[h]	134[s]	2,219
Deferred income taxes	608	—	—	—	608
Other assets	558	—	153[i]	(226)[t]	485
	$ 26,346	$ 921	$ 203	$ 43	$ 27,513
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)					
Current liabilities:					
Accounts payable and accrued access costs	$ 3,276	$ 834[b]	$ (39)[j]	$ 106[u]	$ 4,177
Current portion of long-term debt	330	—	—	—	330
Other current liabilities	3,710	782[b]	(83)[k]	(133)[v]	4,276
Total current liabilities	7,316	1,616	(122)	(27)	8,783
Liabilities subject to compromise	37,532	(37,532)[b]	—	—	—
Long-term debt	1,600	—	(35)[l]	—	1,565
Long-term debt—new	—	5,552[b]			5,552
Other liabilities	762	3[b]	(51)[m]	72[w]	786
Deferred income taxes	225	921[a]	61[m]	(2)	1,205
Minority interests	1,150	—	—	—	1,150
Preferred stock subject to compromise	436	(436)[d]	—	—	—
Shareholders' Equity (Deficit):					
Common stock—old (Predecessor)	31	(31)[d]	—	—	—
Common stock—new (Successor)	—	3[b]	—	—	3
Additional paid-in capital	56,444	(56,444)[d]	—	—	—
		8,639[b]			8,639
Accumulated deficit	(78,629)	—	—	—	—
		—	350[c]	—	
		22,324[b]			
		55,955[n]			
Deferred stock-based compensation	—	(170)[b]	—	—	(170)
Treasury stock	(185)	185[d]	—	—	—
Accumulated other comprehensive loss	(336)	336[n]	—	—	—
Total shareholders' equity (deficit)	(22,675)	30,797	350	—	8,472
	$ 26,346	$ 921	$ 203	$ 43	$ 27,513

(a) To record adjustments to deferred tax assets and liabilities as a result of the impact of the estimated gain related to cancellation of indebtedness resulting from the application of the effects of the Plan.

(b) To record the discharge of the liabilities and preferred stock subject to compromise and the issuances of new MCI common stock with an agreed value of $8.5 billion and new long–term debt of $5.6 billion (net of $114 million discount). Included in the additional paid–in capital portion of this adjustment is the effect of $170 million to reflect the increase for the issuance of approximately 8.6 million restricted stock unit awards. Additionally, the Company recorded $170 million of deferred stock–based compensation.

(c) To record the net change in equity value from historical basis to fresh–start basis of $350 million.

(d) To record the extinguishment of old equity interest in accordance with the Plan.

(e) To record the estimated fair value of the Predecessor Company's assets and liabilities upon completion of the Company's review in conjunction with an independent third party valuation specialist.

(f) To record the elimination of ($24) million of prepaid pension assets in excess of the projected benefit obligation. In addition, net current deferred tax assets were decreased ($50) million to represent the difference between the assigned book values and the tax basis of the recognized assets and liabilities. Also, prepaid rights of way were increased by $7 million to record their fair value.

(g) To record the Predecessor Company's tangible assets at their estimated fair value.

(h) To record the fair value of intangible assets (including trademarks, customer acquisition costs, favorable leasehold interests, patents and certain other intangibles) as estimated by the Predecessor Company in conjunction with an independent third party valuation specialist.

(i) To record equity and cost method investments along with rights of way at fair value, adjustments of $140 million and $101 million were made, respectively. Additionally, Predecessor Company deferred assets totaling ($88) million were eliminated.

(j) To record the elimination of deferred rent expense of the Predecessor Company.

(k) To record the elimination of certain deferred revenues of the Predecessor Company for which no remaining contractual obligation exists. Other deferred revenues were adjusted to estimated fair value.

(l) To record the elimination of certain capital lease obligations.

(m) To record the elimination of certain long–term deferred installation revenue. Net non–current deferred tax liabilities were also increased to represent the difference between the assigned book values and the tax basis of the recognized assets and the liabilities. Lastly, the Predecessor Company's accrued pension liability was eliminated.

(n) To record the elimination of the Predecessor Company's prior accumulated deficit and accumulated other comprehensive loss.

(o) To adjust the carrying value of the Company's assets and liabilities upon completion in 2004 of the Company's fair value reviews in conjunction with an independent third party valuation specialist.

(p) Reflects on a pro forma basis the amounts that would have been displayed on the Company's December 31, 2003 balance sheet if adjustments resulting from the fair value reviews completed in 2004 and other adjustments had been known at that date.

(q) Includes adjustments to decrease prepaid expenses by ($60) million, primarily related to the fair value of certain prepaid indefeasible rights of use agreements. This was partially offset by increases related to certain asset carrying values classified in assets held for sale by $35 million and a reclassification from other assets of $7 million and intangible assets of $3 million.

(r) Includes adjustments which increased property, plant and equipment by $183 million due to increases in the valuation of enterprise license agreements and a decrease in the valuation of indefeasible rights of use due to changes in the allocation of the amount of economic obsolescence and negative goodwill. This increase was partially offset by adjustments for errors identified in the fourth quarter of 2004 primarily related to application of the effects of the Plan, which decreased property, plant and equipment by $(33) million.

(s) Includes adjustments which increased intangibles by $46 million due to changes in the allocation of the amount of economic obsolescence and negative goodwill. In addition, the original right of way fair value adjustment of $101 million was reclassified from other assets. These increases were partially offset by decreases of $(5) million related to adjustments for errors identified in the fourth quarter of 2004 primarily related to application of the effects of the Plan and reclassifications to other current assets and other assets of $(3) million and $(5) million, respectively.

(t) Includes adjustments to reduce the carrying value of certain indefeasible rights of use agreements by ($123) million and a reclassification of the original right of way fair value adjustment to intangible assets, which reduced other assets by ($101) million. Additionally, there were reclassifications of ($7) million to other current assets and $5 million from intangible assets.

(u) Includes adjustments increasing accounts payable and accrued access costs by $116 million due to property tax and other liabilities that should not have been adjusted in fresh–start reporting. These increases were partially offset by a decrease of ($10) million related to adjustments for errors identified in the fourth quarter of 2004 primarily related to application of the effects of the Plan.

(v) Includes adjustments decreasing deferred revenues related to certain capacity sales agreements by ($144) million, decreasing other current liabilities by ($28) million related to adjustments for errors identified in the fourth quarter of 2004 primarily related to application of the effects of the Plan and a decrease of ($72) million related to the reclassification of unfavorable lease accruals from short–term to long–term liabilities. These decreases were partially offset by an increase related to the recognition of an unfavorable lease accrual of $91 million as well as increases to property tax and other liabilities of $20 million that should not have been adjusted in fresh–start reporting.

(w) Includes adjustments related to the reclassification of unfavorable leases of $72 million from short–term to long–term liabilities.

(5) Voluntary Reorganization under Chapter 11

Bankruptcy Proceedings

On July 21, 2002, WorldCom, Inc. and substantially all of its direct and indirect domestic subsidiaries (the "Initial Filers") filed voluntary petitions for relief in the Bankruptcy Court under Chapter 11. On November 8, 2002, the Predecessor Company filed voluntary petitions for an additional 43 of its domestic subsidiaries (collectively with the Initial Filers, the "Debtors"). Under Chapter 11, certain claims against the Debtors in existence prior to the filing of the petitions for relief under the federal bankruptcy laws were stayed while the Debtors continued business operations as Debtors–In–Possession ("DIP"). Prior to the application of fresh–start reporting, the Predecessor Company's December 31, 2003 consolidated balance sheet included related balances subject to compromise. However, the adoption of fresh–start reporting resulted in the settlement of such balances based on the estimated payment amounts pursuant to the Plan with the difference recorded as a reorganization gain in the consolidated statement of operations for 2003.

The Predecessor Company filed its second amendment to the Plan on October 21, 2003, and this Plan was confirmed by the Bankruptcy Court on October 31, 2003. The Debtors continued to operate their businesses and manage their properties as Debtors–In–Possession through April 20, 2004. On April 20, 2004, the Plan was consummated at which time the Predecessor Company merged with and into MCI and the separate existence of the Predecessor Company ceased to exist.

The Plan also required pursuant to Section 5.07 that the Board of Directors conduct a reasonable review of the Company's cash needs, including amounts that may be necessary to satisfy all claims to be paid in cash pursuant to the Plan. Accordingly, the Board of Directors commenced a comprehensive review and sought information and guidance from management and financial advisors to determine the amount of excess cash greater than $1 billion. On August 5, 2004, the Board of Directors completed its review of the Company's excess cash pursuant to Section 5.07 of the Plan and declared the amount of excess cash to be $2.2 billion. The Board of Directors decided to distribute a portion of the excess cash through a return of capital to shareholders and declared cash dividends of $0.40 per share payable on September 15, 2004 and December 15, 2004. On February 11, 2005, the Board of Directors, pursuant to Section 5.07 of the Plan and continuing its distribution of the Company's excess cash as a return of capital to shareholders, declared another cash dividend of $0.40 per share payable on March 15, 2005 to shareholders of record on March 1, 2005.

Impacts of the Application of the Plan

Shares Issued as a result of the Plan

In accordance with the Plan, the Company issued approximately 296 million shares of MCI common stock to settle claims of debt holders and 10 million shares to settle its Securities and Exchange Commission civil penalty. The Company also reserved approximately 11 million shares of MCI common stock for issuance under the new MRSP, of which approximately 8.6 million shares of restricted stock were granted on the Emergence Date. As contemplated in the Plan, the Company expected to issue approximately 20 million shares of MCI common stock pursuant to the Plan to settle claims of general unsecured creditors. This amount has been reduced from 20 million to 5.4 million during 2004 as a result of the issuance of approximately 5.7 million shares, 0.5 million shares that will not be issued related to certain unsecured creditors receiving cash in lieu of stock, and a change in estimate of 8.4 million shares that are no longer expected to be issued.

Creditor Settlements

During 2004, the Company paid approximately $1.4 billion in cash, and issued a total of approximately 5.7 million shares of common stock to unsecured creditors in addition to the 296 million shares issued to secured creditors, to satisfy certain provisions of the Plan. The Company continues its settlement process of outstanding claims. During the year ended December 31, 2004, the Company recorded net settlement gains of $148 million, including $88 million as a decrease to selling, general and administrative expenses, $32 million as an increase to revenues, and $28 million as a decrease to access cost expenses in its consolidated statement of operations. The net settlement gains reflect the differences between original estimated claim amounts and settlement amounts finalized in the period and a change in estimate of $62 million (see Note 2).

The Company estimates that $777 million remains to be paid related to outstanding creditor claims (including interest on tax obligations). This estimate is based on various assumptions and reflects the Company's judgment based upon its prior pre-petition claims settlement history and the terms of its Plan. If these assumptions prove incorrect, actual payments could differ from the estimated amounts.

Debt and Interest expense

On the Emergence Date, the Company issued new Senior Notes (see Note 11).

No interest expense related to pre-petition debt was accrued following the Petition Date as none of the allowed claims against the Predecessor Company had underlying collateral in excess of the principal amount of debt. If the Company had recognized interest on the basis of the amounts it was contractually required to pay, additional interest expense of $701 million, $2.2 billion and $970 million would have been recorded in 2004, 2003 and 2002, respectively. As the Company adopted fresh-start reporting as of December 31, 2003, and all of the Predecessor Company's obligations were removed from its December 31, 2003 consolidated balance sheet, contractual interest has not been disclosed on the face of the Company's consolidated statement of operations for 2004.

Reorganization items, net

Following the filing of the Chapter 11 cases, the Predecessor Company commenced a comprehensive reorganization process, together with its financial and legal advisors, to review and analyze its businesses, owned properties, contracts and leases to determine if any of these owned assets should be divested and which contracts and leases should be rejected or assumed during the Chapter 11 cases. The reorganization efforts included asset dispositions, sale of businesses, rejection of leases and contracts and other operational changes.

The Company continued to incur reorganization costs during 2004 and will continue to experience reorganization expenses for professional fees and other bankruptcy costs. As the Company adopted the

provisions of fresh–start reporting on December 31, 2003, for accounting purposes, reorganization expenses and changes in estimates to reorganization items previously accrued have been included in the appropriate captions within the 2004 consolidated statement of operations, primarily selling, general, and administrative expenses. For 2004, the amounts of such expenses were $42 million and were for professional services related to the Company's bankruptcy proceedings.

Reorganization items consisted of the following for the years ended December 31, 2003 and 2002 (in millions):

	Predecessor Company	
	Year Ended December 31,	
	2003	2002
Contract rejections	$ (237)	$ (363)
Write–off of debt issuance costs and original issue discounts	—	(200)
Employee retention, severance and benefits	(121)	(97)
Loss on disposal of assets	(22)	(56)
Lease terminations	(178)	(64)
Professional fees	(125)	(43)
Gains on settlements with creditors	56	14
Effects of the plan of reorganization and fresh–start reporting	22,324	—
Increase to fresh–start basis of assets and liabilities	350	—
Interest earned by debtor entities during reorganization	40	7
Income (expense) from reorganization items, net	$22,087	$ (802)

Included in reorganization items, net for the year ended December 31, 2003 was the Predecessor Company's gain recognized from the effects of the Plan. The gain resulted from the difference between the Predecessor Company's carrying value of remaining pre–petition liabilities, minority interests and redeemable preferred stock subject to compromise and the amounts to be distributed pursuant to the Plan. The gain from the effects of the Plan and the application of fresh–start reporting was comprised of the following (in millions):

	Predecessor Company
	Year Ended December 31, 2003
Discharge of liabilities subject to compromise:	
Long–term debt	$ 30,679
Accrued interest	580
Pre–petition accounts payable and accrued access costs	1,561
8% Junior Subordinated Deferrable interest debentures, Series A, due to affiliated trust	750
Subsidiary preferred shares subject to mandatory redemption	660
Other liabilities, primarily the $2,250 SEC penalty	3,302
Total	37,532
Discharge of preferred stock subject to compromise	436
Issuance of new common stock	(8,472)
Issuance of new debt, net of a $114 discount	(5,552)
Accrual of amounts to be settled in cash	(1,620)
Gain from the effects of the Plan	$ 22,324

(6) Loss per Share

The Successor Company adopted a new capital structure as of December 31, 2003 upon the adoption of fresh–start reporting. On the Emergence Date, the Company issued approximately 315 million shares of new MCI common stock, which included approximately 8.6 million shares of restricted stock. Under fresh–start reporting, these shares were reflected as outstanding as of December 31, 2003. In addition, on the Emergence Date, the Company expected to issue 20 million additional shares pursuant to the Plan to unsecured creditors, which were not reflected as outstanding as of December 31, 2003, however all conditions of distribution had been met. These shares were considered contingently issuable under SFAS No. 128, *"Earnings per Share."* During 2004, share issuances, changes in distribution and changes in estimate reduced the amount of contingently issuable shares to approximately 5.4 million as of December 31, 2004. The Company's calculations of weighted average shares outstanding for the year ended December 31, 2004 follows (in millions):

	Successor Company Year Ended December 31, 2004
Weighted average common shares outstanding	316.8
Add: Weighted average shares contingently issuable to unsecured creditors	11.7
Less: Weighted average unvested restricted stock[1]	(7.7)
Weighted average common shares outstanding used in basic calculation	320.8
Add: Weighted average unvested restricted stock[2]	—
Weighted average common shares outstanding used in diluted calculation	320.8

(1) As these shares were not vested during the period, they have been excluded from the weighted average share calculation used to determine basic loss per share.

(2) Calculation of diluted shares excludes the unvested shares of restricted stock and the unissued shares related to the ESPP that would be anti–dilutive.

The Company's calculations of basic and diluted (loss) income per share for the year ended December 31, 2004 follows (in millions, except per share amounts):

	Successor Company Year Ended December 31, 2004
(Loss) income, as reported:	
Continuing operations	$ (4,028)
Discontinued operations	26
Net loss	$ (4,002)
Basic and diluted (loss) income per share:	
Continuing operations	$ (12.56)
Discontinued operations	0.08
Loss per share	$ (12.48)
Weighted average common shares outstanding used in basic and diluted calculation	320.8

(7) Property, Plant and Equipment and Asset Retirement Obligations

Property, plant and equipment consisted of the following at December 31, 2004 and 2003 (in millions):

	Successor Company	
	As of December 31,	
	2004	2003
Land	$ 194	$ 198
Furniture, fixtures, buildings and other	2,527	3,512
Transmission equipment (including conduit)	2,153	3,800
Software	651	429
Telecommunications equipment	593	3,020
Construction in progress	653	579
	6,771	11,538
Less: Accumulated depreciation	512	—
Property, plant and equipment, net	$ 6,259	$ 11,538

In 2004, the Company recorded impairment charges related to long–lived assets of $2.8 billion (see Note 3) and removed from its consolidated balance sheet approximately $2.0 billion in long–lived assets related to its sale of Embratel. For the years ended December 31, 2004, 2003 and 2002, depreciation expense was $1.7 billion, $2.2 billion and $2.6 billion, respectively.

As a result of fresh–start reporting, the accumulated depreciation of property, plant and equipment was removed to adjust the basis in the Predecessor Company's assets to their net book value. The asset carrying values were also adjusted to their fair values which was included in the Successor Company's December 31, 2003 consolidated balance sheet (see Note 4). Additionally, as a result of the 2004 impairment charges, accumulated depreciation was removed to establish a new cost basis for the Company's long–lived assets.

The following table summarizes activities related to the Company's liabilities for asset retirement obligations for the years ended December 31, 2004 and 2003 (in millions):

Balance as of January 1, 2003 (Predecessor Company)	$275
Accretion	21
Additions	20
Dispositions	(17)
Revisions	(16)
Balance as of December 31, 2003 (Successor Company)	283
Accretion	27
Additions	22
Dispositions	(20)
Revisions	(11)
Balance as of December 31, 2004 (Successor Company)	$301

(8) Intangible Assets

Definite–lived intangibles consist primarily of patents and customer lists. The Company's indefinite–lived intangible assets consist of channel rights and tradenames.

As of January 1, 2002, pursuant to the adoption of SFAS No. 142, the Predecessor Company reported a $32 million expense as a cumulative effect of a change in accounting principle in its consolidated statement of operations to reduce the carrying value of SkyTel's indefinite–lived channel rights intangible asset to its estimated fair value of $1 million.

As a result of fresh–start reporting, the accumulated amortization was removed to adjust the basis in the Predecessor Company's assets to their net book value. In 2004, the Company recorded impairment charges related to its definite–lived and indefinite–lived intangible assets reducing the carrying value by $478 million and $260 million, respectively. Additionally, as a result of the 2004 impairment charges, accumulated amortization was removed to establish a new cost basis for the Company's intangible assets. In 2002, the Predecessor Company recorded impairment charges of $400 million to reduce goodwill to zero and intangible assets to their fair value of $1.6 billion (see Note 3).

The following table reflects amounts related to the Company's intangible assets subject to amortization (in millions):

	Successor Company			
	As of December 31,			
	2004			2003
	Gross Carrying Amount	Accumulated Amortization	Weighted Average Useful Life in Years	Gross Carrying Amount
Customer lists	$577	$ 54	4.5	$ 1,163
Other intangibles	127	5	10.3	182
	$704	$ 59		$ 1,345

The following table reflects the carrying value of the Company's intangible assets that are not subject to amortization (in millions):

	Successor Company	
	As of December 31,	
	2004	2003
Tradenames	$335	$ 630
Channel rights	11	7
Other	—	103
	$346	$ 740

Intangible asset amortization expense was $216 million, $136 million and $260 million for the years ended December 31, 2004, 2003 and 2002, respectively.

The following table reflects the estimated amortization of existing intangible assets over the future periods indicated (in millions):

Years Ending December 31,	
2005	$166
2006	165
2007	66
2008	66
2009	64
Thereafter	118

(9) Marketable Securities and Investments

As of December 31, 2004 and 2003, short–term available–for–sale debt securities were $1.1 billion and $15 million, respectively. As of December 31, 2004 and 2003, long–term investments (including the long–term portion of available–for–sale securities) were $116 million and $238 million, respectively, and include available–for–sale securities, equity and cost method investments and derivative instruments.

Available–for–Sale Securities

As of and for the years ended December 31, 2004 and 2003, available–for–sale securities consisted of the following (in millions):

	Successor Company				Predecessor Company			
	As of and For the Year Ended December 31, 2004				As of and For the Year Ended December 31, 2003			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Short–term marketable securities:								
Commercial paper	$ 119	$ —	$ —	$ 119	$ 15	$ —	$ —	$ 15
Certificates of deposit	95	—	—	95	—	—	—	—
U.S. government securities	810	—	(1)	809	—	—	—	—
Corporate bonds	32	—	—	32	—	—	—	—
Total	1,056	—	(1)	1,055	15	—	—	15
Long–term investments:								
Equity investments	27	4	(1)	30	11	6	(1)	16
Total available–for–sale	$1,083	$ 4	$ (2)	$ 1,085	$ 26	$ 6	$ (1)	$ 31

Contractual maturities of available–for–sale debt securities at December 31, 2004 were as follows (in millions):

	Cost	Estimated Fair Value
Due in less than one year	$ 803	$ 802
Due in 1 to 5 years	253	253
	$ 1,056	$ 1,055

The components of investment income (loss) for each of the years ended December 31, 2004, 2003, and 2002 were as follows (in millions):

	Successor Company	Predecessor Company	
	2004	2003	2002
Gross realized gain from sales of available–for–sale securities	$ —	$ 3	$ 6
Impairment charges	—	—	(17)
Net unrealized holding gain (loss)	2	7	(22)
Investment income (loss)	$ 2	$ 10	$ (33)

The Company realized proceeds from sale of available–for–sale securities of $5 million and $10 million in 2003 and 2002, respectively.

Interest Rate Risk. Fixed–income securities are subject to interest rate risk. The fixed–income portfolio consists primarily of relatively short–term investments to minimize interest rate risk. The weighted–average maturity of all fixed–income securities held does not exceed 18 months. The final legal maturities of U.S. Government Securities and corporate bonds do not exceed 3 years and 1 year, respectively.

Investments also consist primarily of investment grade securities to minimize credit risk. Securities include those issued by banks and trust companies that have long–term debt rated at least "A–3" or "A" according to Moody's Investors Service ("Moody's") and Standard & Poor's Corporation ("S&P"), respectively. Investments in commercial paper issued by corporations are rated "P–1" or "A–1" or higher according to Moody's and S&P, respectively.

The Company is subject to restrictions on its ability to invest in certain investments, as described in its Senior Notes (see Note 11).

Equity Method Investments

Income (loss) of equity method investments is recorded as miscellaneous income (expense) in the consolidated statements of operations. (Loss) income from equity method investments was approximately $(39) million, $32 million and $(5) million for the years ended December 31, 2004, 2003 and 2002, respectively. Dividend income was $1 million for the year ended December 31, 2004 as the Company received a dividend from an entity whose investment was previously reduced to zero.

In 2002, the Company reduced its investment in General Communications, Inc. ("GCI") from 23% to 18%, but continued to account for this investment under the equity method of accounting as the Company continued to maintain significant control over the entity. In December 2004, the Company further reduced its interest in GCI from 18% to 13% and received $31 million. The Company recognized a $1 million loss in the 2004 consolidated statement of operations. As a result of the reduction in ownership, the Company has classified this investment as an available–for–sale security as of December 31, 2004.

On June 30, 2000, the Company entered into a Sponsor Credit Agreement with Avantel S.A. ("Avantel") and Banco Nacional de Mexico S.A. whereby the Predecessor Company loaned $96 million to Avantel. Interest was payable quarterly at the rate of London Interbank Offered Rate ("LIBOR") plus 3%. In June 2002, the Predecessor Company determined that a portion of the loan was not recoverable and reduced the receivable to estimated fair value of $48 million. The difference between the carrying value and estimated fair value was charged to selling, general and administrative expense in the consolidated statement of operations. In 2003, the Predecessor Company decreased the note receivable by $30 million as a result of equity losses in excess of the Predecessor Company's initial investment carrying value.

As part of Avantel's financing arrangement with various lenders, the Predecessor Company pledged to Avantel's lenders the Predecessor Company's Avantel shares, representing approximately a 45% equity ownership in the issued common stock of Avantel. Upon the occurrence of an event of default by Avantel, the lenders may exercise their right to take ownership of the Predecessor Company's pledged shares and exercise all voting and corporate rights and powers pertaining to those shares. The lender's recourse to the Predecessor Company is limited to its pledged shares.

As part of a potential sale of Avantel, the potential acquirers agreed to settle the outstanding note, receivables and payables due between the parties by requiring Avantel to make a single payment to the Company of $4 million. As a result of this settlement agreement, the Company reduced its note receivable reserve by $12 million, which resulted in a $4 million net carrying value for all its receivables and payables related to Avantel. The Company recognized a $12 million benefit from adjustments to loans with Avantel and recorded the benefit

as a credit in selling, general and administrative expenses in the consolidated statement of operations. In November 2004, the parties discussed changes to be made to the corporate structure of Avantel in order to meet regulatory requirements. This restructuring will require the parties to amend certain terms in the sales agreement to reflect the new corporate structure. Therefore, the transaction completion date contained in the sales agreement has been extended to June 30, 2005.

Cost Method Investments

Dividend income recorded on cost investments for the years ended December 31, 2004, 2003 and 2002 was $1 million in each year and was recorded in miscellaneous income (expense) in the consolidated statements of operations. Proceeds from the sale of cost method investments in 2004 were $19 million, and the Company recorded a gain in its 2004 consolidated statement of operations for $8 million.

In 2004, 2003 and 2002, the Company determined that the carrying values of certain cost method investments exceeded their fair values and were impaired. As such, the Company reduced the carrying value of its cost method investments in 2004, 2003 and 2002 by $1 million, $12 million and $8 million, respectively.

Derivative Instruments

The Company holds warrants to purchase additional common shares of companies in which it invests as well as warrants in companies in which it has no investment. In addition, certain holdings of convertible preferred stock contain embedded derivatives that are not clearly and closely related to the stock. As of December 31, 2004 and 2003, the Company had $2 million and $3 million, respectively, in derivative instruments as defined by SFAS No. 133 related to these investments. These derivative instruments were recorded at fair value in the consolidated balance sheet with the changes in fair values recorded in miscellaneous income (expense) in the consolidated statements of operations. The Company recognized losses related to derivative instruments of $2 million and $5 million in 2003 and 2002, respectively.

Investments and derivative instruments (excluding foreign currency derivative instruments) consisted of the following at December 31, 2004 and 2003 (in millions):

Investment Type	Ownership Percentage As of December 31, 2004	Successor Company As of December 31, 2004	Successor Company As of December 31, 2003
Equity method investments:			
Avantel	45%	$ 78	$ 120
General Communication, Inc.	— (1)	—	38
Comunicaciones Mtel, S.A.	—	1	7
Other	—	—	27
Total equity investments		79	192
Cost method investments	— (2)	5	27
Available–for–sale equity securities (long–term)	—	30	16
Derivative instruments	—	2	3
Total investments		$116	$ 238

(1) As of December 31, 2004, the Company had a 13% voting interest and a 2% ownership interest in GCI. As noted above, as a result of the reduction in ownership during 2004, the Company has classified the investment, with a carrying value of $11 million, as an available–for–sale security as of December 31, 2004.

(2) Includes entities in which the Company's investment in economic and voting interests is less than 20% and for which the Company has no significant influence on the operations of the entities.

(10) Other Current Liabilities

Other current liabilities consisted of the following at December 31, 2004 and 2003 (in millions):

	Successor Company	
	As of December 31,	
	2004	2003
Income tax liabilities	$1,519	$1,228
Advance billings and deferred revenue	382	507
Other taxes	368	469
Accrued salaries and bonuses	269	453
Accrued expenses	306	375
Accrued reorganization expenses	81	228
Accrued SEC penalty	—	500
Other	273	601
Total	$3,198	$4,361

(11) Debt

Debt consisted of the following at December 31, 2004 and 2003 (in millions):

	Successor Company	
	As of December 31,	
	2004	2003
6.908% Senior Notes Due 2007	$1,983	$1,983
7.688% Senior Notes Due 2009	1,983	1,983
8.735% Senior Notes Due 2014	1,699	1,699
Embratel debt obligations	—	1,574
Capital leases and other (maturing through 2023)	268	322
Discount on Senior Notes	—	(114)
Total	5,933	7,447
Less: current portion	24	330
Long-term portion	$5,909	$7,117

Senior Notes Due 2007, 2009 and 2014

Pursuant to the Plan, the Company issued approximately $2.0 billion principal amount of Senior Notes due 2007 (the "2007 Senior Notes"), approximately $2.0 billion principal amount of Senior Notes due 2009 (the "2009 Senior Notes") and approximately $1.7 billion principal amount of Senior Notes due 2014 (the "2014 Senior Notes" and, together with the 2007 Senior Notes and the 2009 Senior Notes, the "Senior Notes" or "Indentures"). The Senior Notes are senior unsecured obligations of the Company and are guaranteed by all of the existing and future domestic restricted subsidiaries of the Company.

The 2007 Senior Notes, the 2009 Senior Notes and the 2014 Senior Notes mature on May 1, 2007, May 1, 2009 and May 1, 2014, respectively. Interest on the Senior Notes is payable semi-annually in arrears. The initial

interest rates of the Senior Notes were 5.908%, 6.688% and 7.735%, respectively. The initial interest rates were subject to a one–time reset after the Company applied for and received ratings for the Senior Notes from Moody's and S&P. In December 2004, the Company received B2 and B+ ratings from Moody's and S&P, respectively. As such, the interest on the Senior Notes was increased by 1% effective December 15, 2004.

Commencing on May 1, 2005 with respect to the 2007 Senior Notes, May 1, 2006 with respect to the 2009 Senior Notes and May 1, 2009 with respect to the 2014 Senior Notes, the Company will have the right to redeem some or all of the Senior Notes. The initial call prices equal 102.454%, 102.844% and 103.3675% of the principal amount, respectively, plus accrued and unpaid interest. In addition, the call prices for the 2007 Senior Notes, 2009 Senior Notes and the 2014 Senior Notes thereafter decline ratably for a period of one year, two years and three years, respectively, until the call price equals 100% of the principal amount. Prior to the call dates applicable to the Senior Notes, the Company may redeem some or all of such Senior Notes by paying a "make–whole" premium based on U.S. Treasury rates. At any time prior to May 1, 2007, the Company may redeem, with the net cash proceeds of an equity offering, up to 35% of the aggregate principal amount of each series of Senior Notes at a price equal to 100% of the principal amount plus a premium.

Upon the occurrence of a change of control, the Company will be obligated to make an offer to purchase all of the outstanding Senior Notes at a price equal to 101% of par value plus accrued interest. Also, the Company will be required to make an offer to purchase the outstanding Senior Notes at a price equal to 100% of par value plus accrued interest with "excess proceeds" related to certain asset sales.

The Senior Notes are subject to typical affirmative and negative covenants for securities of this type, including covenants that limit the amount of debt the Company may incur and restrict the Company's ability to make cash distributions, to invest in third parties and to engage in asset sales or other specified transactions.

The Senior Notes are subject to customary events of default including any failure to make timely payments of interest or principal on the Senior Notes, failure to comply with the affirmative and negative covenants, the occurrence of certain events of bankruptcy involving the Company or the acceleration of other outstanding indebtedness of the Company in excess of $100 million.

The Senior Notes are subject to covenants that limit the Company's ability to make certain cash distributions based on its cumulative net income or loss since the Issue Date. The impairment charges recorded during the third quarter of 2004 will not affect the Company's ability or its current plans to continue to distribute excess cash pursuant to Section 5.07 of the plan of reorganization to its shareholders in the form of a quarterly dividend until such excess cash is fully utilized. In addition, if the excess cash is fully paid out to shareholders, any further dividends will be limited by the covenants in the indentures for the Senior Notes, which generally restrict dividends and certain other payments to an amount equal to 50% of cumulative adjusted net income since April 2004 (or minus 100% of cumulative losses) plus proceeds of equity offerings. Consequently, further dividends may not be possible as long as the Senior Notes or other debt instruments with similar covenants remain outstanding. As of December 31, 2004, the Company did not have any retained earnings available for distribution.

Debtor–in–Possession Facility and Letter of Credit Facilities

On July 23, 2002, the Predecessor Company negotiated its Debtor–in–Possession Agreement ("DIP Agreement") for $750 million in Debtor–in–Possession Financing (the "DIP Facility"). The DIP Facility was amended to the amount of $1.1 billion and was approved by the Bankruptcy Court on October 15, 2002. In January 2004, the Company reduced the size of the DIP Facility to $300 million. As of December 31, 2003, there were no advances outstanding under the DIP Facility and the Company had $77 million of letters of credit

outstanding under the DIP Facility. Additionally, the Company had $47 million in undrawn letters of credit that were issued under a pre–petition $1.6 billion credit facility that was terminated as of the Petition Date, and Digex had a letter of credit of $1 million under a separate credit facility as of December 31, 2003.

On the Emergence Date, the DIP Facility was terminated. Approximately $100 million in letters of credit were rolled over to new letter of credit facilities entered into on the Emergence Date with JPMorgan Chase Bank, Citibank, N.A. and Bank of America, N.A. (the "Letter of Credit Facilities"), including the remaining $17 million of undrawn letters of credit on the pre–petition $1.6 billion credit facility. On October 12, 2004, the Commitment under the Letter of Credit Facilities was increased from $150 million to $300 million. In addition, the Company pays a facility fee under the Letter of Credit Facilities equal to .05% per annum of the daily amount of the Commitment (whether used or unused). If any fee or other amount payable under any Letter of Credit Facility is not paid when due, additional interest equal to 2% per annum plus the federal funds rate (determined in accordance with such Letter of Credit Facility) will be incurred on the overdue amount. The Letter of Credit Facilities mature in April 2005. As of December 31, 2004, under the Letter of Credit Facilities, the Company had $137 million letters of credit outstanding, $162 million in availability, and $1 million reserved for issuance. During the year ended December 31, 2004, the Company pledged $144 million in cash as collateral for its outstanding letters of credit that has been classified as restricted cash in other current assets in the consolidated balance sheet.

Other Debt

Prior to the Company's disposal of Embratel in 2004 (see Note 17), Embratel's debt obligations were included in the Company's consolidated balance sheet.

Embratel's loans and financing were principally comprised of credits from various banks and also from its suppliers of telecommunications equipment used to enhance domestic and international telecommunications services. The debt was mainly denominated in U.S. dollars, Brazilian Reais, Japanese Yen and Euros and bore fixed interest rates ranging from 4% to 13% per annum, and variable interest rates ranging from 0.13% to 4% per annum over the LIBOR. The LIBOR rate at December 31, 2003 was 1.22%. Most of Embratel's credit agreements included cross–default provisions and cross–acceleration provisions that would permit the holders of such indebtedness to declare the indebtedness to be in default and to accelerate the maturity thereof if a significant portion of the principal amount of Embratel's debt was in default or accelerated. Embratel's outstanding debt that contained such provisions totaled $1.1 billion as of December 31, 2003.

As described in Note 12, a portion of Embratel's debt was partially hedged against the exchange variation of the Brazilian Real as compared to the denomination of its outstanding debt through "swap" agreements.

The aggregate principal repayments required in each of the years ending December 31, 2005 through December 31, 2009 and thereafter related to the Company's debt obligations are as follows (in millions):

Years Ending December 31,	
2005	$ 24
2006	23
2007	2,012
2008	26
2009	2,008
Thereafter	1,840
Total	$5,933

(12) Financial Instruments

The Company's financial instruments include cash and cash equivalents, marketable securities, debt and equity investments, trade payables, trade receivables, and long and short–term debt. The Company also holds derivative financial instruments which may be freestanding or embedded in another contract. The Company's derivative financial instruments include derivatives embedded in the Company's holdings of redeemable preferred convertible stock, and warrants to purchase stock. Embratel had foreign currency swap agreements.

The carrying amount of the Company's cash and cash equivalents, marketable securities, trade receivables, trade payables and cost method investments approximate fair value and are excluded from the table below. The Company estimates the fair value of its short and long–term debt and derivative instruments using prices quoted in active markets. For those short and long–term debt instruments for which no active quoted market price is available, the fair value is estimated using current rates offered to the Company for debt of a similar maturity. Upon the Company's adoption of fresh–start reporting as of December 31, 2003, carrying values were adjusted to fair value. The difference between carrying value and fair value of the Company's financial instruments as of December 31, 2003 relates to the inclusion of Embratel's financial instruments at that date. The carrying amount and fair values of financial instruments at December 31, 2004 and 2003 were as follows (in millions):

	Successor Company			
	As of December 31,			
	2004		2003	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Short–term debt	$ 24	$ 24	$ 330	$ 335
Long–term debt	5,909	6,171	7,117	7,233
Derivative assets excluding investments (see Note 9)	$ —	—	16	16

Concentrations of Credit Risk—As of December 31, 2004, the Company did not have any significant concentration of business transacted with a particular customer, supplier, lender or former affiliate that could, if suddenly adversely impacted, severely impact its consolidated statements of operations. The Company is exposed to concentrations of credit risk from customers which are other telecommunications service providers. The Company invests its cash with several high–quality credit institutions.

Derivative Financial Instruments

The Company neither holds nor issues derivative financial instruments for trading purposes nor does it account for any of its derivative instruments as hedges. The Company does hold certain convertible preferred stock securities that contain embedded derivatives that are not clearly and closely related to the stock. The change in the fair value of the embedded derivatives has been recorded through earnings in miscellaneous income (expense). The Company holds warrants to purchase additional common shares of companies. The changes in fair value of the warrants, which meet the definition of a derivative, have been recorded through earnings in miscellaneous income (expense).

The Predecessor Company issued $1.0 billion in dealer remarketable securities in 2000. These securities included an embedded written remarketing option which met the definition of a derivative under SFAS No. 133 and required bifurcation. The remarketing option was cash settled in May 2002 for approximately $47 million with no impact to the consolidated statement of operations.

Embratel had loans denominated in currencies other than its functional currency, primarily in U.S. dollars, and with variable rates of interest. Accordingly, Embratel was exposed to market risk from changes in foreign

exchange rates and interest rates. Embratel managed risk arising from fluctuations in currency exchange rates, which affected the amount of Brazilian Reais necessary to pay the foreign currency denominated obligations, by using derivative financial instruments, primarily currency swaps. As of December 31, 2003, Embratel held outstanding currency swap contracts in the notional amount of $440 million to reduce the impact on its obligations of devaluations of the Brazilian Real. All of Embratel's currency swaps were recorded in the 2003 consolidated balance sheet at fair value with changes in fair value included in discontinued operations in the Company's consolidated statements of operations.

Accounts Receivable Securitization Facility

On May 23, 2002, the Predecessor Company renewed its accounts receivable securitization program (the "A/R Facility") which was an agreement to sell, on an ongoing basis, accounts receivable to a wholly–owned "bankruptcy remote" subsidiary. The subsidiary subsequently sold receivables for proceeds of up to $1.5 billion. Prior to the renewal, the A/R Facility allowed the Company to sell receivables for proceeds of up to $2.2 billion. The Predecessor Company was responsible for servicing the accounts receivable sold. The sale of the receivables was accounted for under SFAS No. 125, *"Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,"* and SFAS No. 140, *"Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities."* No amounts were sold or outstanding as of December 31, 2004 and 2003. The Predecessor Company recorded a loss on the sale of accounts receivable of approximately $21 million for the year ended December 31, 2002, which was included in the consolidated statement of operations in other miscellaneous income (expense).

On June 28, 2002, the purchasing banks exercised their right to terminate the A/R Facility and be paid amounts outstanding thereunder through collections of the receivables. All remaining amounts under the A/R Facility were paid in full after the Petition Date in July 2002 principally through collection of the receivables, with the remaining balance paid as a requirement by the DIP Facility Lenders.

(13) Accumulated Other Comprehensive (Loss) Income

Accumulated other comprehensive (loss) income is comprised of foreign currency translation adjustments, unrealized gain (loss) on available–for–sale securities and the Company's minimum pension liability. The following table sets forth the changes in accumulated other comprehensive (loss) income, net of tax, for each of the three years ended December 31, 2004 (in millions):

	Foreign Currency Translation Adjustments	Net Unrealized Gain (Loss) on Available–for–Sale Securities	Minimum Pension Liability Adjustment	Total Accumulated Other Comprehensive (Loss) Income
Balance, January 1, 2002 (Predecessor Company)	$ (153)	$ 20	$ (9)	$ (142)
Current year change	(156)	(22)	(38)	(216)
Balance, December 31, 2002 (Predecessor Company)	(309)	(2)	(47)	(358)
Current year change	15	7	—	22
Application of fresh–start reporting (Note 4)	294	(5)	47	336
Balance, December 31, 2003 (Successor Company)	—	—	—	—
Current year change	(1)	2	(23)	(22)
Balance, December 31, 2004 (Successor Company)	$ (1)	$ 2	$ (23)	$ (22)

(14) Shareholders' Equity

Successor Company

The Predecessor Company's Plan became effective and it emerged from bankruptcy on April 20, 2004. The Predecessor Company applied fresh–start reporting effective December 31, 2003 and, as a result, reflected all shares of WorldCom group and MCI group common stock, warrants to acquire WorldCom group common stock, Series D, E, and F Junior Convertible preferred stock and SMC Class A preferred stock as cancelled (see Note 5). The equity structure of the Successor Company as of December 31, 2004 and 2003 is discussed below.

MCI Common Stock

On April 20, 2004, the Predecessor Company merged with and into the Successor Company and the separate existence of the Predecessor Company ceased to exist. The Successor Company is a Delaware corporation and filed a new certificate of incorporation ("New Articles"). The New Articles authorized 3,000,000,000 shares of MCI common stock ("common stock") with $0.01 par value. During 2004, the Successor Company issued approximately 296 million shares of common stock to settle claims of debt holders, 10 million shares were issued to settle the SEC civil penalty, approximately 8.6 million shares were issued through the MCI, Inc. 2003 Management Restricted Stock Plan and approximately 5.7 million shares were issued to unsecured creditors. Pursuant to the Plan, such stock had an agreed value of $8.5 billion. Accordingly, the Successor Company recorded common stock, additional paid–in capital and deferred compensation of $3 million, $8.6 billion, and $170 million, respectively, in the consolidated balance sheet as of December 31, 2003 (see Note 4). In addition to any other approval required by law, any action to effect a stock split or reverse stock split of the common stock within one year after April 20, 2004 shall require the approval of the holders of at least ninety–five percent (95%) of the shares of common stock then outstanding.

MCI Shareholder Rights Plan

On April 20, 2004, the Board of Directors of MCI declared a dividend of one right ("Right") for each outstanding share of MCI Common Stock to stockholders of record on that date. The Rights become exercisable upon the earlier of: (i) ten days following a public announcement by another person or group that it has acquired beneficial ownership of 15% or more of the outstanding shares of common stock; or (ii) ten business days following the commencement of a tender offer or exchange offer to acquire beneficial ownership of 15% or more of the outstanding shares of common stock. Certain qualifying tender offers made to all stockholders will not trigger the Rights. The Rights expire on the date of the 2007 annual meeting, unless earlier redeemed at a price of $.001 per Right. If the Rights become exercisable, upon payment of the exercise price of the Right (which was initially set at $75.00 per right), holders may receive (a) MCI common stock with a market value equal to twice the exercise price or (b) common stock of an acquirer of MCI with a market value equal to twice the exercise price.

Embratel Preferred and Common Stock

As of December 31, 2003, there were 210 billion Embratel preferred shares outstanding and 124 billion common shares outstanding all without par value. The preferred shares were non–voting, except under limited circumstances, and were entitled to a minimal non–cumulative dividend of 6% per annum resulting from the division of the subscribed capital by the number of shares or a dividend 10% higher than that paid to each ordinary share, whichever was higher. The preferred shares of Embratel had a priority in relation to the common shares in the event of a liquidation of Embratel. The Embratel preferred shares and common shares not owned by the Company were classified as other minority interests in the Company's 2003 consolidated balance sheet.

Dividends

During 2004, the Company paid $254 million to shareholders pursuant to Section 5.07 of the Plan ($0.40 per share to shareholders of record on September 1 and December 1). As the cash dividends were returns of shareholder capital, the dividends were recorded as reductions of additional paid–in capital in the shareholders' equity section of the Company's consolidated balance sheet.

Predecessor Company

The Predecessor Company's plan of reorganization became effective and it emerged from bankruptcy on April 20, 2004. The Predecessor Company adopted fresh–start reporting effective December 31, 2003, at which time it effectively cancelled all shares of the following securities:

Common Stock

The Predecessor Company maintained two classes of common stock: WorldCom group common stock and MCI group common stock. The rights of the holders of the WorldCom group common stock included one vote per share and one liquidation unit in the event of the dissolution of the Company. The MCI group common stock held variable voting rights, was convertible to WorldCom group common stock at the option of the Board of Directors, and received $^{1}/_{25}$ of a liquidation unit in the event of dissolution. Neither class of common stock held the right to a dividend, although the Predecessor Company historically paid quarterly dividends on the MCI group common stock prior to the Petition Date.

Dividends

The Predecessor Company did not declare nor pay any dividends in 2003. Dividends paid or declared on both common and preferred securities during the year ended December 31, 2002 were as follows (in millions):

	Predecessor Company	
	Year Ended December 31, 2002	
Class of Stock	Cash Dividends Paid	Cash Dividends Declared
MCI group common stock	$142	$ —
Preferred Stock:		
Series D	5	3
Series E	5	3
Series F	7	4

During July 2002, the Predecessor Company paid dividends to existing holders of Series D, E, and F preferred securities in the form of common stock units. Each common stock unit included one share of WorldCom group common stock and 0.0515 shares of MCI group common stock. The number of common stock units included in the dividend payment was determined based on a formula that considered average stock price and other factors. The amount declared in 2002 was $19 million of which $9 million was a stock dividend and $10 million in cash. As a result of the Predecessor Company's bankruptcy filing, all preferred dividends to be paid after the Petition Date were stayed.

The Predecessor Company's Plan became effective and it emerged from bankruptcy on April 20, 2004. The Company adopted fresh–start reporting effective December 31, 2003, at which time it effectively cancelled all shares of the Predecessor Company's redeemable preferred securities (see Note 4).

Digex Series A Convertible Preferred Stock

On November 17, 2003, the Predecessor Company paid approximately $39 million for the acquisition of the remaining interest in Digex. This payment included the purchase of the outstanding shares of Class A Common Stock of Digex not already owned for $1.00 per share. Also included in this payment was the purchase of the 50,000 outstanding shares of Series A Convertible Preferred Stock of Digex from Hewlett–Packard. Following the completion of the purchase, Digex became a wholly–owned subsidiary of the Predecessor Company.

WorldCom Shareholder Rights Plan

On March 7, 2002, the Board of Directors declared a dividend of one preferred share purchase right ("Group Right") for each outstanding share of WorldCom group common stock and for each outstanding share of MCI group common stock. Each Group Right entitled (i) the holder of WorldCom group common stock to purchase one one–thousandth of a share of Series 4 Junior Participating Preferred Stock, par value $.01 per share, of the Predecessor Company at a price of $60.00, subject to adjustment, and (ii) the holder of MCI group common stock to purchase one one–thousandth of a share of Series 5 Junior Participating Preferred Stock, par value $.01 per share, of the Predecessor Company at a price of $40.00, subject to adjustment. The Group Rights were cancelled on the Emergence Date.

(15) Stock–Based Compensation

Successor Company

MCI, Inc. 2003 Management Restricted Stock Plan

In connection with the confirmation of the Predecessor Company's bankruptcy, the Bankruptcy Court and the Predecessor Company's creditors approved the adoption of the MRSP, which became effective on the Emergence Date. Under the MRSP, the Company is authorized to issue restricted stock and restricted stock unit awards with respect to up to 10,921,000 shares of MCI Common Stock. The Company anticipated that restricted stock unit awards of 8,597,739 would be granted to employees on the Emergence Date, however, actual restricted stock awards granted totaled 8,533,988.

The MRSP is administered by the Compensation Committee of the Board of Directors. The plan allows the Committee to make awards of restricted stock or restricted stock units to such officers and key employees of the Company as the Committee in its sole discretion determines to be responsible for the success and future growth and profitability of the Company.

Awards under the MRSP may be granted in any one or a combination of stock awards or stock units. Each type of grant is described below. The Compensation Committee will determine the vesting schedule for any stock awards and stock unit awards. The awards granted on the Emergence Date vest quarterly over a period of three years. To the extent permitted by the Compensation Committee in award agreements, participants may exchange grants between stock units and stock awards.

Stock unit awards may be granted by the committee in its sole discretion. A "stock unit" means a notional account representing one share of Common Stock. Recipients of stock unit awards will be eligible to receive dividend equivalents. A dividend equivalent is the right to receive the amount of any dividend paid on the share of Common Stock underlying a stock unit, which will be payable in cash or in the form of additional stock units. On August 18, 2004, the individual award agreements under the MRSP were amended to allow for the conversion of restricted stock units into shares of Restricted Stock (with one Stock Unit converting to one share of Restricted Stock) and the payment of dividends on unvested Restricted Stock shares. The conversion from Restricted Stock Units into shares of Restricted Stock was not allowed for any units held by employees outside the U.S. or that had been deferred under the Deferred Stock Unit Plan.

Stock awards may be granted by the committee in its sole discretion. A stock award is the transfer of Common Stock with or without payment therefor. A stock award agreement will specify whether the participant will have, with respect to the shares of Common Stock subject to a stock award, all of the rights of a holder of shares of Common Stock of the Company.

If there is any change in the Common Stock of the Company through merger, consolidation, reorganization, recapitalization, stock dividend, stock split, reverse stock split, split up, spin–off, combination of shares, exchange of shares, dividend in kind or other like change in capital structure or distribution (other than normal cash dividends) to shareholders of the Company, an adjustment will be made to the shares available under the MRSP and to each outstanding stock unit such that each such award shall thereafter be exercisable for such securities, cash and/or other property as would have been received in respect of the Common Stock subject to such stock unit had such award been exercised in full immediately prior to such change or distribution, and such an adjustment shall be made successively each time any such change shall occur. In the event of any change or distribution described in the preceding sentence, in order to prevent dilution or enlargement of participants' rights under the MRSP, the committee will have authority to adjust, in an equitable manner, the number and kind of shares that may be issued under the MRSP, the number and kind of shares subject to outstanding awards, the purchase price applicable to outstanding awards, and the fair market value of the Common Stock and other value determinations applicable to outstanding awards. Appropriate adjustments may also be made by the committee in the terms of any awards under the MRSP to reflect such changes or distributions and to modify any other terms of outstanding awards on an equitable basis, including modifications of performance targets and changes in the length of performance periods, if applicable. In addition, the committee is authorized to make adjustments to the terms and conditions of, and the criteria included in, awards in recognition of unusual or nonrecurring events affecting the Company or the consolidated financial statements of the Company, or in response to changes in applicable laws, regulations, or accounting principles.

If there is a change in control of the Company and any participant is terminated without "cause" (as such term is defined in the agreement pertaining to the award) within two years thereafter, all then outstanding stock units of such participant will immediately vest and become settleable and any restrictions on stock awards of such participant will immediately lapse. Thereafter, all awards shall be subject to the terms of any agreement effecting the change in control. As of December 31, 2004, there were 3,358,222 restricted stock awards available for grant; however, on February 28, 2005, the Company granted 3,333,767 shares of restricted stock awards pursuant to the MRSP. The following table summarizes the activity for 2004 (shares in millions):

	Number of Shares	Weighted Average Fair Value
Awards outstanding, January 1, 2004[1]	8.6	$ 19.75
Shares granted	—	—
Shares vested	(1.3)	19.75
Shares forfeited	(1.0)	19.75
Awards outstanding, December 31, 2004	6.3	$ 19.75

(1) Initial awards granted on April 20, 2004 were considered outstanding as of December 31, 2003 as a result of fresh–start reporting (see Note 4).

The Company recorded $170 million of deferred stock–based compensation upon the issuance of approximately 8.6 million shares of restricted stock that were granted on the Emergence Date based on the fair value of the Company's stock on the date of grant. The amount is being amortized over the vesting period of three years on a straight–line basis. The Company recorded approximately $7 million and $29 million to costs of

services and products and selling, general and administrative expense, respectively, in its consolidated statement of operations for 2004. In addition, the Company reversed approximately $20 million of deferred stock–based compensation related to shares that will not vest due to employee terminations during 2004.

MCI, Inc. Deferred Stock Unit Plan

Any participant may elect to defer receipt of all or a portion of the common stock subject to a stock award under the MRSP. Any such election must be made in accordance with procedures established by the compensation committee and prior to the date the portion of the stock units to be deferred vests. Once an election to defer is made, it will be permanent and irrevocable. All distributions will be made in the form of common stock.

A participant's deferred stock unit account will be credited with a number of notional shares of common stock equal to the number of stock units deferred as soon as practicable after the stock units would have been received by the participant absent the deferral election. A participant will, at all times, be 100% vested in any amounts credited to his or her deferred stock unit account. The Company is not required to actually invest amounts credited to participants' accounts in shares of common stock or otherwise.

An amount equal to any regular cash dividend which would have been received by a participant had the amounts credited to his or her deferred stock unit account actually been invested in shares of common stock will be paid to him or her.

MCI, Inc. 2003 Employee Stock Purchase Plan

The Company's bankruptcy plan included the establishment of the ESPP, which became effective on the Emergence Date.

Under the ESPP, which is a stock purchase plan qualified under Section 423 of the Internal Revenue Code, up to 2,200,000 shares of Common Stock may be purchased by eligible employees of the Company through payroll deductions of up to 15% of their eligible compensation. The purchase price will be equal to the lower of 85% of the market value of the stock at the beginning or at the end of each six–month offer period commencing July 1 and January 1 of each calendar year. The ESPP was modified in 2004 so that open market purchases were not required to fund the plan as originally intended and the 2.2 million shares that were reserved upon emergence would be used.

If a participant's employment with the Company or a participating subsidiary terminates, then unless the termination coincides with the last day of an offering period, the payroll deductions allocated to his or her account for that offering period will be returned to him or her. All shares of common stock in the participant's account will be distributed to him or her.

If the Company is a party to a sale of substantially all of its assets, or a merger or consolidation, then the right to purchase shares of common stock under the ESPP will be subject to the agreement of sale, merger or other consolidation.

If there is a stock split, stock dividend or other change affecting the common stock, then the number and kind of securities reserved under the ESPP will be appropriately adjusted by the Board of Directors. Appropriate adjustments will also be made to the purchase price for shares of common stock at the end of the offering period in which such an event occurs and other terms of the ESPP.

Contributions are held in escrow until the end of the offering period, when the accumulated contributions will be applied to the distribution of shares. The ESPP is accounted for using the intrinsic-value-based method of APB Opinion No. 25 and no compensation expense was recorded. However, the ESPP does not meet the criteria as set forth in SFAS No. 123 for noncompensatory plans and therefore is deemed compensatory for disclosure purposes only. During 2004, employees contributed $19 million to the ESPP, however, no shares were issued in 2004. The $19 million of employee contributions was included in other current assets as restricted cash and is offset by $19 million in other current liabilities in the Company's consolidated balance sheet. As of December 31, 2004, the ESPP provided for the issuance of 2.2 million shares through open market purchases, from treasury shares and from authorized but unissued shares. In January 2005, the Company issued 1,531,531 shares to employees under the ESPP for the offering period ended December 31, 2004.

Embratel Plan

Embratel also maintained a separate stock option plan. The plan granted Embratel's directors and employees options to purchase Embratel preferred shares at the market value on the grant date. The options became exercisable over a three to four year period and expired ten years from the grant date. Until the third quarter of 2001, options were granted with the exercise price adjusted for inflation until the exercise date using the General Market Price Index, became exercisable over a three-year period and expired 10 years after the date of grant. Pursuant to the Embratel Plan, options granted could be exercised upon the occurrence of certain events, including a change in shareholder control of Embratel.

Summarized information relating to the Embratel Option Plan is as follows (in millions):

	Number of Options
Balance January 1, 2002	6,265
Granted	2,097
Expired or canceled	(478)
Balance December 31, 2002	7,884
Granted	2,807
Exercised or sold	(1,221)
Expired or canceled	(739)
Balance December 31, 2003	8,731
Weighted average exercise price on December 31, 2002 (per thousand shares)	$ 1.54
Weighted average exercise price on December 31, 2003 (per thousand shares)	$ 2.06

The fair values of the Embratel Option Plan options granted during the years ended December 31, 2003 and 2002 have been estimated at the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	Year Ended December 31,	
	2003	2002
Expected volatility	57%	64%
Risk free interest rate	17%	27%
Expected life (years)	5	5
Dividend yield	—	—

Predecessor Company

WorldCom Plans

The Predecessor Company adopted fresh-start reporting (see Note 4) as of December 31, 2003, at which time it effectively cancelled all common stock options under the Predecessor Company's 1990 Stock Option Plan, the 1997 Stock Option Plan, the 1999 Stock Option Plan, and the MCI ESPP in addition to several other stock option plans assumed from various acquired companies, (collectively, the "Option Plans").

As of December 31, 2003 and 2002, the Predecessor Company had authorized 1,025 million shares of WorldCom group common stock for issuance under the Option Plans, including the stock option plans assumed from various acquisitions. As of December 31, 2002, 611 million options were available for issuance and approximately 414 million options had been granted under the Option Plans.

Effective with the recapitalization and issuance of the MCI group tracking stock in June 2001, each outstanding stock option under the Option Plans was converted into a stock option to acquire shares of WorldCom group common stock having the same terms and conditions, except that the exercise price and the number of shares issuable upon exercise were divided and multiplied, respectively, by 1.0319. The information presented below reflects this conversion ratio.

Information regarding options and warrants granted and outstanding is summarized below (in millions, except share price):

	Number of Options and Warrants	Weighted Average Exercise Price
Balance, January 1, 2002	400	$ 29.85
Granted	4	15.63
Exercised	(2)	6.94
Expired or canceled	(175)	37.99
Balance, December 31, 2002	227	23.49
Granted	—	—
Exercised	—	—
Expired or canceled	—	—
Balance, December 31, 2003 (Predecessor Company)	227	$ 23.49
Application of fresh-start reporting (see Note 4)	(227)	
Balance, December 31, 2003 (Successor Company)	—	

Approximately 114 million of the options expired or canceled in 2002 represent options cancelled as part of a voluntary exchange program in which employees could exchange previously granted stock options for options with new exercise prices, expiration dates and vesting schedules to be issued at a future date that was to be six months and one day from the date of cancellation. The issuance of the new options never occurred due to the Company's bankruptcy filing. The options granted during 2002 were granted at an average fair value of $3.24.

(16) Severance and Restructuring Programs

The Company provides severance benefits to its employees under its Severance Policy. These benefits vest when the employee is notified of his termination. The amount of benefit varies based on the employee's term of

service. Severance benefits for employees who had been notified of termination on or before June 14, 2002 were paid in a lump-sum on the date of termination. Severance benefits for terminations after that date are paid in equal bi-weekly payments for the duration of the severance benefits.

Throughout 2004, 2003 and 2002, the Company implemented workforce reductions on a company-wide basis, impacting all business segments. Amounts for employee termination costs were recorded as announced to the affected employees and in accordance with the Company's Severance Policy. In 2004, 2003 and 2002, a total of 9,783, 4,194 and 15,774 employees were terminated; as of December 31, 2004, 247 employees included in the Company's terminations were still actively working. During 2004, approximately 2,300 employees voluntarily terminated their employment with the Company after receiving notification that their positions would be eliminated. Terminations during 2003 and those completed after the Petition Date in 2002 were recorded in the consolidated statements of operations as reorganization items, net (see Note 5).

In 2004, 2003, and 2002, the Company identified certain properties related to the closing of call centers which it planned to vacate and sublease, where possible. In accordance with SFAS No. 146, *"Accounting for Costs Associated with Exit or Disposal Activities,"* the Company recorded charges of approximately $20 million, $6 million, and $36 million as selling, general and administrative expenses in its consolidated statements of operations for the years ended December 31, 2004, 2003, and 2002, respectively.

The following table summarizes the Company's accrual of severance and other restructuring expenses and payments during the years ended December 31, 2004, 2003 and 2002 (in millions):

	Severance	Other
Balance as of January 1, 2002 (Predecessor Company)	$ —	$ 65
Expenses	133	36
Cash payments during 2002	(101)	(5)
Balance as of December 31, 2002 (Predecessor Company)	32	96
Expenses	58	6
Cash payments during 2003	(79)	(10)
Balance as of December 31, 2003 (Successor Company)	11	92
Expenses	163	20
Cash payments during 2004	(154)	(4)
Balance as of December 31, 2004 (Successor Company)	$ 20	$ 108

(17) Discontinued Operations and Assets Held for Sale

The Company has identified certain non-core assets that it has determined are not part of its expected future operations. As such, these assets and businesses, once identified and qualifying for discontinued operations under SFAS No. 144, are reflected as discontinued operations in the consolidated statements of operations and as assets held for sale in the consolidated balance sheet.

Discontinued Operations

In May 2002, the Predecessor Company committed to a plan to exit its WorldCom Wireless ("Wireless") resale business because of continuing operating losses. In July 2002, the Predecessor Company sold its wireless customer contracts, with no book value, to several wireless providers and resellers for a total of approximately $34 million, which was recognized as a gain in 2002. All contracts were effectively transitioned to other providers by October 2002. During 2003, the Company recorded $12 million of revenue for amounts received during the period within discontinued operations.

In June 2003, the Predecessor Company decided to dispose of its Multichannel Multipoint Distribution Service ("MMDS") business which included network equipment, licenses and leases utilized for the provision of wireless telecommunications services via Multichannel Multipoint Distribution Service. In June 2003, the Predecessor Company received Bankruptcy Court approval to dispose of these assets, and this standalone entity was reclassified to discontinued operations under SFAS No. 144, and related revenues and expenses were reclassified to discontinued operations for all periods presented.

On July 8, 2003, an Asset Purchase Agreement was entered into with Nextel Spectrum Acquisition Corp. ("Nextel") for the sale of substantially all of the assets of MMDS for $144 million in cash. In addition, the Company entered into a three–year extension of a customer contract between subsidiaries of MCI and Nextel. The sale was approved by the Bankruptcy Court on July 22, 2003, as modified in certain respects. The Company completed the sale in May 2004 and received $144 million in cash for the assets, which was equal to their carrying value which included a reserve for post–closing adjustments of $2 million. This reserve was subsequently settled for an immaterial amount resulting in the recognition of a gain on the sale of approximately $2 million.

In November 2003, the Board of Directors approved a plan to dispose of its 19% economic investment in Embratel, as well as other Latin American entities. On March 15, 2004, the Company announced that it had entered into a definitive agreement to sell its ownership interest in Embratel and other Latin American subsidiaries to Telefonos de Mexico. On April 21, 2004, the agreement was amended which increased the cash purchase price to $400 million from $360 million. On April 27, 2004, these assets qualified as discontinued operations under SFAS No. 144 when the Company received bankruptcy court approval for the sale. Accordingly, the Company has reclassified all revenues and expenses to discontinued operations for all periods presented. On July 23, 2004, the Company completed the divestiture for $400 million. As of the sale date, all obligations under the Share Purchase Agreement were completed. The Company recognized a gain on the sale of approximately $12 million within discontinued operations in its consolidated statement of operations.

In June 2004, the Company decided to dispose of additional Latin American operations and began the marketing of Proceda Tecnologia e Informatica S.A. ("Proceda"), an information technology outsourcing company in Brazil specializing in the following areas: data center services, mainframe services, hosting, technical support, help desk management, integrated solutions, and e–business. These assets qualified as discontinued operations under SFAS No. 144 in June 2004 and, accordingly, the Company has reclassified all revenues and expenses to discontinued operations for all periods presented. The operations were sold on December 2, 2004 for $3 million. The Company recognized an immaterial gain within discontinued operations in the consolidated statement of operations.

In June 2004, the Company commenced its internal evaluation related to OzEmail Pty. Ltd ("OzEmail"), an Internet service provider providing dial–up, broadband and wireless products to Australian consumers and small business enterprises. In July 2004, the Company began to market OzEmail for sale. The related assets qualified as discontinued operations under SFAS No. 144 in July 2004 and, accordingly, the Company has reclassified all revenues and expenses to discontinued operations for all periods presented and reclassified all assets and liabilities as "held for sale" in the consolidated balance sheet as of December 31, 2004. On February 28, 2005, the Company completed the divestiture of OzEmail for approximately $86 million and will record a gain of approximately $80 million within discontinued operations in its 2005 consolidated statement of operations.

The consolidated statements of operations reflect Wireless, MMDS, Embratel (and other companies related to the transaction), Proceda, and OzEmail as discontinued operations for all periods presented. The combined operating results of these entities through the date of disposition and gains from the sale of assets are reflected in the consolidated financial statements for the years ended December 31, 2004, 2003, and 2002 as follows (in millions):

	Successor Company	Predecessor Company	
	Year Ended December 31,		
	2004	2003	2002
Revenues	$ 1,925	$ 3,065	$ 4,387
Operating expenses	(1,821)	(2,835)	(4,410)
Other expense	(77)	(7)	(556)
Minority interests (expense) income	(4)	(172)	173
Income tax (expense) benefit	(11)	(94)	204
Gain on sale of assets	14	—	—
Net income (loss)	$ (26)	$ (43)	$ (202)

Assets Held for Sale

OzEmail

As of December 31, 2004, assets held for sale in the consolidated balance sheet relate to OzEmail. Assets include cash and other assets, and liabilities represent accounts payable and accrued access costs. Additionally, related cumulative translation adjustments are included as part of shareholders' equity.

Douglas Lake

The Predecessor Company deemed Mr. Bernard J. Ebbers ("Mr. Ebbers"), its former Chief Executive Officer, to be in default of the terms of a Promissory Note he signed to the Company dated April 29, 2002. The Promissory Note was secured by Predecessor Company stock as well as Mr. Ebbers' equity interests in certain enterprises. On May 29, 2003, the Predecessor Company entered into an agreement to sell one of Mr. Ebbers' properties, Douglas Lake, and on July 1, 2003, the Bankruptcy Court approved the sale of the property. As a result, the Predecessor Company reclassified the asset in its consolidated balance sheet as "held for sale" effective July 1, 2003 under SFAS No. 144. The carrying value of the property was $54 million as of December 31, 2003. The property was sold in February 2004 for approximately $50 million, which was net of disposal costs. The Company received approximately $37 million in net proceeds in connection with the closing, and expects to receive additional proceeds of up to approximately $13 million, pending the resolution of certain tax matters and the final determination of any indemnification claims made by the purchaser pursuant to the purchase agreement. The Company recorded the estimated loss of $4 million as selling, general and administrative expenses in the 2004 consolidated statement of operations.

Embratel

During 2004, Embratel qualified for discontinued operations and was ultimately sold as noted above. The removal of these assets in 2004 had a significant effect on the Company's consolidated balance sheet. As Embratel was removed from the consolidated balance sheet during 2004, actual amounts removed from the consolidated balance sheet would have reflected current year operations through the date of disposal. The following condensed balance sheet of Embratel as of December 31, 2003 identifies the assets and liabilities included in the Successor Company's consolidated balance sheet as of December 31, 2003. These amounts represent the Company's basis in the investment and includes adjustments for U.S. GAAP, consolidation eliminations, and purchase accounting (in millions):

	Successor Company
	As of December 31, 2003
ASSETS	
Cash	$ 595
Receivables	556
Other current assets	125
Total current assets	1,276
Property, plant and equipment	1,986
Non–current assets	958
Total assets	$ 4,220
LIABILITIES AND EQUITY	
Current portion of long–term debt	$ 289
Current liabilities	948
Total current liabilities	1,237
Long–term debt	1,285
Other long–term liabilities	149
Minority interest	1,149
Total liabilities	3,820
MCI's investment	400
Total liabilities and equity	$ 4,220

(18) Leases and Commitments

The Company leases office facilities, office equipment and telecommunications equipment under non–cancelable operating leases having initial terms of more than one year. Various facility leases include renewal options, and most leases include provisions for rent escalation to reflect increased operating costs or require the Company to pay certain maintenance and utility costs. Included with telecommunication facilities are contractual commitments with incumbent local phone companies that provide ports to the Company and obligations under right–of–way and franchise agreements with various entities. At December 31, 2004, future minimum payments under non–cancelable leases and commitments and capital lease obligations were as follows (in millions):

	Operating Leases and Commitments			
	Office Facilities and Equipment	Telecommunications Facilities	Total	Capital Leases
As of December 31,				
2005	$ 806	$ 319	$1,125	$ 49
2006	761	135	896	49
2007	696	99	795	52
2008	198	85	283	41
2009	123	76	199	38
Thereafter	390	498	888	198
Total	$2,974	$ 1,212	$4,186	427
Interest				(159)
Total				$ 268

Rental expense under operating leases was $945 million, $1.1 billion and $1.8 billion for the years ended December 31, 2004, 2003 and 2002, respectively. The reduction in expense relates to the Company's reduction in leases due to rejections during the Chapter 11 proceedings.

Property, plant and equipment assets under capital leases were $56 million and $91 million as of December 31, 2004 and 2003, respectively. Fresh–start reporting as of December 31, 2003 and the 2004 impairment charges eliminated the accumulated depreciation on these assets (see Note 7). As of December 31, 2004, accumulated depreciation on these assets was $6 million. The Company recorded $9 million, $6 million, and $6 million in depreciation expense on these assets for the years ended December 31, 2004, 2003 and 2002, respectively.

The Company and Electronic Data Systems Corporation ("EDS") have negotiated dual outsourcing agreements. The Company has outsourced portions of its information technology operations to EDS, pursuant to which EDS has assumed responsibility for the Company's information technology system operations at several locations. As of December 31, 2004, the contractual obligation associated with this contract was estimated to be approximately $1.6 billion in the aggregate and has been included with office facilities and equipment in the table above.

The Company has contractual obligations to utilize network facilities from local exchange carriers with terms greater than one year. The Company has assessed its minimum exposure related to penalties to exit the contracts and, as of December 31, 2004, the obligation associated with this liability was estimated to be approximately $1.4 billion and has been excluded from the table above.

The Company is obligated to pay a portion of maintenance and repair costs for certain cable systems which it uses to transmit voice, data and Internet traffic. As no minimum obligation is identified under these

agreements, the Company has excluded these obligations from the commitment table above. However, the Company estimates these obligations as of December 31, 2004 to be approximately $733 million over the contract period, which can exceed 20 years. During 2004, 2003, and 2002, the Company incurred expenses under these agreements of $40 million, $93 million, and $124 million, respectively.

As of December 31, 2004, the Company had various miscellaneous purchase commitments for services in the aggregate amount of $137 million.

(19) Contingencies

The filing of the Chapter 11 cases automatically stayed proceedings in private lawsuits relating to the Debtors pre–petition claims. Claims arising after the Petition Date were not discharged on emergence.

Right–of–Way Litigation. Prior to the Petition Date, the Predecessor Company was named as a defendant in five putative nationwide and twenty–five putative state class actions involving fiber optic cable on railroad, pipeline and utility rights–of–way. The complaints allege that the railroad, utility and/or pipeline companies from which the Predecessor Company obtained consent to install its fiber optic cable held only an easement in the right–of–way, and that the consent of the adjoining landowners holding the fee interest in the right–of–way did not authorize installation. The complaints allege that because such consent was not obtained, the fiber optic network owned and operated by the Predecessor Company trespasses on the property of putative class members. The complaints allege causes of action for trespass, unjust enrichment and slander of title, and seek injunctive relief, compensatory damages, punitive damages and declaratory relief. By the Petition Date, twenty–two putative class actions remained pending. In the remaining eight cases, class certification had been denied and/or the action had been dismissed. These cases were stayed as a result of the Predecessor Company's bankruptcy filing, initially as a result of the automatic stay provisions of the Bankruptcy Code, and presently by operation of the discharge injunction incorporated into the modified Second Amended Joint Plan of Reorganization. To date, the Bankruptcy Court has denied all motions to lift the automatic stay or the discharge injunction.

Certain of the right–of –way plaintiffs filed individual and/or putative class proofs of claim in the bankruptcy proceedings. To date, the Bankruptcy Court has denied all pending motions to certify classes with respect to these proofs of claim, and has declined to extend the bar date to allow the late–filing of claims by unnamed class members. As a result of these rulings, the Company's exposure in these matters has been substantially reduced.

The Company also is litigating in the Bankruptcy Court, and in several federal appellate courts, the question of whether the discharge injunction contained in the Modified Second Amended Joint Plan of Reorganization bars the initiation or continuation of actions outside of the Bankruptcy Court based on the continued presence of the fiber optic cable after the Company's discharge from bankruptcy. To date, one federal appellate court has agreed with the Company's position, and the Bankruptcy Court recently issued decisions in two right–of–way cases finding that any further prosecution after the bankruptcy violates the discharge injunction.

The Predecessor Company executed a settlement agreement in February 2002 regarding all right–of–way litigation in Louisiana, and in June 2002 regarding all other railroad right–of–way litigation nationwide. However, following the Petition Date, the Predecessor Company opted out of the nationwide settlement agreement because the Oregon court did not approve it, and the Predecessor Company did not elect to proceed to seek approval in Illinois. During the bankruptcy proceedings, the Predecessor Company rejected the Louisiana right–of–way settlement agreement, but has since entered into an agreement in principle to implement the Louisiana agreement as a pre–petition claim against the Predecessor Company. The Company accrued for its estimate to settle the pre–petition litigation as of December 31, 2004 and 2003.

State Tax. In conjunction with the Predecessor Company's bankruptcy claims resolution proceeding, certain states have filed claims concerning the Predecessor Company's state income tax filings and its approach to related–party charges. To date, various states have filed proofs of claims in the aggregate amount of approximately $750 million. In addition, the State of Mississippi has filed a claim in the aggregate amount of approximately $2 billion. The Company is in discussions with the appropriate state taxing officials on these and other similar issues related to state income taxes owed by the Company and its subsidiaries.

On March 17, 2004, the Commonwealth of Massachusetts on behalf of itself and thirteen other states filed a motion to disqualify KPMG LLP ("KPMG") from serving as the Company's accountant, auditor and tax advisor on the grounds that KPMG is not disinterested as required by Section 327(a) of the Bankruptcy Code. The Company believes that the filing of this motion is merely a litigation tactic and that the motion has no merit. The bankruptcy court held hearings on the motion, at the conclusion of which the bankruptcy court took the matter under advisement. On June 30, 2004, the bankruptcy court denied this motion and the states have appealed the order denying the motion.

Other. The Company provides indemnifications of varying scope and size to certain customers against claims of intellectual property infringement made by third parties arising from the use of its products as are usual and customary in the Company's business. Additionally, the Company provides indemnifications in certain lease agreements in which it agrees to absorb the increased cost to the lessor resulting from an adverse change in certain tax laws, which are usual and customary in leases of these types. The Company evaluates estimated losses for such indemnifications under FASB Interpretation No. 45, "*Guarantors' Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others.*" In relation to the indemnifications in certain lease agreements, as the indemnifications are contingent on tax law changes, the maximum amount of loss cannot be estimated until there is actually a change in tax law. To date, the Company has not incurred significant costs as a result of such obligations and has not accrued any liabilities related to such indemnifications in the consolidated financial statements.

In the normal course of business, the Company is subject to other proceedings, lawsuits and claims, including proceedings under government laws and regulations related to environmental and other matters. Such matters are subject to many uncertainties and outcomes are not predictable with assurance. Consequently, the Company is unable to ascertain the ultimate aggregate amount of monetary liability or financial impact with respect to these matters at December 31, 2004. While these matters could affect operating results when resolved in future periods, based on current information, the Company does not believe any monetary liability or financial impact would be material to its consolidated financial condition, results of operations, or cash flows. The Company, where appropriate, accrued for its estimates to settle outstanding litigation as of December 31, 2004 and 2003.

(20) Income Taxes

The Company is subject to U.S. federal, state, local and foreign income taxes. The domestic and foreign components of (loss) income from continuing operations before provision for income taxes for the years ended December 31, 2004, 2003 and 2002 were as follows (in millions):

	Successor Company	Predecessor Company	
	Year Ended December 31,		
	2004	2003	2002
Domestic	$(2,652)	$25,648	$(9,213)
Foreign	(856)	(2,870)	512
(Loss) income from continuing operations before income taxes	$(3,508)	$22,778	$(8,701)

The significant components of the provision for (benefit from) income taxes related to continuing operations for the years ended December 31, 2004, 2003 and 2002 were as follows (in millions):

	Successor Company	Predecessor Company	
	Year Ended December 31,		
	2004	2003	2002
Current:			
Federal	$ 116	$ —	$ (154)
State and local	332	80	78
Foreign	142	343	(89)
Total current expense (benefit)	590	423	(165)
Deferred:			
Federal	(206)	29	154
State and local	120	2	11
Foreign	16	(141)	258
Total deferred (benefit) expense	(70)	(110)	423
Income tax expense related to continuing operations	$ 520	$ 313	$ 258

A reconciliation of differences between the U.S. federal income tax statutory rate and the effective income tax rates for (loss) income from continuing operations, which includes federal, state, local and foreign income taxes for the years ended December 31, 2004, 2003 and 2002, is as follows:

	Successor Company	Predecessor Company	
	Year Ended December 31,		
	2004	2003	2002
U.S. federal statutory tax (benefit) expense rate	(35.0)%	35.0%	(35.0)%
Goodwill	—	—	0.3
Foreign income inclusion	0.3	3.0	3.2
Penalties	—	—	8.6
State income taxes (net of federal benefit)	11.7	0.2	0.7
Valuation allowance	23.1	(43.3)	18.7
Foreign taxes	13.7	4.9	1.7
Other	1.0	1.6	4.8
Effective tax rate	14.8%	1.4%	3.0%

The effective tax rate is the provision for income taxes expressed as a percentage of (loss) income from continuing operations before income taxes. The 2004 effective rate is different than the expected federal statutory rate of 35% primarily due to the tax benefits of losses from continuing operations offset by an increase in (i) the valuation allowance attributable to current year losses without benefit, (ii) the provision for state income taxes, including current accruals and changes in tax reserves, and (iii) the provision for foreign taxes, including changes in tax reserves and increases in dollar–denominated exposure due to the weakness of the U.S. dollar and the denomination of liabilities in local currencies.

In accordance with fresh–start reporting, any future changes in income tax contingencies that existed as of the fresh–start date would typically be adjusted to intangible assets, until exhausted, then to additional paid–in capital and not through income. As a result of the impairment of intangible assets in the third quarter of 2004, the Company will record net increases in income tax contingencies existing at the fresh–start date, that would

otherwise have served to increase the carrying value of intangible assets above their fair value, as additional income tax expense. The Company will record any decreases in pre–acquisition valuation allowance (not offset with decreases in the related gross deferred tax asset) to intangible assets. For the fourth quarter of 2004, the Company recognized $189 million of net additional expense attributable to changes in pre–fresh start federal, state and foreign tax contingencies, foreign exchange gains/losses and related interest. Additionally, the Company recognized $13 million of reductions of pre–fresh–start foreign income tax valuation allowances which was offset to intangibles.

The 2003 effective rate is lower than the expected statutory rate of 35% primarily due to a decrease in the valuation allowance. The net amount of the valuation allowance decreased significantly in 2003 primarily as a result of the establishment of the deferred tax liability for the effects of the Plan.

The 2002 effective rate is lower than the expected federal statutory rate of 35% primarily due to the tax benefits of losses from continuing operations offset by (i) an SEC civil penalty and other permanent items non–deductible for tax purposes, (ii) an increase in the valuation allowance attributable to losses from operations for which no tax benefit was recorded, and (iii) the utilization of NOLs, which were carried back for five years as a result of a change in tax law.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and amounts used for income tax purposes, and the impact of available NOL carryforwards. The components of the deferred tax assets and liabilities were as follows as of December 31, 2004 and 2003 (in millions):

	Successor Company	
	As of December 31,	
	2004	2003
Deferred tax assets:		
Depreciation, amortization and impairment	$ 1,988	$ 3,836
Intangibles	639	905
Provision for doubtful accounts	216	420
Net operating loss carryforwards	308	2,824
Accrued liabilities	376	523
Investments	30	727
Embratel deferred tax assets	—	781
Tax credits	—	306
Other	311	722
Total deferred tax assets	3,868	11,044
Less: valuation allowance	(1,904)	(1,150)
Net deferred tax assets	$ 1,964	$ 9,894
Deferred tax liabilities:		
Basis difference in subsidiary stock	1,005	—
Basis difference in trade accounts receivable	444	—
Basis difference in intercompany accounts receivable	448	—
Basis difference in other assets	79	—
Embratel deferred tax liabilities	—	140
Effects of bankruptcy plan	—	9,113
Other	148	250
Total deferred tax liabilities	$ 2,124	$ 9,503
Net deferred tax (liabilities) assets	$ (160)	$ 391

In 2004, the Company estimated the effect of amending its returns for 1999 through 2003 to reflect the impact of the restatement of the Company's previously issued consolidated financial statements. Additionally, the Company analyzed its deferred tax balances as of December 31, 2003 in light of its amended returns. Both the amended returns and the analysis of the deferred tax balances resulted in a net decrease in deferred tax balances of $598 million as of December 31, 2003, offset by a corresponding decrease in valuation allowance. Changes to the December 31, 2003 deferred tax balances included increases to (i) depreciation, amortization and impairment (including a reclassification of line installation costs from a deferred tax liability) of $2.3 billion, (ii) intangibles of $368 million, (iii) accrued liabilities of $382 million, and (iv) investments of $195 million. Additionally, changes to the December 31, 2003 deferred tax balances included decreases to (i) net operating loss of $3.1 billion, (ii) provision for doubtful accounts of $504 million, and (iii) net other deferred taxes of $250 million. These changes have been reflected in the above table to facilitate comparability, however, reclassifications have not been reflected in the December 31, 2003 consolidated balance sheet.

During the third quarter of 2004, the Company impaired its indefinite–lived intangible assets, recognizing an impairment charge of $260 million. As a result of the impairment charge, the Company recognized a $99 million tax benefit which reduced the Company's long–term deferred income tax liability as the impairment reduced the difference between the book and tax basis.

Deferred tax assets are reduced by a valuation allowance if, based on the weight of the available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. After consideration of all evidence, both positive and negative, the Company determined that it is more likely than not that a portion of the Company's deferred tax assets will not be realized and that a valuation allowance of $1.9 billion, $1.2 billion and $11.4 billion was deemed necessary as of December 31, 2004, 2003 and 2002, respectively. For the years ended December 31, 2004, 2003, and 2002, the Company's decision to establish a valuation allowance was primarily based on negative evidence of cumulative losses in recent years.

The ability of the Company to use its NOL carryforwards and other tax attributes may be subject to certain statutory and other limitations after the Emergence Date. One such limitation is the required reduction of certain tax attributes due to the cancellation of indebtedness. The United States Treasury Department and the Internal Revenue Service ("IRS") have issued temporary regulations that provide for tax attribute reduction when the debt of a member of a consolidated group is forgiven. Upon adoption of fresh–start reporting, the Company established a deferred tax liability to account for the cancellation of indebtedness resulting on emergence. Following the application of the attribute reduction rules, the Company estimates all of its federal NOL, capital loss and credit carryforwards and the majority of its state NOL and credit carryforwards will be eliminated and will not be available for use in future periods. Accordingly, the Company estimates (i) none of its federal NOLs, capital loss or credit carryforwards and (ii) $557 million of state NOLs (which expire from 2008 through 2024) will remain following application of the attribute reduction rules. The Company also has $788 million of NOLs in foreign jurisdictions ($639 million of NOLs which do not expire and $149 million of NOLs which expire between 2005 and 2012) which are not subject to the attribute reduction rules.

Additionally, as a result of the application of the attribute reduction rules, the Company estimates it will reduce its tax basis in current assets (including trade accounts receivable, intercompany accounts receivable and other current assets) by $1.5 billion and non–current assets (including property, plant and equipment, intangibles and other long–term assets) by $5.7 billion. Furthermore, due to certain federal income tax recapture provisions, the Company recorded a deferred income tax liability of $1.0 billion attributable to the future recognition of taxable gain on subsidiary stock. The Company further estimates an additional $1.1 billion would arise for the future recognition of taxable gain on subsidiary stock if certain of the Company's subsidiaries appreciate in value

and the financial accounting basis exceeds the tax basis in such stock. These liabilities were determined using estimates of fair market value and the Company's separate legal entity accounting records and are therefore subject to limitations as set forth in the discussion of other tax contingencies below, including the risk of adjustments resulting from review by tax authorities. If appreciation of the Company's subsidiaries occurs as described above, or adjustments result from review by taxing authorities, the additional tax liability of $1.1 billion may be required to be recorded either as an additional deferred tax liability or as a reduction to deferred tax assets. This would also result in the reduction in the valuation allowance as shown in the table above by up to approximately $1.1 billion. Absent adjustments by taxing authorities, future taxable gain would only become a current tax obligation in the event of the disposition or certain reorganizations of the appreciated subsidiaries by the Company.

Moreover, the Company expects that its future ability to utilize any remaining NOLs generated before the "ownership change" that occurred with respect to the Company when it emerged from bankruptcy, and possibly its future ability to utilize "built–in" loss deductions, if any, that existed as of the Emergence Date, will be limited by Internal Revenue Code Section 382 ("Section 382"). If certain requirements are met, the Company could qualify for a "bankruptcy" exception to the general Section 382 limitations. Under this exception, the Company's future ability to utilize any remaining NOLs and built–in loss deductions would not be limited, but the amount of the Company's pre–Emergence Date NOLs would be reduced, prior to the tax attribute reduction described in the preceding paragraph, by an amount equal to a specified portion of the Company's pre–change interest expense. In addition, if the Company were to undergo a second "ownership change" within two years after the Emergence Date, it would be prohibited from utilizing any pre–change NOLs or built–in loss deductions. Even if the requirements for qualification for the bankruptcy exception are met, the Company may elect not to have the bankruptcy exception apply. Because it is unclear whether the Company will meet the requirements to qualify for the bankruptcy exception, and because the Company currently expects in any event to elect out of the bankruptcy exception in order to avoid the effects of a second "ownership change" that would occur as a result of the agreement entered into by the Company and Verizon (see Note 26), the Company currently expects to be subject to the Section 382 limitations. Such limitations are a significant reason for the Company's 2004 current federal tax expense of $116 million and corresponding increase in taxes payable.

Prior to the *Job Creation and Worker Assistance Act of 2002* (the "JCWA Act"), enacted by Congress on March 9, 2002, NOLs could be carried back to reclaim U.S. federal income taxes paid in the two years preceding the tax year in which the NOLs were generated, and could be utilized to offset 90% of the alternative minimum tax liability. The JCWA Act extended the carryback period to the five years preceding the tax year in which the NOL was generated, and allowed alternative minimum tax NOL to be carried back to reclaim up to 100 percent of alternative minimum tax liability. As a result of this legislation change, the Predecessor Company received a tax refund in 2002 and recognized $210 million of U.S. federal income tax benefit due to the carryback of NOLs which were previously reduced by a valuation allowance.

On October 22, 2004, the President signed the *American Jobs Creation Act of 2004* (the "AJC Act"). The AJC Act provided for nearly $137 billion in tax cuts over the next ten years. Significant provisions of the AJC Act included a repeal of the extraterritorial income tax provisions that were declared illegal by the World Trade Organization; relief for U.S. manufacturer; reform of the taxation of multinational corporations; targeted tax cuts; and fairly broad anti–abuse and tax shelter disclosure rules and penalties. The Company's analysis of this legislation concludes that it will have no material impact on its consolidated financial statements.

State Tax Claims. In conjunction with the Predecessor Company's bankruptcy claims resolution proceeding, certain states have filed claims concerning the Predecessor Company's state income tax filings and its approach to related–party charges. To date, various states have filed proofs of claims in the aggregate amount of

approximately $750 million. In addition, the State of Mississippi has filed a claim in the aggregate amount of approximately $2 billion. The Company is in discussions with the appropriate state taxing officials on these and other similar issues related to state income taxes owed by the Company and its subsidiaries.

Other Tax Contingencies. As of December 31, 2004, the Company's management has determined the Company had a material weakness in its internal controls around income tax accounting. A component of this material weakness was that the Company did not have adequate controls and procedures with respect to separate legal entity accounting records for the Company and its domestic subsidiaries for 2004 and prior years. The Company will use its separate legal entity accounting records, which constitute the best available information, as a basis to comply with certain U.S. federal and state tax filing requirements for 2004 and prior years. The Company's tax accruals are based on the aforementioned separate company financial information.

In addition to the state contingencies relating to the Predecessor Company's approach to related–party charges, the Company has reserved for additional tax contingencies attributable to federal, state and foreign jurisdiction tax return filings. Such contingencies are for tax liabilities and related interest attributable to the ongoing audits of the Company's federal tax returns (the Company's federal tax returns from 1992 through 2003 are still open and subject to IRS examination, as are numerous state, local and foreign income tax filings for recent years), as well as certain tax positions taken on federal, state and foreign income tax returns for which the statutes remain open. The Company's reserves for these additional tax contingencies are based on the aforementioned separate company financial information.

During 2004, the Company undertook a series of domestic and international restructurings to reduce the number of legal entities within the group, simplify the Company's organizational structure and enhance operational efficiencies. Additional restructurings are planned for 2005. The majority of these restructurings have been effected through tax–free reorganizations. Where such transactions are taxable, however, the Company has estimated and provided for such tax liability. The Company's provision for additional tax liabilities attributable to such reorganizations is based on the aforementioned separate company financial information.

The Company's tax filings and reserves for the contingencies described in the preceding paragraphs including the aforementioned limitations on separate legal entity accounting records, are subject to audit, and the respective taxing authorities may contest the information on which these tax filings are based and may make additional assessments beyond that which has already been provided for.

The Company considers earnings relating to remaining foreign subsidiaries and affiliates to be indefinitely reinvested outside of the United States and, accordingly, no U.S. deferred income taxes have been recorded with respect to such earnings. Should the earnings be remitted as dividends, the Company may be subject to additional U.S. taxes, net of allowable foreign tax credits. The Company has determined that it is not practicable to estimate the amount of any additional taxes which may be payable on the undistributed earnings.

The following table includes the changes related to the Company's tax valuation allowances for the years ended December 31, 2004, 2003 and 2002 (in millions):

	Successor Company				
	Balance at Beginning of Period	Additions	Deductions	Other changes	Balance at End of Period
2004	$ 1,150	$ 754	$ —	$ —	$ 1,904

	Predecessor Company				
	Balance at Beginning of Period	Additions	Deductions	Other changes	Balance at End of Period
2003	$11,445	$ —	$ (9,958)	$ (337)	$ 1,150
2002	9,497	1,728	—	220	11,445

Included in the 2003 "Other changes" are adjustments reflecting the Company's aforementioned estimated effect of amending its returns for 1999 through 2003 as well as the Company's analysis of certain deferred tax balances.

(21) Pension and Other Postretirement Benefit Plans

The Company maintains two defined benefit pension plans, the MCI Communications Corporation Plan and WorldCom International Data Services, Inc. Plan (collectively, the "MCI Plans"), which cover substantially all MCI employees who became WorldCom employees as a result of the Predecessor Company's merger with MCI Communications, Inc. and who work 1,000 hours or more in a year. Effective January 1, 1999, participants of the MCI Plans no longer earn future compensation credits, although interest accruals and benefit vesting continues. Annual service cost for the MCI Plans is determined using the projected unit credit actuarial method, and prior service cost is amortized on a straight–line basis over the average remaining service period of the employees. As a result of fresh–start reporting, all unamortized prior service costs were eliminated and the generation of any future amounts subsequent to December 31, 2003 will be amortized under the same method as discussed above. As of December 31, 2004, there were approximately 21,000 participants in these plans.

The accumulated benefit obligation of the MCI Communications Corporation Plan exceeded the fair value of its assets by $99 million and $73 million at December 31, 2004 and 2003, respectively.

The WorldCom International Data Services, Inc. Plan held assets in excess of the accumulated benefit obligation of $15 million and $16 million as of December 31, 2004 and 2003, respectively.

In 2004 and 2003, the Company recorded net curtailment and settlement gains related to workforce reductions of $27 million and $39 million, respectively.

The Company also maintains a postretirement benefit plan that provides health and life insurance benefits to union members who are either currently retired or in active employee status and have satisfied certain eligibility requirements. Actuarially determined postretirement benefit costs are accrued as active employees earn these benefits. As of December 31, 2004, the Company's postretirement plan had approximately 300 participants. The postretirement plan offers a prescription drug benefit and as such is subject to the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act") and has accounted for these benefits as required by FASB Staff Position Financial Accounting Standard 106–2, *"Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003."* Measures of the APBO or net periodic postretirement benefit costs do not reflect any amount associated with the Medicare subsidy because the Company is unable to conclude if benefits provided by the plan are actuarially equivalent to Medicare Part D under the Act.

Additionally, Embratel sponsored a defined benefit plan and a postretirement medical assistance plan (collectively, the "Embratel Benefit Plans"). Contributions to the defined benefit and postretirement medical assistance plans were based on actuarial studies prepared by independent actuaries under Brazilian regulations, and actuarial studies were reviewed periodically to determine whether adjustments to the contributions were necessary. In addition, Embratel had a defined contribution plan to which it contributed.

Benefit Obligations

The following table sets forth changes in the accumulated benefit obligations for the MCI Plans and Embratel Benefit Plans for the years ended December 31, 2004 and 2003 (in millions):

	MCI Plans		Embratel Benefit Plans	
	Pension Benefits	Other Benefits	Pension Benefits	Other Benefits
Change in Benefit Obligations				
Benefit obligations at January 1, 2003 (Predecessor Company)	$444	$ 31	$253	$ 79
Interest cost	28	2	33	11
Actuarial loss (gain)	25	5	18	(2)
Benefits paid	(11)	(3)	(28)	(3)
Foreign currency exchange	—	—	57	17
Settlement gain	(39)	—	—	—
Assumption changes	6	—	15	—
Benefit obligations at December 31, 2003 (Successor Company)	$453	$ 35	$348	$ 102
Interest cost	27	1		
Actuarial loss (gain)	3	(3)		
Benefits paid	(12)	(2)		
Curtailment loss	3	—		
Settlement gain	(30)	—		
Assumption changes	27	—		
Benefit obligations at December 31, 2004 (Successor Company)	$471	$ 31		

Plan Assets and Funded Status

The following table presents both the change in the value of pension plan assets and the funded status of each plan for the years ended and as of December 31, 2004 and 2003 (in millions):

	MCI Plans		Embratel Benefit Plans	
	Pension Benefits	Other Benefits	Pension Benefits	Other Benefits
Change in Plan Assets				
Fair value of assets at January 1, 2003 (Predecessor Company)	$378	$ —	$271	$ 16
Actual return on plan assets	54	—	47	5
Foreign currency exchange	—	—	60	3
Employer contributions	14	—	—	—
Benefits paid	(11)	—	(28)	(3)
Effect of settlements and transfers	(39)	—	—	—
Fair value of assets at December 31, 2003 (Successor Company)	$396	$ —	$350	$ 21
Actual return on plan assets	31	—		
Employer contributions	2	—		
Benefits paid	(12)	—		
Effect of settlements and transfers	(30)	—		
Fair value of assets at December 31, 2004 (Successor Company)	$387	$ —		
As of December 31, 2003:				
(Underfunded) funded status	$(57)	$ (35)	$ 2	$ (81)
Unrecognized net actuarial (gain) loss	—	—	(19)	26
Unrecognized transition liability	—	—	1	—
Net amount recognized (Successor Company)	$(57)	$ (35)	$(16)	$ (55)
As of December 31, 2004:				
Underfunded status	$(84)	$ (31)		
Unrecognized net actuarial loss	28	1		
Net amount recognized (Successor Company)	$(56)	$ (30)		

Balance Sheet Recognition

Amounts recognized in the consolidated balance sheets as of December 31, 2004 and 2003 are as follows (in millions):

	MCI Plans		Embratel Benefit Plans	
	Pension Benefits	Other Benefits	Pension Benefits	Other Benefits
As of December 31, 2003:				
Accrued benefit cost, net amount recognized (Successor Company)	$(57)	$ (35)	$(16)	$ (55)
As of December 31, 2004:				
Accrued benefit cost	$(79)	$ (30)		
Accumulated other comprehensive loss	23	—		
Net amount recognized (Successor Company)	$(56)	$ (30)		

The weighted–average asset allocations for the Company's pension plans by asset category (excluding Embratel) were as follows:

	Successor Company		
	Actual Asset Allocation As of December 31,		
	2004	2003	Target Asset Allocation
Equity securities	51%	52%	43%
Debt securities	40%	45%	49%
Real estate	8%	—	8%
Other	1%	3%	—

The Company has established and maintains an investment policy for assets held in each MCI Defined Benefit Pension trust. The investment strategies are long–term in nature and designed to meet the following objectives:

- Ensure that funds are available to pay benefits as they become due;
- Maximize the trusts' total returns subject to prudent risk taking; and
- Preserve and/or improve the funded status of the trusts over time.

The current investment strategy, as adopted by the Company, provides for the following asset allocation policies:

	Percent of Total Fund MCI Communications Corporation Plan		
	Minimum	Target	Maximum
U.S. equities	33%	38%	43%
Non–U.S. equities	10%	12%	15%
Total equities[1]	43%	50%	58%
Fixed income	35%	40%	45%
Real estate[2]	—	10%	15%
Cash and cash equivalents	—	—	10%

	Percent of Total Fund WorldCom International Data Services, Inc. Plan		
	Minimum	Target	Maximum
U.S. equities	30%	40%	45%
Fixed income	55%	60%	70%
Cash and cash equivalents	—	—	10%

(1) Minimums and maximums for equities do not equal sums of minimums and maximums for each portfolio, but rather reflect constraints for overall equity exposure.

(2) Allocations to real estate will occur over multiple time periods. Assets targeted to real estate, but not yet allocated, will be invested in fixed income securities with corresponding adjustments to fixed income rebalancing guidelines.

The Company reviews the asset mix of the funds on a regular basis. Generally, each fund's asset mix will be rebalanced to the target mix as individual portfolios approach their minimum or maximum levels. The effective asset mix of all portfolios will be measured considering all futures and options positions. Securities convertible into common stock, or which provide for equity participation, are considered to be equities.

To meet its asset allocation objective, the Company has developed an investment manager structure that is based on the current asset allocation policies and investment guidelines. Each investment manager is engaged to manage a specific asset class portfolio. Periodically, the Company may make changes to the investment managers and allocations, as considered appropriate. In general, investment manager performance will be evaluated over a three to five year time horizon. Investments in certain telecommunication companies' securities, including those of the Company, either directly or through controlled affiliates, are to be excluded from portfolio holdings unless held through commingled or mutual funds. Performance objectives set out for each manager are net of investment management fees.

Futures contracts may be used as a substitute for holding the underlying asset related to the futures contract. All deliverable long futures contracts must be fully backed by cash equivalent holdings in the portfolio so that the portfolio is not leveraged. Futures contracts, if any, will be marked to market daily. Regarding mortgage derivatives, the investment manager is prohibited from investing in securities with a high sensitivity to changes in interest rates and prepayment spreads. The purchase, sale, or any other dealings with put or call option securities is limited to a maximum of 10% of portfolio value based on the notional value of the securities. Investment managers who fail to observe the above restrictions will be liable for any investment losses. As of December 31, 2004 and 2003, the fund did not have investments in any derivative instruments.

Actuarial Assumptions

The measurement dates used to determine pension and other postretirement benefit measurements for the plans are December 31, 2004, 2003, and 2002. The actuarial assumptions used to compute the net periodic pension cost, non–qualified pension benefit cost and postretirement benefit cost are based upon information available as of the beginning of each year, specifically, market interest rates, past experience and management's best estimate of future economic conditions. Changes in these assumptions may impact future benefit costs and obligations. In computing future costs and obligations, the Company must make assumptions about such things as employee mortality and turnover, expected salary and wage increases, discount rate, expected long–term rate of return on plan assets, and expected future cost increases. Two of these items generally have the most significant impact on the level of cost: (1) discount rate and (2) expected long–term rate of return on plan assets.

Annually, the Company sets its discount rate based upon the yields on high–quality fixed–income investments available at the measurement date and expected to be available during the period to maturity of the pension benefits. In making this determination, the Company considers, among other things, the yields on S&P's high–quality non–callable AA corporate bonds as of year–end.

The expected rate of return on plan assets is the long–term rate of return the Company expects to earn on trust assets. The rate of return is determined by the investment composition of the plan assets and the long–term risk and return forecast for each asset category. The forecasts for each asset class are generated using historical information as well as an analysis of current and expected market conditions. The expected risk and return characteristics for each asset class are reviewed annually and revised, as necessary, to reflect changes in the financial markets. To compute the expected return on plan assets, the Company applies an expected rate of return to the fair value of the plan assets.

The weighted average assumptions used in determining benefit obligations (excluding Embratel) were as follows:

	Defined Benefit Plans		Other Postretirement Benefits	
	As of December 31,		As of December 31,	
	2004	2003	2004	2003
Discount rate	5.90%	6.25%	5.90%	6.25%
Rate of compensation increase	—	—	5.00%	5.00%

The weighted average assumptions used in determining net periodic pension cost (excluding Embratel) were as follows:

	Defined Benefit Plans			Other Postretirement Benefits		
	Year Ended December 31,			Year Ended December 31,		
	2004	2003	2002	2004	2003	2002
Discount rate	6.25%	6.75%	7.25%	6.25%	6.75%	7.25%
Expected long-term rate of return on plan assets	8.50%	8.50%	8.90%	—	—	—
Rate of compensation increase	—	—	—	5.00%	5.00%	5.00%

For the Embratel Benefit Plans, the weighted average assumptions used in determining the expense and benefit obligations as of and for the years ended December 31, 2003 and 2002 were as follows: discount rate and expected rate of return on plan assets of 11.3%; average salary increases and social security increases of 5%.

For the MCI Plans, the postretirement benefit obligation was calculated assuming that health-care costs increased by 13.00% in 2004 and 6.75% in 2003, and the rate of increase in the per capita cost of covered health-care benefits thereafter (the health-care cost trend rate) was assumed to decrease to 5.00% by 2009 and remain at that level thereafter.

For the Embratel Benefit Plans, the postretirement benefit obligation was calculated assuming that health-care costs increased by inflation plus 4% in 2003, and the rate of increase in the per capita cost of covered health-care benefits thereafter was assumed to decrease gradually to inflation plus 2.7% in 2046 and remain at that level thereafter.

Net Periodic Cost

The components of the net postretirement benefit and pension costs for the years ended December 31, 2004, 2003 and 2002 were as follows (in millions):

	MCI Plans [1]		Embratel Benefit Plans [1]	
	Pension Benefits	Other Benefits	Pension Benefits	Other Benefits
Year Ended December 31, 2002: (Predecessor Company)				
Interest cost on accumulated pension/postretirement benefit obligation	$ 31	$ 2	$ 28	$ 9
Expected return on plan assets	(40)	—	(37)	(2)
Amortization of prior service cost	1	—	—	—
Curtailment loss	26	—	—	—
Settlement loss	7	—	—	—
Amortization of net actuarial (gain) loss	—	—	(1)	1
Net periodic pension/postretirement benefit expense (income)	$ 25	$ 2	$ (10)	$ 8
Year Ended December 31, 2003: (Predecessor Company)				
Interest cost on accumulated pension/postretirement benefit obligation	$ 28	$ 2	$ 33	$ 11
Expected return on plan assets	(29)	—	(36)	(2)
Amortization of prior service cost	1	—	—	—
Settlement loss	5	—	—	—
Amortization of net actuarial loss	2	1	—	1
Net periodic pension/postretirement benefit expense (income)	$ 7	$ 3	$ (3)	$ 10
Year Ended December 31, 2004: (Successor Company)				
Interest cost on accumulated pension/postretirement benefit obligation	$ 27	$ 1		
Expected return on plan assets	(32)	—		
Curtailment loss	3	—		
Settlement loss	2	—		
Amortization of net actuarial loss (gain)	1	(3)		
Net periodic pension/postretirement benefit expense (income)	$ 1	$ (2)		

(1) Service costs were not material due to the MCI Plans being frozen in 1999 and the limited amount of participants in the Embratel Benefit Plans.

Assumed health–care cost trend rates have a significant effect on the amounts reported for the costs each year as well as on the accumulated postretirement benefit obligation. A one–percentage–point change in assumed health–care cost trend rates would have the following effects (in millions):

	One Percentage–Point Increase	One Percentage–Point Decrease
Increase (decrease) in total of service and interest cost components	$ —	$ —
Increase (decrease) in accumulated postretirement benefit obligation	3	(3)

Cash Flows

In 2005, the Company expects to contribute approximately $1 million to its defined benefit pension plans. In 2004, the Company contributed $2 million to its pension plans.

The estimated future benefit payments are as follows (in millions):

	Defined Benefit Plans	Other Postretirement Benefits
2005	$ 35	$ 2
2006	29	2
2007	29	3
2008	28	3
2009	28	3
2010 to 2014	137	13

Defined Contribution Plans

The Company has a defined contribution retirement plan qualifying under the provisions of Section 401(k) of the Internal Revenue Code. Employees are eligible to participate in the 401(k) plan immediately upon hire. For the years ended December 31, 2004, 2003 and 2002, participants could contribute up to $13,000, $12,000 and $11,000, respectively, of annual earnings on a tax–deferred basis. Upon the completion of one year of service, the Company matches 100 percent of the first 5% of employee contributions. This matching is done retroactively to the beginning of the calendar year in which each employee has reached his one–year anniversary. Employees are immediately vested in all contributions to the plan. The Company's matching contributions were $75 million, $78 million and $100 million for the years ending December 31, 2004, 2003 and 2002, respectively. Effective August 8, 2002, WorldCom group and MCI group common stocks were no longer available as investment options under the 401(k) plan.

(22) Business Segments and Geographic Area Information

As of December 31, 2003 and through the first quarter of 2004, the Company's business segments represented strategic business units based on the types of customers each segment served. These segments consisted of Business Markets, Mass Markets, International and Embratel. These segments were determined in accordance with how the Company's executive management analyzed, evaluated and operated the Company's entire global operations.

In March 2004, the Company changed its segment reporting by realigning its previous business segments into three new business segments: Enterprise Markets, U.S. Sales & Service, and International & Wholesale Markets. Enterprise Markets serves the following customers which had been served by Business Markets in the past: global accounts, government accounts, conferencing and MCI Solutions customers. U.S. Sales & Service serves the previous Mass Markets accounts and certain commercial accounts. International & Wholesale Markets serves customers internationally, as well as the Company's wholesale accounts that were previously included in Business Markets. The Company began operating under these new segments in the second quarter of 2004.

In addition, the Company developed methodologies to fully allocate indirect costs that were previously reported in Corporate and Other to the new business segments. These costs include expenses associated with the operation of the Company's network, access costs and costs of services and products, indirect selling, general and administrative expenses, depreciation and amortization, impairment charges, and corporate functions. The Company allocated the 2004 impairment charges using the same methodology used for depreciation and amortization expense. The allocation methodologies are based on statistical and operational data that is generated from the Company's continuing operations. These amounts can fluctuate based upon the performance of the individual segments.

As a result of the realignment of its segments and the allocation of indirect costs on a segment basis, the Company changed the way it manages its business to utilize operating (loss) income information to evaluate the performance of its business segments and to allocate resources to them.

Embratel's results of operations, which were previously reported in a separate business segment, have been reclassified to discontinued operations for all periods, and therefore have been excluded from this business segment information for all years presented.

Current Business Segments

The following is a description of the Company's business segments:

- Enterprise Markets includes Global and Government Accounts, as well as Conferencing and MCI Solutions businesses. Global Accounts provides telecommunications services to large global customers requiring international and complex network services. Government Accounts provides similar services to various government agencies. In both cases, these services include local–to–global business data, Internet, voice services and managed network services.

- U.S. Sales & Service segment serves Mass Markets accounts which include subscription–based residential and very small business accounts, and transactional products including 10–10–987, 10–10–220, 1–800–COLLECT, MCI Prepaid card, as well as Commercial Accounts which serves small to medium–size business accounts. Commercial Accounts also includes the Company's SkyTel business, which provides wireless email, interactive two–way messaging, wireless telemetry services and traditional text and numeric paging to customers throughout the United States.

- International & Wholesale Markets provides telecommunications services to business customers and telecommunications carriers in Europe, the Middle East and Africa (collectively "EMEA"), the Asia Pacific region, Latin America and Canada. These services include voice telecommunications, data services, Internet and managed network services. This segment also serves the Company's domestic and international wholesale accounts.

All revenues for the Company's products and services are generated through external customers. The Company has three main product and service categories: Voice, Data and Internet.

The Company determined that it was impracticable to restate its 2002 results into the current business segment structure, as much of the information required to generate the segment data was not available. As such, the Company has included segment data for 2004 and 2003 under the current segment structure, and for 2004, 2003 and 2002 under the previous segment structure. Financial information for each reportable business segment and revenue product line under the current segment structure follows (in millions):

	Year Ended December 31, 2004 (Successor Company)			
	Enterprise Markets	U.S. Sales & Service	International & Wholesale Markets	Total
Revenues:				
Voice	$1,830	$ 6,728	$ 4,105	$12,663
Data	2,316	1,610	1,446	5,372
Internet	665	738	1,252	2,655
Total revenues	4,811	9,076	6,803	20,690
Costs of sales and services	2,950	4,910	5,365	13,225
Selling, general and administrative expenses	1,028	3,007	1,185	5,220
Depreciation and amortization expenses	460	841	623	1,924
Loss (gain) on property dispositions	3	(3)	(1)	(1)
Impairment charges	870	1,627	1,016	3,513
Operating loss	$ (500)	$ (1,306)	$ (1,385)	(3,191)
Interest expense				(402)
Miscellaneous income				85
Loss from continuing operations before income tax				$ (3,508)
Segment assets	$2,447	$ 4,335	$ 4,200	$10,982(1)

	Year Ended December 31, 2003 (Predecessor Company)			
	Enterprise Markets	U.S. Sales & Service	International & Wholesale Markets	Total
Revenues:				
Voice	$1,893	$ 8,354	$ 4,387	$14,634
Data	2,577	2,012	1,892	6,481
Internet	859	749	1,543	3,151
Total revenues	5,329	11,115	7,822	24,266
Costs of sales and services	3,201	5,755	5,812	14,768
Selling, general and administrative expenses	1,123	3,887	1,469	6,479
Depreciation and amortization expenses	649	821	846	2,316
Loss on property dispositions	15	16	12	43
Operating income (loss)	$ 341	$ 636	$ (317)	660
Interest expense				(105)
Miscellaneous income				136
Reorganization items, net				22,087
Income from continuing operations before income taxes, minority interests and a cumulative effect of a change in accounting principle				$22,778
Segment assets	$3,744	$ 6,753	$ 8,904	$19,401(1)

(1) Excludes certain assets that are not attributable to an individual segment since the asset is monitored by, accounted for, or is generated from a central corporate–wide program. As such, the Company has excluded $6.1 billion from its asset allocation in 2004 primarily related to its $5.5 billion in cash, cash equivalents and marketable securities and $574 million related to deferred income taxes and investments. In 2003, the Company has excluded $8.1 billion from its asset allocation primarily related to its $6.2 billion in cash, cash equivalents and marketable securities and $1.9 billion related to deferred income taxes and investments.

As of December 31, 2003, the Predecessor Company's business segments represented strategic business units based on the types of customers each segment served. These segments consisted of Business Markets, Mass Markets, International and Embratel (excluded from segment information since the business was reclassified to discontinued operations for all periods presented). These segments were determined in accordance with how the Predecessor Company's executive management, as of the end of 2003, analyzed, evaluated and operated the Predecessor Company's entire global operations.

The Predecessor Company evaluated the performance of its segments and allocated resources to them based on revenues and direct selling, general and administrative expenses. Expenses associated with the operation of the Predecessor Company's network, indirect selling, general and administrative expenses and corporate functions were evaluated based on their respective costs and, therefore, were included in Corporate and Other. Revenue and expenses were measured in accordance with the policies and procedures described in Note 2. The following is a description of each of the business segments prior to the Company's realignment in 2004.

Previous Business Segments

The following is a description of the Predecessor Company's business segments as they existed as of December 31, 2003:

- Business Markets provides telecommunications services to large domestic and multinational businesses, government agencies and other communication carriers in the United States. These services include local–to–global business data, Internet, voice services and managed network services to businesses and governments.

- Mass Markets provides local, long distance and international voice telephone service and Internet telecommunications services to residential and small business customers in the United States.

- International provides telecommunications services to business customers and telecommunications carriers in EMEA, the Asian Pacific region, Latin America and Canada. These services include voice telecommunications, data services, Internet and managed network services.

All revenues for the Predecessor Company's products and services are generated through external customers. The Predecessor Company had three main product and service categories: Voice, Data, and Internet. Financial information for each reportable business segment and revenue product line under the previous segment structure follows (in millions):

	Year Ended December 31, 2004 (Successor Company)				
	Business Markets	Mass Markets	International Operations	Corporate and Other	Total
Revenues:					
Voice	$ 5,111	$ 5,056	$ 2,496	$ —	$12,663
Data	5,035	17	320	—	5,372
Internet	1,780	15	860	—	2,655
Total revenues	11,926	5,088	3,676		20,690
Access costs and costs of services and products				13,225	13,225
Gross profit					7,465
Selling, general and administrative expenses	1,117	1,478	610	2,015	5,220
Depreciation and amortization expenses				1,924	1,924
Gain on property dispositions				(1)	(1)
Impairment charges				3,513	3,513
Operating loss					(3,191)
Interest expense					(402)
Miscellaneous income					85
Loss from continuing operations before income taxes					$ (3,508)

	Year Ended December 31, 2003 (Predecessor Company)				
	Business Markets	Mass Markets	International Operations	Corporate and Other	Total
Revenues:					
Voice	$ 5,846	$ 6,353	$ 2,435	$ —	$14,634
Data	6,081	22	378	—	6,481
Internet	2,205	3	943	—	3,151
Total revenues	14,132	6,378	3,756		24,266
Access costs and costs of services and products				14,768	14,768
Gross profit					9,498
Selling, general and administrative expenses	1,397	2,132	708	2,242	6,479
Depreciation and amortization expenses				2,316	2,316
Loss on property dispositions				43	43
Operating income					660
Interest expense					(105)
Miscellaneous income					136
Reorganization items, net					22,087
Income from continuing operations before income taxes, minority interests and a cumulative effect of a change in accounting principle					$22,778

	Year Ended December 31, 2002 (Predecessor Company)				
	Business Markets	Mass Markets	International Operations	Corporate and Other	Total
Revenues:					
Voice	$ 6,219	$ 7,462	$ 2,313	$ —	$15,994
Data	7,560	21	358	—	7,939
Internet	3,687	—	873	—	4,560
Total revenues	17,466	7,483	3,544		28,493
Access costs and costs of services and products				16,765	16,765
Gross profit					11,728
Selling, general and administrative expenses	1,901	2,217	1,050	2,894	8,062
Depreciation and amortization expenses				2,903	2,903
Unclassified, net				(35)	(35)
Loss on property dispositions				123	123
Impairment charges				4,999	4,999
Operating loss					(4,324)
Interest expense					(1,354)
Miscellaneous expense					(2,221)
Reorganization items, net					(802)
Loss from continuing operations before income taxes, minority interests and a cumulative effect of a change in accounting principle					$ (8,701)

Information about Geographic Areas

The Company's revenues by geographic area represent the location that the sale originated and not specifically the segment that reflects the revenue, as some international revenues are included in Enterprise Markets. Information about the Company's revenues by geographic area follows (in millions):

	Successor Company	Predecessor Company	
	Year Ended December 31,		
	2004	2003	2002
Revenue:			
United States	$ 16,719	$ 20,186	$ 24,849
EMEA	3,261	3,275	2,844
Asia Pacific	458	473	552
Other	252	332	248
Total	$ 20,690	$ 24,266	$ 28,493

Information about the Company's property, plant and equipment assets by geographic area follows (in millions):

	Successor Company	
	As of December 31,	
	2004	2003
Property, plant and equipment, net:		
United States	$5,155	$ 7,637
EMEA	949	1,678
Brazil	—	1,987
Asia Pacific	129	188
Other	26	48
Total	$6,259	$11,538

(23) Related Party Transactions

Ebbers Loan Arrangements

From shortly after the Predecessor Company's inception until April 29, 2002, Bernard J. Ebbers served as the Predecessor Company's President and Chief Executive Officer. Beginning on or about September 1995, Mr. Ebbers and companies under his control entered into various loan agreements with Bank of America, N.A. (or its predecessors in interest). Between 1995 and 2000, Mr. Ebbers or companies under his control borrowed certain amounts from Bank of America under these loan agreements, and became obligated under a Bank of America letter of credit in the amount of $45.6 million issued in connection with a donation to his alma mater, Mississippi College. In connection with these transactions, Mr. Ebbers pledged shares of the Predecessor Company's common stock. In addition, to secure his obligations incurred in connection with acquisitions of interests in outside businesses and other transactions, Mr. Ebbers pledged several million shares of the Predecessor Company's common stock and certain assets to an affiliate of Citicorp.

Commencing in 2000 and continuing through April 2002, Mr. Ebbers requested from time to time that the Predecessor Company loan funds to him and/or guarantee loans he had received from other institutions in response to margin calls being made by such institutions following declines in the value of the Predecessor Company's common stock. In response to his requests, the Compensation and Stock Option Committee (the "Compensation Committee") of the Predecessor Company's former Board of Directors approved direct loans to Mr. Ebbers of $100 million in 2000 and an additional $65 million on January 30, 2002, for a total of $165 million. The Compensation Committee also approved a guarantee by the Predecessor Company of a $150 million loan from Bank of America to Mr. Ebbers and the $45.6 million Bank of America letter of credit noted above. The Compensation Committee approved these loans and guarantees following a determination that it was in the best interest of WorldCom and its shareholders to avoid forced sales by Mr. Ebbers of his common stock. The Predecessor Company's former Board of Directors subsequently ratified the loans and guarantees. The Predecessor Company determined that the interest rate charged to Mr. Ebbers was below market rates and that a more appropriate rate of interest for the period from 2000, when the loans were first provided, until March 31, 2002, was 11.11% (reflecting that while interest rates declined over that period, the risk of non–payment of the loans increased). The Predecessor Company recorded interest income of $8 million in 2002, of which $7 million was imputed interest on the loans. The amount imputed was recorded as a reduction to selling, general and administrative expenses to recognize that this interest was not charged to Mr. Ebbers and was considered additional compensation to Mr. Ebbers.

Following further declines in the trading price of the Predecessor Company's common stock through early February 2002, the Predecessor Company made aggregate payments to Bank of America of approximately $198.7 million to repay all of the outstanding debt guaranteed by the Predecessor Company and deposited approximately $36.5 million with Bank of America (of which approximately $2 million was remitted to the Predecessor Company as of March 2003) to collateralize the letter of credit.

On April 2, 2002, the Predecessor Company and Mr. Ebbers entered into a letter agreement (the "Ebbers Letter Agreement") whereby Mr. Ebbers (i) indemnified the Predecessor Company against any losses incurred in respect of the loans and guarantees provided by the Predecessor Company and (ii) pledged 9,287,277 shares of WorldCom group common stock and 575,149 shares of MCI group common stock (representing all of Mr. Ebbers' unencumbered shares in WorldCom, Inc.) to secure his obligations. In addition, on April 18, 2002, the Predecessor Company and Mr. Ebbers entered into a pledge and security agreement (the "Ebbers Pledge and Security Agreement"), whereby Mr. Ebbers granted the Predecessor Company security interests in all of his interest in BC Yacht Sales, Inc., a yacht sales company wholly–owned by Mr. Ebbers, and BCT Holdings, LLC, a shipyard in which Mr. Ebbers held a 99.8% interest (collectively, "Intermarine") and Douglas Lake. In addition, Mr. Ebbers owned an 86.25% interest in Joshua Holdings LLC ("Joshua"), the majority shareholder in Joshua Timberlands LLC ("Joshua Timberlands"), a timber venture located in several southeastern states. Due to restrictions set forth in a credit agreement between Joshua Timberlands and The Travelers Insurance Company, Mr. Ebbers only granted a security interest totaling 21.25% of the capital stock of Joshua. The Predecessor Company also received a pledge by the other two interest holders in Joshua relating to an additional 13.75% of its capital stock. Under agreements between the Predecessor Company and Mr. Ebbers dated April 17, 2002, the Predecessor Company became entitled to exercise sole and exclusive control of Mr. Ebbers pledged property interests, including voting interests upon notice to the relevant company (the "Control Agreements").

On April 29, 2002, in connection with Mr. Ebbers' resignation as President, Chief Executive Officer and Director of WorldCom, the Predecessor Company consolidated these various demand loan and guaranty arrangements into a single promissory term note in the principal amount of approximately $408.2 million (the "Ebbers Note"). Pursuant to the terms of the Ebbers Note, in addition to accrued and unpaid interest as described below, the principal amount was subject to payment over five years on the following schedule: $25 million on April 29, 2003, $25 million on April 29, 2004, $75 million on April 29, 2005, $100 million on April 29, 2006, and all remaining principal on April 29, 2007. The Ebbers Note also provided for the payment of interest on the outstanding balance, compounded monthly, on each repayment date at a fluctuating interest rate equal to that under one of the Predecessor Company's credit facilities, which was 2.31875% per annum as of April 29, 2002. The Ebbers Note further provided that all principal and accrued interest would become immediately due and payable (1) upon the death of Mr. Ebbers, (2) upon demand in the case of certain events of default, or (3) automatically without notice in the case of certain events of bankruptcy by or against Mr. Ebbers.

On April 30, 2003, the Predecessor Company served Mr. Ebbers with a notice of event of default under the Ebbers Note due to his failure to make the scheduled $25 million principal payment on April 29, 2003. As a consequence, all principal and accrued interest under the Ebbers Note became immediately due and payable. Mr. Ebbers disputes that he is in default under the Ebbers Note due to the receipt of proceeds of asset sales discussed below. To date, Mr. Ebbers has not made any payment with respect to his obligations under the Ebbers Note. After giving consideration to various factors, including what the Predecessor Company considered to be a default of the Ebbers Note and management's knowledge and estimates of Mr. Ebbers' financial condition, the Predecessor Company concluded that the collectibility of the Ebbers Note was remote. Accordingly, the Predecessor Company established a valuation reserve, reflected as of March 2002, which the Predecessor Company recorded as bad debt expense (a component of selling, general and administrative expenses) in an amount equal to the outstanding principal and accrued interest balance under the Ebbers Note less the amount anticipated to be realized by the Predecessor Company in connection with the disposition of the Intermarine,

Douglas Lake and Joshua Timberlands collateral. Subsequent to the March 2002 filing, the Predecessor Company obtained a third party independent appraisal of the Joshua Timberlands properties which indicated a value less than the balance of the senior debt. In addition, the Predecessor Company was able to secure sales contracts for the Intermarine and Douglas Lake properties. Accordingly, as of June 2002, the Predecessor Company increased the reserve to include the entire amount of the note, net of the ultimate selling prices of the Intermarine and Douglas Lake properties.

The Predecessor Company has exercised certain of its rights under the Ebbers Pledge and Security Agreement and the Control Agreements to require the sale of Intermarine and Douglas Lake, and to apply the proceeds to reduce the principal amount outstanding under the Ebbers Note. In October 2002, the Predecessor Company acquired Mr. Ebbers' interests in Intermarine through a strict foreclosure action. In December 2002, the Predecessor Company sold a yacht and, in February 2003, sold substantially all of the remaining assets of Intermarine. The net proceeds of these sales plus the proceeds of prior sales of other yachts contained in the bank account of Yacht Sales totaled approximately $17.4 million. In January 2003, the Predecessor Company exercised certain control rights with respect to Mr. Ebbers's interests in Douglas Lake which was sold in 2004 (see Note 17). Based on the appraised net value of the Joshua Timberlands property, the Predecessor Company has elected not to exercise its right to foreclose on the Joshua Timberlands assets at this time. The Company will continue in its efforts to recover all amounts due and payable under the Ebbers Note.

On July 9, 2004, the Company initiated an action in the United States Bankruptcy Court for the Southern District of New York seeking a judgment for all amounts due under the Ebbers Note. On December 9, 2004 the Company filed a motion for partial summary judgment for the Ebbers Note balance. The Bankruptcy Court has extended the time for Ebbers to respond to the motion due to Ebbers' criminal trial.

Ebbers Separation Agreement

The Predecessor Company also entered into a separation agreement with Mr. Ebbers as of April 29, 2002, which provided for his resignation from all directorships, offices and positions with the Predecessor Company, and for his appointment to serve the Predecessor Company's Board of Directors as non–executive "Chairman Emeritus" at the pleasure of the Board. Pursuant to the separation agreement, Mr. Ebbers agreed to remain available for a period of five years to provide consulting services from time to time. The agreement also provided for the Predecessor Company to make an annual pension payment of $1.5 million to Mr. Ebbers for the remainder of his life and an annual pension benefit of $750,000 to his current spouse for the remainder of her life, should she survive him. In addition, the Predecessor Company agreed to continue in effect its indemnification of him and to provide continued medical and life insurance benefits for Mr. Ebbers' lifetime at the Predecessor Company's expense and limited use of the Predecessor Company's aircraft, subject to reimbursement to the Predecessor Company by Mr. Ebbers on the same basis as is currently in effect with the Predecessor Company for personal usage. Mr. Ebbers was also granted the right to lease office space from the Predecessor Company. The separation agreement further provided that all of Mr. Ebbers' outstanding options to purchase WorldCom group common stock or MCI group common stock became fully vested and exercisable as of April 29, 2002, and would generally remain exercisable for a period of five years following that date (or, if earlier, the expiration of the original term). As of April 29, 2002, Mr. Ebbers held (i) unvested options to acquire 1,788,627 shares of WorldCom group common stock at a weighted–average exercise price of $30.90 per share, (ii) vested options to acquire 9,510,678 shares of WorldCom group common stock at a weighted–average exercise price of $21.25 per share, and (iii) no vested or unvested options to acquire MCI group common stock. Under the separation agreement, Mr. Ebbers further agreed to be subject to a number of restrictive covenants, including a five–year non–competition covenant in favor of the Predecessor Company's affiliates and the Predecessor Company. The Predecessor Company and Mr. Ebbers also agreed to and executed a mutual release of actual or potential claims, subject to certain exceptions. Finally, the separation agreement provided that, in the event of

any breach of the separation agreement by Mr. Ebbers, default by Mr. Ebbers with respect to any of his obligations under the Ebbers Note and related arrangements or the filing of bankruptcy by him, the payment of pension benefits described above would be permanently discontinued and all outstanding amounts due to the Predecessor Company by him would be accelerated as provided in the Ebbers Note.

The Predecessor Company has not made any of the pension payments under the separation agreement nor provided any of the other benefits under the agreement except health benefits. Additionally, the Predecessor Company ceased providing health benefits on March 31, 2003. The Predecessor Company believes that Mr. Ebbers had breached the separation agreement. However, Mr. Ebbers asserts that he has not breached the separation agreement and that the Predecessor Company breached the separation agreement prior to any alleged breach by Mr. Ebbers.

Mr. Ebbers has filed proofs of claim in the Predecessor Company's Chapter 11 cases seeking, among other things, payment of benefits under the separation agreement. On September 30, 2003, the Predecessor Company filed a notice of rejection of the separation agreement in its Chapter 11 case. The notice indicated it was merely a protective measure, as the Predecessor Company believes the separation agreement is not an executory contract on account of the prior breach by Mr. Ebbers. On October 15, 2003, Mr. Ebbers objected to the notice of rejection. Additionally, in the complaint filed against Ebbers on July 9, 2004, the Company asserted that Ebbers was in default of the Ebbers note and consequently the Company had no further obligations to Ebbers under the separation agreement.

Other Transactions with Ebbers

During 2002, the Predecessor Company provided office space and Internet access at no charge to the Jackson Bandits, a minor league hockey team owned in part by Mr. Ebbers. The cost associated with the 1,300 square foot office space and the T–1 Internet connection totaled approximately $160,000. Additionally, Mr. Ebbers was an owner of KLLM Transportation, Inc. ("KLLM"), for which the Predecessor Company provided voice telecommunications services in the amount of $122,000. There was no receivable from KLLM as of December 31, 2002. During 2002, the Predecessor Company also provided telecommunications services to other companies owned by Mr. Ebbers. The total revenue generated in 2002 by the sale of such services to these companies was approximately $22,000.

Mr. Ebbers individually provided Ronald Beaumont, the Predecessor Company's Chief Operating Officer of WorldCom Group from December 2000 until May 2002, with a $650,000 personal loan that accrued interest at a rate of 10% per annum. The loan from Mr. Ebbers was provided in two installments, with $250,000 loaned in 2000 and an additional $400,000 loaned in 2002.

Transactions with Ronald Beaumont

During 2002, the Predecessor Company purchased services from three companies owned by Mr. Beaumont (Beaumont Events Company, Beaumont Ranch Company and Beaumont Key Services). The companies were engaged by the Predecessor Company to host certain events. The total cost of these services provided during 2002 totaled $21,000.

Kellett Airplane Arrangements

In 2001, the Predecessor Company leased a Falcon 20 airplane to Kellett Investment Corporation ("KIC"), controlled by Stiles Kellett Jr., who at the time was a member of the Predecessor Company's Board of Directors and chairman of the Compensation Committee. Pursuant to the terms of the Predecessor Company's lease to

KIC, the Predecessor Company leased the Falcon 20 aircraft to KIC for a nominal monthly fee with a term expiring on June 15, 2002. KIC was also responsible under the lease for the costs of the insurance on the airplane, the pilots, the hangar expense, fuel, and payment to the Predecessor Company of a $400 per hour flight fee. The Predecessor Company retained responsibility under the lease for reimbursing KIC for the costs of the maintenance for the airplane.

In 2002, Mr. Breeden, the Corporate Monitor, conducted an investigation of the airplane arrangement. On September 6, 2002, Mr. Breeden sent a summary of his investigation of the lease arrangement to the Predecessor Company's Board of Directors, which concluded that the terms of the lease arrangement were below fair market value and the lease should have been disclosed to the Board of Directors and on Mr. Kellett's annual "directors' and officers' questionnaire." Mr. Breeden recommended, among other things, that the Predecessor Company seek to obtain additional amounts owed to the Predecessor Company under the lease arrangement, and that the Board of Directors remove Mr. Kellett as a director. In October 2002, the Predecessor Company entered into a settlement agreement with Mr. Kellett pursuant to which Mr. Kellett paid to the Predecessor Company the balance necessary for reimbursement for his use of the airplane under the lease at a rate of $3,000 per hour, offset by amounts the Predecessor Company owed him which totaled $148,000 in 2002. Under the settlement agreement, Mr. Kellett also resigned from the Board of Directors.

Roberts Airplane Arrangements

From 2000 to 2002, the Predecessor Company incurred air transportation costs for Bert C. Roberts, Jr. (the Chairman of the Board of Directors from 1998 until his resignation in December 2002 and a member of the Compensation Committee) and other WorldCom employees. Such transportation was provided by BR Ventures ("BRV"), a wholly–owned company held by Mr. Roberts. The Predecessor Company paid BRV for use of the aircraft for WorldCom business at a rate of approximately $1,600 per flight hour. The Predecessor Company paid BRV for Mr. Roberts's personal use of the aircraft using an Internal Revenue Service formula, which amounts were imputed as income to Mr. Roberts. The Predecessor Company paid approximately $159,000 to BRV under this arrangement in 2002.

Transactions with Brown Brothers & Harriman ("BB & H")

Lawrence Tucker, a member of the Predecessor Company's Board of Directors from 1998 through October 2000 and an Advisory Director from November 2000 through October 2002, was a General Partner of BB & H. During 2002, the Predecessor Company provided telecommunications services to BB & H in the amount of $533,000.

Transactions with Companies Related to John Sidgmore

John Sidgmore, the Predecessor Company's interim President and Chief Executive Officer from April 2002 through December 2002 and a member of the Predecessor Company's Board of Directors from 1998 through October 2002, was a venture partner of New Enterprise Associates ("NEA") since October 2001. During 2002, the Predecessor Company provided voice and data services to NEA in the amount of $170,000.

Mr. Sidgmore was also Chairman and Chief Executive Officer of eCommerce Industries, Inc. ("ECI"). During 2002, the Predecessor Company provided various telecommunications services to ECI in the amounts of $275,000. The Predecessor Company also provided telecommunications services to United Business Computers, a subsidiary of ECI, during 2002 in the amounts of $196,000.

Legal Services from Patton Boggs

Mr. Laurence Harris, a director of the Company, was a partner in the law firm Patton Boggs LLP ("Patton Boggs") during 2004. As of December 31, 2004, Mr. Harris was "of counsel" for the firm. The total cost of various legal services provided by Patton Boggs in 2004 was approximately $1 million. As of December 31, 2004, the amount payable to Patton Boggs was approximately $86,000. Mr. Harris does not share in any of the fees received by Patton Boggs from the Company.

Transactions with Telefonos de Mexico, S.A. de C.V.

During the year ended December 31, 2004, the Company entered into numerous transactions with Telefonos de Mexico, S.A. de C.V. and its subsidiaries ("Telmex"), a company controlled by Mr. Carlos Slim Helu, a significant shareholder of the Company. Telmex is a leading provider of telecommunications services, primarily in Mexico. As a result of these transactions, the Company recognized revenues of approximately $31 million and incurred expenses of approximately $197 million during the year ended December 31, 2004. The services provided to Telmex include telecommunication services. As of December 31, 2004, receivables for services due to the Company from Telmex were approximately $7 million, and approximately $34 million was payable to Telmex.

Transactions with Embratel

Daniel Crawford, Acting President—International & Wholesale Markets during 2004, was, until July 23, 2004, Chairman of the Board of Directors of Embratel. When the Company sold its ownership interest in Embratel in July, 2004, Mr. Crawford resigned from the Board of Directors of Embratel and has no further relationship with Embratel as an officer or director. During the period in which Mr. Crawford was on the Board of Directors of Embratel, all intercompany transactions were eliminated in consolidation. The Company has continued to maintain a commercial relationship with Embratel since the sale, and continues to utilize Embratel to serve its customers' communication needs in Brazil. During 2004, the total costs of services provided by Embratel were approximately $29 million and the total revenues for services provided to Embratel by the Company were approximately $15 million. As of December 31, 2004, receivables for services due to the Company from Embratel totaled approximately $6 million, and approximately $11 million was payable to Embratel.

Other Transactions

Certain directors of the Company are affiliated with various entities that purchase the Company's voice, data, and Internet telecommunications services. These purchases are made in the ordinary course of business and the directors do not have any involvement in the selection of the Company as a provider of these services.

(24) Condensed Combined Financial Statements (Unaudited)

In accordance with SOP 90–7, the following unaudited condensed combined financial statements of the Debtors, consisting of substantially all of the Predecessor Company's direct and indirect domestic subsidiaries, represents the unaudited results of operations for the Debtor entities for the years ended December 31, 2003 and 2002. These statements have been prepared on the same basis as the Predecessor Company's consolidated financial statements. The application of fresh–start reporting effectively eliminated the debtor companies for accounting purposes and as such, no statement of financial position has been presented as of December 31, 2003.

Debtors Unaudited Condensed Combined Statements of Operations
Years Ended December 31, 2003 and 2002
(In Millions)

	Predecessor Company	
	Year Ended December 31,	
	2003	2002
Revenues[1]	$21,010	$28,182
Operating expenses[1]	19,573	31,475
Operating income (loss)	1,437	(3,293)
Other expense, net	(797)	(4,736)
Reorganization items, net[2]	22,087	(802)
Income (loss) from continuing operations before income taxes, minority interests and cumulative effects of changes in accounting principles	22,727	(8,831)
Income tax expense	(264)	(129)
Minority interests, net of tax	6	21
Income (loss) from continuing operations before cumulative effects of changes in accounting principles	22,469	(8,939)
Loss from discontinued operations	(43)	(202)
Cumulative effects of changes in accounting principles	(215)	(32)
Net income (loss)	22,211	(9,173)
Distributions on preferred securities	—	(19)
Net income (loss) attributable to common shareholders[3]	$22,211	$ (9,192)

(1) Included revenues and associated costs of the Predecessor Company's non–debtor international subsidiaries that were subject to transfer pricing agreements with one of the Predecessor Company's debtor subsidiaries, which effectively transferred the revenues and expenses of the non–debtor international subsidiaries to a debtor entity.

(2) All reorganization gains and losses were related to the Debtors' operations during the Chapter 11 period.

(3) The net loss attributable to common shareholders of the Debtors was equal to the Predecessor Company's consolidated net loss attributable to common shareholders because WorldCom, Inc. (ultimate Parent company of all consolidated subsidiaries) was a debtor and all non–debtor subsidiaries were accounted for on the equity method of accounting in these unaudited condensed combined financial statements of the debtor entities. Equity in earnings (losses) were included in other income (expense), net.

(25) Selected Quarterly Financial Information (Unaudited)

The following represents the Company's quarterly results for 2004 and 2003 (in millions, except per share amounts):

	Successor Company			
	Quarter ended 2004			
	March 31[6]	June 30[6]	September 30	December 31
Revenues	$5,418	$ 5,222	$ 5,076	$ 4,974
Operating (loss) income	(270)	37[1]	(3,392)[2]	434[3]
Loss from continuing operations	(386)	(70)	(3,400)	(172)
Net loss attributable to common shareholders	(388)	(71)	(3,398)	(145)[4]
Loss per share:				
Basic	(1.19)	(0.22)	(10.65)	(0.45)
Diluted	(1.19)	(0.22)	(10.65)	(0.45)

	Predecessor Company			
	Quarter ended 2003			
	March 31[6]	June 30[6]	September 30[6]	December 31[6]
Revenues	$6,592	$ 6,159	$ 5,969	$ 5,546
Operating income (loss)	598	317	77	(332)
Income (loss) from continuing operations	271	(2)	(45)	22,245[5]
Net income (loss) attributable to common shareholders	51	9	(55)	22,206

(1) Included a $95 million reduction in access costs for a change in estimate regarding contributions to the Universal Service Fund for 2003 and the first quarter of 2004, as well as $62 million in gains from creditor settlements.

(2) Included $3.5 billion of impairment charges related to the Company's long–lived and indefinite–lived assets (see Note 3).

(3) Included the effects of a total of $100 million in gains from creditor settlements, a $76 million benefit related to property tax adjustments and value added tax settlements, a $61 million reduction in bad debt expense including a change in estimate, and a $66 million increase to revenue including a change to billing adjustment assumptions, offset by an increase to access costs of $25 million related to vendor settlements and other increases of $8 million.

(4) Included the effects of income tax expense related to changes in estimates of $275 million regarding the Company's pre–confirmation contingencies and current year provision for state income taxes.

(5) Included the Predecessor Company's gain of approximately $22.3 billion from the effects of its Plan which were recorded on December 31, 2003 upon the adoption of fresh–start reporting (see Note 5).

(6) Amounts have been reclassified from previously reported amounts to reflect Embratel, Proceda and OzEmail as discontinued operations as follows (in millions):

	Successor Company	
	Quarter ended 2004	
	March 31	June 30
Revenues, as reported	$6,295	$5,236
Reclassified to discontinued operations	(877)	(14)
Revenues, as restated	$5,418	$5,222
Operating (loss) income, as reported	$ (205)	$ 41
Reclassified to discontinued operations	(65)	(4)
Operating (loss) income, as restated	$ (270)	$ 37
Loss from continuing operations, as reported	$ (383)	$ (66)
Reclassified to discontinued operations	(3)	(4)
Loss from continuing operations, as restated	$ (386)	$ (70)
Loss per share from continuing operations, as reported	$ (1.17)	$ (0.21)
Loss per share from continuing operations, as restated	(1.18)	(0.22)
Loss per share from discontinued operations, as reported	(0.02)	(0.01)
Loss per share from discontinued operations, as restated	(0.01)	(0.00)

	Predecessor Company			
	Quarter ended 2003			
	March 31	June 30	September 30	December 31
Revenues, as reported	$7,228	$6,900	$ 6,780	$ 6,407
Reclassified to discontinued operations	(636)	(741)	(811)	(861)
Revenues, as restated	$6,592	$6,159	$ 5,969	$ 5,546
Operating income (loss), as reported	$ 634	$ 366	$ 180	$ (272)
Reclassified to discontinued operations	(36)	(49)	(103)	(60)
Operating income (loss), as restated	$ 598	$ 317	$ 77	$ (332)
Income (loss) from continuing operations, as reported	$ 266	$ 13	$ (48)	$ 22,213
Reclassified to discontinued operations	5	(15)	3	32
Income (loss) from continuing operations, as restated	$ 271	$ (2)	$ (45)	$ 22,245

(26) Subsequent Events

Merger Agreement

On February 14, 2005, Verizon Communications Inc. ("Verizon"), the Company and a wholly–owned subsidiary ("Merger Sub") of Verizon entered into an Agreement and Plan of Merger (the "Merger Agreement"). The Merger Agreement provides that, upon the terms and subject to the conditions set forth in the Merger Agreement, the Company will merge with and into the Verizon subsidiary (the "Merger"), with Merger Sub continuing as the surviving person (or, in certain situations, as provided in the Merger Agreement, a wholly–owned corporate subsidiary of Verizon will merge with and into the Company, with the Company as the surviving person.)

At the effective time and as a result of the Merger, the Company will become a wholly–owned subsidiary of Verizon and each share of the Company's common stock will be converted into the right to receive (x) 0.4062 shares of Verizon common stock and (y) cash in the amount of $1.50 per share, which amount of cash and

number of shares may be reduced pursuant to a purchase price adjustment based on the Company's bankruptcy–claims and for certain tax liabilities, on the terms specified in the Merger Agreement. The Merger Agreement also provides for payment of a special cash dividend in the amount of $4.10 per share (less the per share amount of any dividend declared by the Company during the period beginning February 14, 2005 and ending on the closing date of the merger) of MCI common stock after the Merger Agreement is approved by the shareholders. All outstanding Company stock–based awards at the effective time will be replaced by a grant of Verizon stock–based awards.

Consummation of the Merger is subject to customary conditions, including (i) approval of the shareholders of the Company, (ii) expiration or termination of the applicable Hart–Scott–Rodino waiting period and receipt of certain other federal, state or international regulatory approvals, (iii) absence of any law or order prohibiting the closing, (iv) subject to certain exceptions, the accuracy of representations and warranties and the absence of any Material Adverse Effect (as defined in the Merger Agreement) with respect to each party's business. In addition, Verizon's obligation to close is subject to other conditions, including (i) absence of any pending U.S. governmental litigation with a reasonable likelihood of success seeking to prohibit the closing or to impose certain limitations, (ii) receipt of a bankruptcy order issued by the Unites States Bankruptcy Court for the Southern District allowing for the substitution of shares of Verizon common stock for shares of MCI common stock to satisfy certain bankruptcy–related claims, and (iii) receipt of an order issued by the United States District Court for the Southern District of New York relating to the Company's Corporate Monitor and certain affirmative obligations imposed by prior order of the United States District Court for the Southern District of New York. The Merger Agreement contains certain termination rights for both the Company and Verizon, and further provides that, upon termination of the Merger Agreement under specified circumstances, the Company may be required to pay Verizon a termination fee of $200 million.

Consummation of the Merger will constitute a "Change of Control" under the Company's outstanding Senior Notes, which will obligate the surviving person to make an offer to purchase such Notes within 30 days after the effective time at a purchase price equal to 101% of principal amount plus accrued interest.

On February 15, 2005, the Company received notice that an individual shareholder filed a putative class action on behalf of himself and all shareholders of the Company against the Company and all of the individual members of the Board of Directors in Chancery Court in the State of Delaware. Subsequently, Plaintiff filed an amended complaint that added among other things, Verizon as a defendant in the case. Plaintiff alleges that the Company and the Board of Directors breached their fiduciary duties to shareholders in entering into the Merger Agreement with Verizon rather than accepting the merger proposal propounded by Qwest Communications International, Inc. As a remedy, Plaintiff requests that the Chancery Court issue an injunction prohibiting consummation of the Merger Agreement. Additionally, the Company has received notice that three additional putative class actions containing similar allegations were filed on February 18, 2005 against the Company and the Board of Directors in the Chancery Court in the State of Delaware. The Company will aggressively defend itself in these cases.

On February 24, 2005, the Company received a revised proposal from Qwest Communications International, Inc. ("Qwest") to acquire it. The Company's board of directors announced that it would conduct a thorough review of the Qwest proposal. On March 2, 2005, the Company announced its intention to engage with Qwest to review their February 24, 2005 proposal. This decision was made with the concurrence of Verizon. Subsequently, MCI and Qwest have been in ongoing discussions regarding Qwest's proposal. These discussions are continuing.

Other

On January 20, 2005, the Company announced its acquisition of Network Security Technologies, Inc., a privately–held provider of managed security services, for approximately $105 million in cash. The acquisition was completed on February 25, 2005.

On February 15, 2005, the Company announced that it entered into a sales agreement to sell OzEmail for approximately $86 million. The Company completed the divestiture on February 28, 2005 and will record a gain of approximately $80 million in discontinued operations in its 2005 consolidated statement of operations.

EMPLOYMENT AGREEMENT

THIS EMPLOYMENT AGREEMENT (the "Agreement") is made and entered into effective as of April 2, 2004 (the "Effective Date"), by and between WorldCom, Inc., a Georgia corporation (the "Company"), and Robert Blakely (the "Executive"). In consideration of the mutual covenants set forth herein, the Company and the Executive hereby agree as follows:

1. Position; Duties.

(a) During the Period of Agreement (as defined in Section 2), the Executive shall be employed as the Executive Vice President and Chief Financial Officer of the Company. The Executive shall report directly to President and Chief Executive Officer. The Executive shall have the duties, responsibilities, powers, and authority customarily associated with the position of Executive Vice President and Chief Financial Officer and shall perform such other and unrelated services and duties as may be assigned to the Executive from time to time by the President and Chief Executive Officer consistent with the Executive's position as Executive Vice President and Chief Financial Officer.

(b) The Executive shall diligently, competently, and faithfully perform all duties, and shall devote the Executive's entire business time, energy, attention, and skill to the performance of duties for the Company and its subsidiaries and affiliates and will use the Executive's best efforts to promote the interests of the Company. It shall not be considered a violation of the foregoing for the Executive to serve on industry, civic, religious or charitable boards or committees, so long as such activities do not individually or in the aggregate significantly interfere with the performance of the Executive's responsibilities as an employee of the Company in accordance with this Agreement.

2. Term. The initial term of this Agreement shall commence on the Effective Date and continue through December 31, 2006, unless terminated prior to such date as provided at Section 8 hereof (the "Period of Agreement"). The Period of Agreement may be extended upon the written agreement of the parties as approved by the Board of Directors of the Company (the "Board"). Upon the expiration of the Period of Agreement, except as provided herein, this Agreement shall terminate, and any continuation of the Executive's employment with the Company thereafter shall be "at–will."

3. Base Salary. The Executive's annual base salary (the "Base Salary") shall be $700,000, which amount shall not be decreased except upon mutual consent or due to a decrease generally applicable to all senior executives of the Company. The Board or, if so delegated by the Board, the Compensation Committee shall review the Base Salary annually, but shall not have any obligation to increase such amount. No increase in the Executive's Base Salary may be implemented prior to review and approval by the Board or, if so delegated by the Board, the Compensation Committee. Any increase in Base Salary shall constitute the Executive's "Base Salary" thereafter under this Agreement. The Base Salary shall be payable in substantially equal installments in accordance with the Company's payroll policy in effect from time to time and shall be subject to any payroll or other deductions as may be required to be made pursuant to law, government or court order or by agreement with, or consent of, the Executive.

4. Bonus. The Executive shall be eligible to receive a bonus equal to 75% of the Executive's Base Salary for performance at target levels based upon performance standards, with smaller or greater bonus opportunities for performance below or above target levels, all as determined by the Board.

5. Benefits and Perquisites. The Executive shall be entitled to participate in such life insurance, disability, medical, dental, pension, profit sharing and retirement plans and other programs as may be made generally available from time to time by the Company for the benefit of executives at the Executive's level and its employees generally. The Company shall provide the Executive with such perquisites as are provided from time

to time by the Company to its executives generally. The Executive shall be entitled to receive such other compensation, benefits and perquisites as set forth on Appendix 1 to this Agreement.

6. Expenses. The Company shall reimburse the Executive for all reasonable expenses reasonably incurred by the Executive in performing services hereunder, which are incurred and accounted for in accordance with the Company's policies and procedures applicable thereto.

7. Liability Insurance; Indemnification. The Company shall maintain officers' liability insurance coverage for Executive in reasonable amounts during the Period of Agreement and, for any act or omission occurring during the Period of Agreement, at all times thereafter for the duration of any period of limitations during which any action may be brought against the Executive, in the same amount and to the same extent as the Company covers members of the Board. The Executive shall be indemnified and held harmless to the fullest extent permitted under the Company's Articles of Incorporation, Bylaws, and applicable law, including the U.S. Bankruptcy Code (11 U.S.C. § 101 *et seq.*), from any and all claims, lawsuits, losses, damages, assessments, amounts paid in settlement, penalties, expenses, costs and liabilities of any kind or nature, including without limitation, court costs and reasonable attorneys' fees, which the Executive may sustain directly as a result of, or in connection with, any act or omission by the Company or its employees or any claim, suit or other proceeding brought or threatened by a third party (including but not limited to governmental or regulatory agencies or bodies) in connection with the Executive's employment with the Company or any subsidiary or affiliate thereof.

8. Termination of Employment.

(a) *Death or Disability.* The Period of Agreement shall terminate automatically upon the Executive's death. If the Company determines in good faith that the Disability of the Executive has occurred (pursuant to the definition of "Disability" set forth below), it may give to the Executive written notice of its intention to terminate the Executive's employment. In such event, the Period of Agreement and the Executive's employment with the Company shall terminate effective on the thirtieth (30th) day after receipt by the Executive of such notice given at any time after the date of the Executive's Disability, while such Disability is continuing ("Disability Effective Date"); provided that, within the thirty (30) days after such receipt, the Executive shall not have returned to full–time performance of the Executive's duties. For purposes of this Agreement, "Disability" means the completion of a period of the Executive's physical or mental incapacity which continues for not less than six (6) consecutive months or six (6) months in any twelve (12)–month period, as determined by a doctor mutually agreeable to the Executive and the Board. Until the Disability Effective Date, the Executive shall be entitled to all compensation provided for under this Agreement. It is understood that nothing in this Section 8(a) shall serve to limit the Company's obligations under Section 9(c) hereof.

(b) *By the Company for Cause.* The Company may terminate the Executive's employment and the Period of Agreement immediately for "Cause." For purposes of this Agreement, "Cause" means (i) the commission of (x) a felony or (y) a misdemeanor (excluding a petty misdemeanor) involving dishonesty, fraud, financial impropriety, or moral turpitude; (ii) any knowing or deliberate violation of a requirement of the Sarbanes–Oxley Act of 2002 or other material provision of the federal securities laws; (iii) willful neglect or willful misconduct in the discharge of the Executive's duties (after receiving written notice from the Board specifying the manner in which the Executive is alleged to have willfully failed properly to discharge the Executive's duties and after having had the opportunity to cure such failure within thirty (30) days from receipt of such notice), (iv) any willful conduct that could reasonably be anticipated to result in or materially contribute to (whether by act or by omission to act) a violation by the Company of the Permanent Injunction dated November 26, 2002 (the "Permanent Injunction") or other orders binding on the Company issued by the Honorable Jed S. Rakoff of the U.S. District Court of the Southern District of New York (the "Court"), or (v) material breach by the Executive of this Agreement, including any of the covenants contained herein. In the event that the Company asserts that grounds exist for termination with Cause, prior to such termination, it shall so notify the Executive and within fifteen (15) days shall afford the Executive a hearing before the Board regarding any disputed facts. The Board shall make a final determination regarding the existence of "Cause" upon completion of any such hearing, provided, however, that

any determination that "Cause" exists shall require an affirmative vote of two–thirds (2/3) of the non–employee directors of the Company. If any such determination remains pending after such fifteen (15)–day period, the Company shall be entitled to suspend the Executive's duties (with full pay) pending determination of the existence of "Cause"; provided that such period of suspension shall not exceed thirty (30) days. The Executive's acts or omissions shall not be "willful" if conducted in good faith and with a reasonable belief that such conduct was in the best interests of the Company.

(c) *By Executive for Good Reason.* The Executive may terminate Executive's employment and the Period of Agreement for Good Reason upon at least thirty (30) days' prior written notice from the Executive to the President and Chief Executive Officer of the Company. For purposes of this Agreement, "Good Reason" means, without the Executive's prior written consent, the occurrence of (i) a demotion or removal of the Executive from any of the Executive's positions, (ii) a material adverse change by the Company in the Executive's duties or responsibilities, (iii) a decrease in the Executive's Base Salary or the Company's failure to provide an opportunity to earn performance bonuses and other compensation as provided in Sections 4 and 5, above, and Section 10, below, or (iv) any other material breach of this Agreement by the Company which is not cured within thirty (30) days' prior written notice by the Executive to the Company specifying such breach. "Good Reason" does not include (A) any failure to extend the term of this Agreement at the conclusion of the Period of Agreement, (B) the failure of the Company to grant any annual equity award if established performance standards are satisfied, provided equivalent compensation is provided, (C) implementation of any changes in corporate governance required as part of the SEC settlement or any other actions by the Company to comply with the Permanent Injunction or any other order binding on the Company issued by the Court or to comply with any provision of law, or (D) any adverse change in compensation or benefits applicable to all senior executives which is proportionate to each such executive's compensation or benefits, as the case may be, immediately prior to such change. The Executive shall be required to make any assertion of "Good Reason" within 45 days of the events allegedly giving rise to "Good Reason".

(d) *Other than for Cause or Good Reason.* The Executive or the Company may terminate the Executive's employment and the Period of Agreement for any reason other than for Good Reason or other than for Cause, respectively, upon fifteen (15) days' prior written notice to the Company or Executive, as the case may be.

(e) *Notice of Termination.* Any termination of employment by the Company or by the Executive shall be communicated by a notice of termination to the other party hereto given in accordance with Section 19 of this Agreement (the "Notice of Termination"). For purposes of this Agreement, a "Notice of Termination" means a written notice which (i) indicates the specific termination provision in this Agreement relied upon, (ii) sets forth in reasonable detail, if necessary, the facts and circumstances claimed to provide a basis for termination of the Executive's employment under the provision so indicated, and (iii) if the Date of Termination (as defined below) is other than the date of receipt of such notice, specifies the termination date. The failure by the Executive or the Company to set forth in the Notice of Termination any fact or circumstance which contributes to a showing of the basis for termination shall not waive any right of such party hereunder or preclude such party from asserting such fact or circumstance in enforcing his/her or its rights hereunder.

(f) *Date of Termination.* "Date of Termination" means the date specified in the Notice of Termination; provided, however, that if the Executive's employment is terminated by reason of death or Disability, the Date of Termination shall be the date of death of the Executive or the Disability Effective Date, as the case may be.

9. Obligations of the Company Upon Termination. The following provisions describe the obligations of the Company to the Executive upon termination of the Executive's employment during the Period of Agreement. However, except as explicitly provided in this Agreement, nothing in this Agreement shall limit or otherwise adversely affect any rights which the Executive may have under applicable law, under any other written agreement with the Company, or under any compensation or benefit plan, program, policy or practice of the Company.

(a) *Termination not for Cause or for Good Reason.* If the Executive's employment is terminated during the Period of Agreement by Company not for Cause (and other than due to death or Disability) or by the Executive for Good Reason, the Executive shall, in lieu of any other severance benefits under the Company's severance plans, be entitled to the following:

(i) continuation of the Executive's then–current Base Salary and then –current target bonus for a period of two (2) years after the Date of Termination (the "Salary Continuation Period"), the Base Salary component to be payable as set forth in Section 3, above, and the target bonus component to be payable in monthly installments equal to one–twelfth (1/12) of the Executive's then–current annual target bonus opportunity set forth in Section 4, above; provided that the sum of such payments shall not exceed the maximum amount permitted under the Company's Articles of Incorporation;

(ii) continued health coverage for the Executive and the Executive's eligible dependents at active employee rates for the Salary Continuation Period, with COBRA continuation to begin at the end of such period;

(iii) payment of all accrued but not yet paid Base Salary, accrued vacation, any earned and unpaid bonus for the previous year or other performance period, unreimbursed business expenses (in accordance with Company policy and procedures), and any accrued unpaid benefits under the Company's group benefit plans, payable through the Date of Termination (collectively, "Accrued Obligations"); and

(iv) a bonus (based upon actual performance) for the year (or other performance period) in which the Executive's termination occurs, prorated based on the number of days elapsed during said year (or other performance period) through the Date of Termination, payable at the time bonuses are paid to senior executives generally.

The Executive shall be entitled to the amounts and benefits under this Section 9(a) (other than Accrued Obligations) only upon the Executive's execution (*without revocation*) of a general release of all claims of the Executive that may be brought against the Company occurring through and including the release date in the form of Appendix 2 hereto (with such changes therein as may be necessary to make it valid and encompassing under applicable law).

(b) *Termination for Cause, for other than Good Reason or at the Expiration of the Period of Agreement.* If the Executive's employment is terminated during the Period of Agreement by the Company for Cause or by the Executive not for Good Reason, or if the Executive's employment is terminated by either party for any reason at the expiration of the Period of Agreement, the Executive will receive the Executive's Accrued Obligations through the Date of Termination (except to the extent subject to disgorgement under any applicable legal requirement). The Company shall be entitled to offset the amount due from the Executive of any repayments of compensation awarded hereunder against any amounts due to the Executive, without waiving or limiting the Company's rights to recover any excess amount due to it.

(c) *Termination Due to Death or Disability.* In the event of the Executive's death or termination of employment due to Disability during the Period of Agreement, the Executive's estate or the Executive, as the case may be, shall be entitled to receive the following:

(i) a bonus (based upon actual performance) for the year (or other performance period) in which the Executive's termination occurs, prorated based on the number of days elapsed during said year (or other performance period) through the Date of Termination, payable at the time bonuses are paid to senior executives generally;

(ii) payment of the Executive's Accrued Obligations; and

(iii) continued health coverage for the Executive and/or the Executive's eligible dependents, as applicable, at active employee rates for eighteen (18) months following the Date of Termination, which will run concurrently with COBRA.

10. Equity Awards. For each full calendar year during the Period of Agreement, the Executive shall be eligible at the targeted performance levels to receive an annual equity award commensurate with the Executive's position as determined by the Board in its discretion.

11. Treatment of Equity Awards on Termination. Upon the termination of Executive's employment, either during, at the expiration of, or after the Period of Agreement, the vesting of any unvested equity awards granted during the Period of Agreement shall be determined as follows:

(a) In the event of termination of the Executive's employment (i) by the Company not for Cause (and other than due to the Executive's death or Disability), or (ii) by the Executive for Good Reason, the Executive shall be deemed to be an active employee of the Company for two (2) years following the Date of Termination for purposes of determining the vesting of each such equity award.

(b) In the event of termination of the Executive's employment (i) by the Executive not for Good Reason or (ii) by the Company for Cause, any such equity awards that are unvested shall be forfeited.

(c) In the event of the Executive's death or termination due to Disability, any such equity awards that are unvested shall immediately fully vest.

12. Non–Competition.

(a) In the event that the Executive's employment is terminated for any reason during the Period of Agreement, but not at or after the expiration of the Period of Agreement, for a period of one (1) year after the Date of Termination, the Executive shall not become an employee, consultant, advisor, director or assume any other position or relationship with the following companies or their subsidiaries and affiliates: AT&T Corporation, SBC Communications, Inc., Sprint Corporation, Qwest, or Verizon Communications.

(b) The Executive agrees to, and shall, execute the Company's Non–Disclosure, Intellectual Property Assignment and Non–Solicitation Agreement, attached hereto as Appendix 3. The terms of the Non–Disclosure, Intellectual Property Assignment and Non–Solicitation Agreement are incorporated herein by this reference and shall survive any termination of the employment relationship created hereunder or the termination of the Period of Agreement.

(c) The Executive acknowledges that the Company has no adequate remedy at law and will be irreparably harmed if the Executive breaches or threatens to breach the provisions of this Section 12, and, therefore, agrees that the Company shall be entitled to injunctive relief to prevent any breach or threatened breach of this Section and that the Company shall be entitled to specific performance of the terms of this Section in addition to any other legal or equitable remedy it may have. Nothing in this Agreement shall be construed as prohibiting the Company from pursuing any other remedies at law or in equity that it may have or any other rights that it may have under any other agreement.

13. Change in Control.

(a) *Definition of "Change in Control."* The definition of Change in Control shall occur upon the occurrence of any one of the following events during the Period of Agreement:

(i) the sale, lease or transfer, in one or a series of related transactions, of all or substantially all of the assets of the Company and its Restricted Subsidiaries (as defined in the indentures pursuant to which senior notes of the Company are to be issued to certain of the Company's creditors in accordance with the Company's Modified Second Amended Joint Plan of Reorganization under chapter 11 of title 11 of the United States Code, as confirmed on October 31, 2003 by the United States Bankruptcy Court for the Southern District of New York) taken as a whole to any other "person" or "group," as that term is used in Section 13(d)(3) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), (other than the

Company or any of its Restricted Subsidiaries), other than a creation of a holding company that does not involve a change in the beneficial ownership of the Company as a result of the transaction and other than a creation of a holding company that does not involve a change in the beneficial ownership of the Company as a result of the transaction;

(ii) the adoption of a plan relating to the liquidation or dissolution of the Company;

(iii) any "person" or "group" (as such terms are used in Sections 13(d) and 14(d) of the Exchange Act) is or becomes the "beneficial owner" (as defined in rules 13d–3 and 13d–5 under the Exchange Act (except that a person shall be deemed to have beneficial ownership of all shares that such Person has a right to acquire, whether such right is exercisable immediately or after 60 days), directly or indirectly of more than 50% of the voting power of the voting stock of the Company by way of purchase, merger or consolidation or otherwise;

(iv) the merger or consolidation with or into another Person or merger of another Person into the Company with the effect that immediately after that transaction the existing stockholders of the Company immediately before the transaction hold, directly or indirectly, less than 50% of the total voting power of all securities generally entitled to vote in the election of directors, managers or trustees of the Person surviving the merger or consolidation; or

(v) the first day on which a majority of the members of the Company's Board of Directors are not Continuing Directors. For purposes of the preceding clause (e), *"Continuing Directors"* means, as of any date of determination, any member of the Company's Board of Directors who: (i) was a member of the Company's Board of Directors on the Effective Date; or (ii) was nominated for election or elected to the Company's Board of Directors with the affirmative vote of, or whose election or appointment was otherwise approved or ratified (whether before or after nomination or election) by, at least a majority of the Continuing Directors who were members of the Company's Board of Directors at the time of the nomination, election or approval, as applicable.

(b) Upon a Change in Control described in Section 13(a)(i), above, all equity awards granted to the Executive shall immediately fully vest and any restrictions on disposition of vested stock or the payment of any deferred stock units shall lapse.

(c) *Impact of Termination by Company or the Executive During Protection Period.* If the Executive's employment is terminated by the Company not for Cause (and other than due to death or Disability) or by the Executive for Good Reason within the two (2)–year period immediately following a Change in Control of the Company (regardless of whether the Period of Agreement would have otherwise expired without the occurrence of a Change in Control) or in the event the Executive's employment is terminated within six (6) months prior to and in anticipation of a Change in Control or is demonstrated to be at the request of a third party that had taken steps reasonably calculated to effect a Change in Control, the Executive shall, in lieu of any other severance benefits and in lieu of benefits provided under Section 9(a), be entitled to the following:

(i) a lump sum payment, to be made within thirty (30) days of the Date of Termination, equal to two (2) times the sum of the Executive's then–current Base Salary and then–current target bonus;

(ii) continued health coverage for the Executive and the Executive's eligible dependents at active employee rates for two (2) years, with COBRA continuation to begin at the end of such period;

(iii) payment of all Accrued Obligations;

(iv) a bonus (based upon actual performance) for the year (or other performance period) in which the Executive's termination occurs, prorated based on the number of days elapsed during said year (or other performance period) through the Date of Termination, payable at the time bonuses are paid to senior executives generally;

(v) all unvested equity awards shall immediately vest and any restrictions on disposition of vested stock or on the payment of any deferred stock units shall lapse;

(vi) any deferred compensation shall become payable;

(vii) any amounts "earned" under other incentive plans that have not vested will vest and become payable as follows: (A) if based upon objective factors that can reasonably be determined, payment shall be based upon actual performance for such period or, if actual performance cannot be determined, pro–rated based on the relevant period of service, and (B) if any other factors or performance measures cannot reasonably be determined, payment shall be at target, pro–rated based on the relevant period of service; and

(viii) the Executive shall receive two (2) years of service and age credit for vesting and eligibility (but not accrual) purposes under Company retirement or welfare programs and other benefit programs, payable outside plans to the extent that the Executive is not eligible for such payment under the terms of such plans, and two (2) years of welfare program coverage at active employee rates.

The Executive shall be entitled to the amounts and benefits under this Section 13(c) (other than Accrued Obligations) only upon the Executive's execution (without revocation) of a general release of all claims of the Executive that may be brought against the Company occurring through and including the release date in the form of Appendix 2 hereto (with such changes therein as may be necessary to make it valid and encompassing under applicable law).

(d) *Parachute Gross–Up*. In the event that the aggregate of all payments or benefits made or provided to, or that may be made or provided to, the Executive under this Agreement and under all other plans, programs and arrangements of the Company (the "Aggregate Payment") is determined to constitute an "excess parachute payment," as such term is defined in Section 280G(b) of the Internal Revenue Code, the Company shall pay to the Executive prior to the time any excise tax imposed by Section 4999 of the Internal Revenue Code ("Excise Tax") is payable with respect to such Aggregate Payment, an additional amount which, after the imposition of all income and excise taxes thereon, is equal to the Excise Tax on the Aggregate Payment. The determination of whether the Aggregate Payment constitutes an excess parachute payment and, if so, the amount to be provided to the Executive and the time of payment pursuant to this Section 13(d) shall be made by an independent auditor (the "Auditor") selected jointly by the Company and the Executive and paid by the Company. The Auditor shall be a nationally recognized United States public accounting firm which has not, during the two (2) years preceding the date of its selection, acted in any way on behalf of the Company or any affiliate thereof. If the Executive and the Company cannot agree on the firm to serve as the Auditor, then the Executive and the Company shall each select one accounting firm and those two firms shall jointly select the accounting firm to serve as the Auditor. Notwithstanding the foregoing, in the event that the amount of the Executive's Excise Tax liability is subsequently determined to be greater than the Excise Tax liability with respect to which any initial payment to the Executive under this Section 13(d) has been made, the Company shall pay to the Executive an additional amount (grossed up for all taxes) with respect to such additional Excise Tax (and any interest and penalties thereon) at the time and in the amount reasonably determined by the Auditor. Similarly, if the amount of the Executive's Excise Tax liability is subsequently determined to be less than the Excise Tax liability with respect to which any prior payment to the Executive has been made under this Section 13(d), the Executive shall refund to the Company the excess amount received, after reduction for any nonrefundable tax, penalties and/or interest incurred by the Executive in connection with the receipt of such excess, and such refund shall be paid promptly after the Executive has received any corresponding refund of excess Excise Tax paid to the Internal Revenue Service. The Executive and the Company shall cooperate with each other in connection with any proceeding or claim relating to the existence or amount of liability for Excise Tax, and all expenses incurred by the Executive in connection therewith shall be paid by the Company promptly upon notice of demand from the Executive.

14. Dispute Resolution. In the event of any dispute between the Company and the Executive, whether arising out of or relating to this Agreement, the breach of this Agreement, or otherwise, including without limitation if the Executive shall assert the existence of Good Reason or any other breach of this Agreement and the Company shall disagree as to the existence of Good Reason or any other asserted breach, the Executive and the Company hereby agree that such dispute shall be resolved by binding arbitration administered by the American Arbitration

Association ("AAA") in accordance with its Commercial Arbitration Rules then in effect, and judgment on the award rendered by the arbitrator may be entered in any court having jurisdiction thereof. Any arbitration shall be held before a single arbitrator who shall be selected by the mutual agreement of the Company and the Executive, unless the parties are unable to agree to an arbitrator, in which case, the arbitrator will be selected under the procedures of the AAA. The arbitrator shall have the authority to award any remedy or relief that a court of competent jurisdiction could order or grant, including, without limitation, the issuance of an injunction, and the parties hereby agree to the emergency procedures of the AAA. However, either party may, without inconsistency with this arbitration provision, apply to any court having jurisdiction over such dispute or controversy and seek interim provisional, injunctive or other equitable relief until the arbitration award is rendered or the controversy is otherwise resolved. Except as necessary in court proceedings to enforce this arbitration provision or an award rendered hereunder, or to obtain interim relief, neither a party nor an arbitrator may disclose the existence, content or results of any arbitration hereunder without the prior written consent of the Company and the Executive. The arbitration proceeding shall be conducted in the Washington, D.C. metropolitan area. In the event of any such proceeding, the losing party shall reimburse the prevailing party upon entry of a final award resolving the subject of the dispute for all reasonable legal expenses incurred, unless the arbitrator determines that to do so would be unjust. This Agreement shall be governed by the substantive provisions of the laws of the State of Delaware.

15. Mutual Cooperation. The parties agree to take reasonable steps (without cost to the Executive) to minimize the Company's tax obligations with respect to annual compensation.

16. Undertaking. Attached hereto as Appendix 4 is a letter constituting an ethics pledge signed by the Executive, which shall be an integral part of this Agreement.

17. Cooperation with Ongoing Investigations. The Executive agrees that the Executive will fully cooperate, and will cause and direct the persons under the Executive's management direction employed by, or consultants or agents to, the Company to cooperate fully, with all governmental investigations of the Company and all orders entered by the Court.

18. Withholding. Anything in this Agreement to the contrary notwithstanding, all payments required to be made by the Company hereunder to the Executive shall be subject to withholding, at the time payments are actually made to the Executive and received by the Executive, of such amounts relating to taxes as the Company may reasonably determine it should withhold pursuant to any applicable law or regulation. In lieu of withholding such amounts, in whole or in part, the Company may, in its sole discretion, accept other provision for payment of taxes as required by law, provided that it is satisfied that all requirements of law as to its responsibilities to withhold such taxes have been satisfied.

19. Notices. Any and all notices required in connection with this Agreement shall be deemed adequately given only if in writing and (a) personally delivered, or sent by first class, registered or certified mail, postage prepaid, return receipt requested, or by recognized overnight courier, (b) sent by facsimile, provided a hard copy is mailed on that date to the party for whom such notices are intended, or (c) sent by other means at least as fast and reliable as first class mail. A written notice shall be deemed to have been given to the recipient party on the earlier of (a) the date it shall be delivered to the address required by this Agreement; (b) the date delivery shall have been refused at the address required by this Agreement; (c) with respect to notices sent by mail or overnight courier, the date as of which the Postal Service or overnight courier, as the case may be, shall have indicated such notice to be undeliverable at the address required by this Agreement; or (d) with respect to a facsimile, the date on which the facsimile is sent and receipt of which is confirmed. Any and all notices referred to in this Agreement, or which either party desires to give to the other, shall be addressed to the Executive's residence in the case of the Executive, or to its principal office in the case of the Company.

20. Waiver of Breach. A waiver by the Company of a breach of any provision of this Agreement by the Executive shall not operate or be construed as a waiver or estoppel of any subsequent breach by the Executive. No waiver shall be valid unless in writing and signed by an authorized officer of the Company.

21. Headings. The headings in this Agreement are inserted for convenience only and are not to be considered a construction of the provisions hereof.

22. Severability. If any provision of this Agreement shall be found invalid or unenforceable for any reason, in whole or in part, then such provision shall be deemed modified, restricted, or reformulated to the extent and in the manner necessary to render the same valid and enforceable, or shall be deemed excised from this Agreement, as the case may require, and this Agreement shall be construed and enforced to the maximum extent permitted by law, as if such provision had been originally incorporated herein as so modified, restricted, or reformulated or as if such provision had not been originally incorporated herein, as the case may be. The parties further agree to seek a lawful substitute for any provision found to be unlawful; provided, that, if the parties are unable to agree upon a lawful substitute, the parties desire and request that a court or other authority called upon to decide the enforceability of this Agreement modify those restrictions in this Agreement that, once modified, will result in an agreement that is enforceable to the maximum extent permitted by the law in existence at the time of the requested enforcement.

23. Successors.

(a) This Agreement is personal to the Executive and without the prior written consent of the Company shall not be assignable by the Executive otherwise than by will or the laws of descent and distribution. This Agreement shall inure to the benefit of and be enforceable by the Executive's heirs and legal representatives.

(b) This Agreement shall inure to the benefit of and be binding upon the Company and its successors and assigns.

(c) The Company shall require any successor (whether direct or indirect, by purchase, merger, reorganization, consolidation, acquisition of property or stock, liquidation, or otherwise) to all or a substantial portion of its assets, by agreement in form and substance reasonably satisfactory to the Executive, expressly to assume and agree to perform this Agreement in the same manner and to the same extent that the Company would be required to perform this Agreement if no such succession had taken place. Regardless of whether such an agreement is executed, this Agreement shall be binding upon any successor of the Company in accordance with the operation of law, and such successor shall be deemed the "Company" for purposes of this Agreement.

(d) As used in this Agreement, the term "Company" shall include any successor to the Company's business and/or assets as aforesaid which assumes and agrees to perform this Agreement by operation of law, or otherwise.

24. Entire Agreement. This Agreement sets forth the entire and final agreement and understanding of the parties and contains all of the agreements made between the parties with respect to the subject matter hereof. This Agreement supersedes any and all other agreements, either oral or in writing, between the parties hereto, with respect to the subject matter hereof. No change or modification of this Agreement shall be valid unless in writing and signed by the Company and the Executive.

25. Survival. The obligations of the parties under Sections 7, 9, 11, 12, 13, 14, 16, 17, 22, 25 and 27 of this Agreement shall survive the termination of the Executive's employment with the Company during the Period of Agreement and the termination or expiration of the Period of Agreement.

26. Counterparts. This Agreement may be executed in several counterparts, each of which shall be considered an original, but which when taken together, shall constitute one agreement.

27. Conflict. In the case of conflict between the terms of this Agreement (the "Agreement Terms") and the provisions of any plan, policy, or practice of the Company as in effect from time to time (the "Standard Provisions"), the Executive's rights or the Company's obligations shall be established by whichever of the Agreement Terms or Standard Provisions would be more beneficial to the Executive.

[Signature Page Follows]

IN WITNESS WHEREOF, the parties have set their signatures as of the date first written above.

COMPANY:

WorldCom, Inc.,
a Georgia corporation

By: _____

Its: _____

EXECUTIVE:

_____

Appendix 1

OTHER COMPENSATION

1. Bonus. A bonus equal to 75 percent of base salary will be guaranteed pro rata (taking the number of days worked out of a year of 365 days) for the period between April 14, 2003 and December 31, 2003, and such bonus shall be paid in the first quarter of 2004.

2. Signing Bonus. The Executive received a signing bonus of $450,000, paid on June 13, 2003. The signing bonus shall be subject to proportionate clawback (based on the number of full calendar months of elapsed service divided by 42 calendar months) in the event the Executive does not complete the initial term of employment for any reason other than termination of the Executive's employment by the Company without Cause, by the Executive for Good Reason, or by death or disability; provided, however, that the full signing bonus shall be repaid within ten days in the event of the Executive's termination by the Company for Cause.

3. Restricted Stock. Upon the Company's emergence from bankruptcy, the Executive will be entitled to receive an initial equity award of restricted stock valued at $3.4 million at the date of emergence. The value of the restricted stock will be determined by Lazard LLC, financial advisor to the company (or if Lazard LLC shall not at the time continue to be the Company's financial advisor such other firm as shall be mutually acceptable to the Company and the Executive) (the "Financial Advisor") and, absent manifest error, the Financial Advisor's determination of the value of such securities shall be binding upon the Company and the Executive. All such restricted shares shall vest ratably over a period of three years from the date of issuance. After releasing such number of shares as shall be necessary to cover taxes due as a result of vesting, 75 percent of the remaining shares shall be restricted as to resale until a date that shall be 6 months following the Executive's termination of employment with the Company. With the prior consent of the Company and the Executive, awards may be made in the form of restricted deferred stock units rather than restricted stock.

In the case of conflict between the terms of this Appendix 1 (the "Terms") and the provisions of the Agreement to which this Appendix 1 is attached (the "Provisions"), the Executive's rights or the Company's obligations shall be established by whichever of the Terms or Provisions would be more beneficial to the Executive.

Appendix 2

GENERAL RELEASE

WHEREAS, the employment of the undersigned ("Executive") is being terminated under circumstances making Executive eligible for severance benefits under Section [9 or 13] of the Employment Agreement between Executive and WorldCom, Inc., effective as of _____, 2004 (the "Employment Agreement") and Executive wishes to receive the benefits described in Section [9 or 13] of the Employment Agreement, benefits to which Executive is not entitled unless Executive executes a general release and waiver of claims.

NOW, THEREFORE, in consideration for the benefits described in Section [9 or 13] of the Employment Agreement, Executive hereby releases and discharges WorldCom, Inc., and any subsidiaries or affiliates thereof (collectively the "Company"), and their respective directors, officers, employees, benefit plans and administrators, successors and assigns from any and all claims, obligations, and liabilities, whether known or unknown, at law or in equity, arising out of Executive's employment with the Company and the termination thereof. This Release is to be broadly construed so as to resolve all pending or potential disputes including, but without limiting the generality of the foregoing, any and all claims under the Age Discrimination in Employment Act, as amended by the Older Workers Benefit Protection Act of 1990, Title VII of the Civil Rights Act of 1964, the Americans with Disabilities Act, the Employee Retirement Income Security Act of 1974, the Equal Pay Act, the Family and Medical Leave Act, the discrimination and wage payment laws of the state in which Executive rendered services to the Company, and any other statute, regulation, or ordinance, and any and all claims based upon alleged wrongful or retaliatory discharge, negligence, intentional infliction of emotional distress, defamation, invasion of privacy, other torts, harassment, employment discrimination or breach of contract (express or implied). Notwithstanding the foregoing, Executive does not waive any rights Executive may have to enforce the terms of Section [9 or 13] of the Employment Agreement, to benefits available after termination under any Company–sponsored employee benefit plan, to insurance protection and/or indemnification for actions taken by the Executive while an employee, officer and/or director of the Company or to make any claims for workers' compensation.

[Executive hereby expressly waives the benefit of California Civil Code Section 1542, which is set forth below, as well as any other statutory or common laws of like nature concerning the waiver of unknown claims, and specifically agrees that this general release shall extend to claims arising out of transactions occurring prior to the date of its signing which the Executive does not know or expect to exist in the Executive's favor at this time. California Civil Code Section 1542 provides:

> A general release does not extend to claims which the creditor does not know or suspect to exist in his favor at the time of executing the release, which if known by him must have materially affected his settlement with the debtor.] [1]

Executive acknowledges and agrees that:

- Executive has read and understands this Release in its entirety;

- Executive has been advised in writing to consult with an attorney concerning this Release before signing it. This subparagraph constitutes such written advice;

- Executive has twenty–one (21) calendar days after receipt of this Release to consider its terms before signing it;

- Executive has the right to revoke this Release in full within seven (7) calendar days of executing it. Any revocation must be personally delivered to the Executive Vice President – Human Resources, or [his/her] designee, or mailed to WorldCom, Inc., [address], and postmarked within seven (7) calendar days

---

[1] Applicable to California residents.

of the date of execution of this Release. None of the terms and provisions of this Release shall become effective or be enforceable until such revocation period has expired;

- Nothing contained in this Release waives any claim that may arise after the date of its execution; and

- Executive executes this Release knowingly and voluntarily, without duress or reservation of any kind, and after having given the matter full and careful consideration.

IN WITNESS WHEREOF, the Executive has executed this Release on the date indicated below and agrees to be bound hereby.

_____

(Signature)

_____

(Print full name)

_____

(Date)

Appendix 3

NON–DISCLOSURE, INTELLECTUAL PROPERTY ASSIGNMENT AND NON–SOLICITATION AGREEMENT

In order for MCI and its operating affiliates and subsidiaries (hereinafter collectively referred to as the "Company") to maintain a competitive edge, the Company must protect its confidential information and customer relationships.

Therefore, as a condition of employment or continued employment with the Company, I agree as follows:

DEFINITIONS

1. "Confidential Information" means information (i) disclosed to or known by me as a consequence of my employment with the Company, (ii) not generally known to others outside the Company, and (iii) which relates to the Company's business. Confidential Information includes but is not limited to the Company's trade secrets, equipment, equipment configuration, research, development efforts, methodologies, testing, engineering, manufacturing, marketing, sales, finances, operations, processes, formulas, methods, techniques, devices, software programs, projections, strategies and plans, personnel information, industry contacts made during my employment, and customer information, including customer needs, contacts, particular projects, and pricing.

2. "Inventions" means any new or useful art, discovery, new contribution, finding or improvement, whether or not patentable, and all know–how related thereto, made, developed or conceived by me (i) in the course of my employment, (ii) relating to the actual or anticipated business of the Company, or (iii) with the use of the Company's time, material, information or facilities.

3. "Works" means any materials for which copyright protection may be obtained, written, made, developed or conceived by me (i) in the course of my employment, (ii) relating to the actual or anticipated business of the Company, or (iii) with the use of the Company's time, material, information or facilities..

NONDISCLOSURE OF CONFIDENTIAL INFORMATION

4. I will not disclose or use any Confidential Information for the benefit of myself or another, unless directed or authorized in writing by the Company to do so, or until such time as the information becomes known to the public through no fault of mine. I will not disclose any Confidential Information to persons inside the Company who do not have a legitimate need to know the information. I will not make copies of Confidential Information except as reasonably necessary to the performance of my duties for the Company.

5. I understand that if I possess any proprietary information of another person or company as a result of prior employment or otherwise, the Company expects and requires that I will honor any and all legal obligations that I have to that person or company with respect to proprietary information, and I will refrain from any unauthorized use or disclosure of such information.

RETURN OF COMPANY PROPERTY

6. All documents and other tangible property relating in any way to the business of the Company are the exclusive property of the Company (even if I authored or created them). I agree to return all such documents and tangible property to the Company upon termination of employment or at such earlier time as the Company may request.

NON–SOLICITATION OF ACCOUNTS

7. During my employment with the Company and for one (1) year after termination of employment with the Company for any reason, I shall not directly or indirectly, provide products or services that are materially

similar to the products or services provided by the Company to any customer of the Company with whom I had direct contact in the course of my employment with the Company or about whom I learned Confidential Information as a result of my employment with the Company, nor will I solicit, induce, or attempt to induce such customers to: (a) stop doing business with or through the Company, or (b) do business with any other person, firm, partnership, corporation or other entity that provides products or services materially similar to those provided by the Company.

NON–SOLICITATION OF EMPLOYEES

8. During my employment and for one (1) year following termination of my employment with the Company for any reason, I shall not, directly or indirectly, assist in the hiring of, or induce or attempt to induce any person who is employed by the Company or was employed by the Company within the prior six months to terminate his/her relationship with the Company or to accept employment or affiliation with any firm or entity of which I am an employee, owner, partner or consultant.

DISCLOSURE AND ASSIGNMENT OF INVENTIONS AND WORKS

9. I will promptly disclose to the Company in writing, all Inventions and Works which are conceived, made, discovered, written or created by me alone or jointly with someone else on the Company's time or on my own time, while I am employed by the Company.

10. All Works created by me, alone or with others, shall be deemed "works made for hire" under the copyright laws and shall be owned by the Company.

11. I hereby assign to the Company all of my rights in all Inventions, and in all Works to the extent such Works may not, by operation of law, be works made for hire.

12. I will, without further compensation, give the Company all assistance it reasonably requires (whether during my employment or after my employment) to perfect, protect, and use its rights to Inventions and Works. In particular, I will sign all documents, do all things, and supply all information that the Company considers necessary or desirable to transfer or record the transfer of my entire right, title and interest in Inventions and Works; and to enable the Company to obtain patent, copyright, or other legal protection for Inventions and Works. Any out–of–pocket expenses will be paid by the Company.

13. An invention for which none of the Company's equipment, supplies, facilities, or Confidential Information was used and which was developed entirely on my own time is exempted from this Agreement so long as it: (1) does not relate in any way to the Company's business, or to the Company's actual or demonstrably anticipated research and development; and (b) does not result in any way from my work for the Company.

14. Also excluded from this Agreement are the following Inventions and Works which I own or control and which were conceived, made, written, or created by me prior to my employment with the Company.

(1) _____

_____

(2) _____

_____

(Attach additional sheets if necessary)

Other than these, I do not claim to own or control rights in any inventions or works subject to copyright and will not assert any such rights against the Company.

IRREPARABLE HARM

15. Irreparable harm would result from any breach by me of the provisions of this Agreement, and monetary damages alone would not provide adequate relief for any such breach. Accordingly, if I breach or threaten to breach this Agreement, injunctive relief in favor of the Company is proper, without the necessity of the Company posting a bond. Moreover, any award of injunctive relief shall not preclude the Company from seeking or recovering any lawful compensatory damages which may have resulted from a breach of this Agreement, including a forfeiture of any payments not yet made to me and a return of any payments already received by me.

SEVERABILITY/MODIFICATION

16. If a provision of this Agreement is held invalid by a court of competent jurisdiction, the remaining provisions will nonetheless be enforceable according to their terms. Further, if any provision is held to be over broad as written, a court may modify that provision to the extent necessary to make the provision enforceable according to applicable law and enforce the provision as modified.

GOVERNING LAW

17. This Agreement shall be construed, interpreted and enforced in accordance with the internal laws of the State of Delaware.

BURDEN AND BENEFIT

18. The Company may assign its rights under this Agreement to any successor in interest, whether by merger, consolidation, sale of assets, or otherwise. This Agreement shall be binding whether it is between me and the Company or between me and any successor or assign of the Company.

NO EFFECT ON TERM OF EMPLOYMENT

19. Nothing in this Agreement prevents or limits my right to terminate my employment at any time for any reason, and nothing in this Agreement prevents or limits the Company from terminating my employment at any time for any reason. I understand and agree that there exist no promises or guarantees of permanent employment or employment for any specified term by the Company.

ENTIRE AGREEMENT

20. I understand that this Agreement contains the entire agreement and understanding between the Company and me with respect to the provisions contained in this Agreement, and that no representations, promises, agreements, or understandings, written or oral, related thereto which are not contained in this Agreement will be given any force or effect. No change or modification of this Agreement will be valid or binding unless it is in writing and signed by the party against whom the change or modification is sought to be enforced. I further understand that even if the Company waives or fails to enforce any provision of this Agreement in one instance, that will not constitute a waiver of any other provisions of this Agreement at this time, or a waiver of that provision at any other time.

ACKNOWLEDGEMENT

21. I hereby acknowledge and represent that I have fully read and understand this Agreement and that I consider all of the terms of my covenants and agreements set forth in this Agreement to be fair and reasonable and to be necessary to protect the Company's ongoing interests.

COMPANY

_____

By

_____

Title

_____

Date

EMPLOYEE

_____

Signature of Employee

_____

Date

_____

Address – Street

_____

Address – City, State, Zip Code

Appendix 4

ETHICS PLEDGE

[Attached]

EMPLOYMENT AGREEMENT

THIS EMPLOYMENT AGREEMENT (the "Agreement") is made and entered into effective as of April 2, 2004 (the "Effective Date"), by and between WorldCom, Inc., a Georgia corporation (the "Company"), and Jonathan Crane (the "Executive"). In consideration of the mutual covenants set forth herein, the Company and the Executive hereby agree as follows:

1. Position; Duties.

(a) During the Period of Agreement (as defined in Section 2), the Executive shall be employed as the President – International and Wholesale Markets of the Company. The Executive shall report directly to President and Chief Executive Officer The Executive shall have the duties, responsibilities, powers, and authority customarily associated with the position of President – International and Wholesale Markets and shall perform such other and unrelated services and duties as may be assigned to the Executive from time to time by the President and Chief Executive Officer consistent with the Executive's position as President – International and Wholesale Markets.

(b) The Executive shall diligently, competently, and faithfully perform all duties, and shall devote the Executive's entire business time, energy, attention, and skill to the performance of duties for the Company and its subsidiaries and affiliates and will use the Executive's best efforts to promote the interests of the Company. It shall not be considered a violation of the foregoing for the Executive to serve on industry, civic, religious or charitable boards or committees, so long as such activities do not individually or in the aggregate significantly interfere with the performance of the Executive's responsibilities as an employee of the Company in accordance with this Agreement.

2. Term. The initial term of this Agreement shall commence on the Effective Date and continue through December 31, 2006, unless terminated prior to such date as provided at Section 8 hereof (the "Period of Agreement"). The Period of Agreement may be extended upon the written agreement of the parties as approved by the Board of Directors of the Company (the "Board"). Upon the expiration of the Period of Agreement, except as provided herein, this Agreement shall terminate, and any continuation of the Executive's employment with the Company thereafter shall be "at–will."

3. Base Salary. The Executive's annual base salary (the "Base Salary") shall be $575,000, which amount shall not be decreased except upon mutual consent or due to a decrease generally applicable to all senior executives of the Company. The Board or, if so delegated by the Board, the Compensation Committee shall review the Base Salary annually, but shall not have any obligation to increase such amount. No increase in the Executive's Base Salary may be implemented prior to review and approval by the Board or, if so delegated by the Board, the Compensation Committee. Any increase in Base Salary shall constitute the Executive's "Base Salary" thereafter under this Agreement. The Base Salary shall be payable in substantially equal installments in accordance with the Company's payroll policy in effect from time to time and shall be subject to any payroll or other deductions as may be required to be made pursuant to law, government or court order or by agreement with, or consent of, the Executive.

4. Bonus. The Executive shall be eligible to receive a bonus equal to 100% of the Executive's Base Salary for performance at target levels based upon performance standards, with smaller or greater bonus opportunities for performance below or above target levels, all as determined by the Board.

5. Benefits and Perquisites. The Executive shall be entitled to participate in such life insurance, disability, medical, dental, pension, profit sharing and retirement plans and other programs as may be made generally available from time to time by the Company for the benefit of executives at the Executive's level and its employees generally. The Company shall provide the Executive with such perquisites as are provided from time

to time by the Company to its executives generally. The Executive shall be entitled to receive such other compensation, benefits and perquisites as set forth on Appendix 1 to this Agreement.

6. Expenses. The Company shall reimburse the Executive for all reasonable expenses reasonably incurred by the Executive in performing services hereunder, which are incurred and accounted for in accordance with the Company's policies and procedures applicable thereto.

7. Liability Insurance; Indemnification. The Company shall maintain officers' liability insurance coverage for Executive in reasonable amounts during the Period of Agreement and, for any act or omission occurring during the Period of Agreement, at all times thereafter for the duration of any period of limitations during which any action may be brought against the Executive, in the same amount and to the same extent as the Company covers members of the Board. The Executive shall be indemnified and held harmless to the fullest extent permitted under the Company's Articles of Incorporation, Bylaws, and applicable law, including the U.S. Bankruptcy Code (11 U.S.C. § 101 *et seq.*), from any and all claims, lawsuits, losses, damages, assessments, amounts paid in settlement, penalties, expenses, costs and liabilities of any kind or nature, including without limitation, court costs and reasonable attorneys' fees, which the Executive may sustain directly as a result of, or in connection with, any act or omission by the Company or its employees or any claim, suit or other proceeding brought or threatened by a third party (including but not limited to governmental or regulatory agencies or bodies) in connection with the Executive's employment with the Company or any subsidiary or affiliate thereof.

8. Termination of Employment.

(a) *Death or Disability.* The Period of Agreement shall terminate automatically upon the Executive's death. If the Company determines in good faith that the Disability of the Executive has occurred (pursuant to the definition of "Disability" set forth below), it may give to the Executive written notice of its intention to terminate the Executive's employment. In such event, the Period of Agreement and the Executive's employment with the Company shall terminate effective on the thirtieth (30th) day after receipt by the Executive of such notice given at any time after the date of the Executive's Disability, while such Disability is continuing ("Disability Effective Date"); provided that, within the thirty (30) days after such receipt, the Executive shall not have returned to full–time performance of the Executive's duties. For purposes of this Agreement, "Disability" means the completion of a period of the Executive's physical or mental incapacity which continues for not less than six (6) consecutive months or six (6) months in any twelve (12)–month period, as determined by a doctor mutually agreeable to the Executive and the Board. Until the Disability Effective Date, the Executive shall be entitled to all compensation provided for under this Agreement. It is understood that nothing in this Section 8(a) shall serve to limit the Company's obligations under Section 9(c) hereof.

(b) *By the Company for Cause.* The Company may terminate the Executive's employment and the Period of Agreement immediately for "Cause." For purposes of this Agreement, "Cause" means (i) the commission of (x) a felony or (y) a misdemeanor (excluding a petty misdemeanor) involving dishonesty, fraud, financial impropriety, or moral turpitude; (ii) any knowing or deliberate violation of a requirement of the Sarbanes–Oxley Act of 2002 or other material provision of the federal securities laws; (iii) willful neglect or willful misconduct in the discharge of the Executive's duties (after receiving written notice from the Board specifying the manner in which the Executive is alleged to have willfully failed properly to discharge the Executive's duties and after having had the opportunity to cure such failure within thirty (30) days from receipt of such notice), (iv) any willful conduct that could reasonably be anticipated to result in or materially contribute to (whether by act or by omission to act) a violation by the Company of the Permanent Injunction dated November 26, 2002 (the "Permanent Injunction") or other orders binding on the Company issued by the Honorable Jed S. Rakoff of the U.S. District Court of the Southern District of New York (the "Court"), or (v) material breach by the Executive of this Agreement, including any of the covenants contained herein. In the event that the Company asserts that grounds exist for termination with Cause, prior to such termination, it shall so notify the Executive and within fifteen (15) days shall afford the Executive a hearing before the Board regarding any disputed facts. The Board shall make a final determination regarding the existence of "Cause" upon completion of any such hearing, provided, however, that any determination that "Cause" exists shall require an affirmative vote of two–thirds (2/3) of the non–employee

directors of the Company. If any such determination remains pending after such fifteen (15)–day period, the Company shall be entitled to suspend the Executive's duties (with full pay) pending determination of the existence of "Cause"; provided that such period of suspension shall not exceed thirty (30) days. The Executive's acts or omissions shall not be "willful" if conducted in good faith and with a reasonable belief that such conduct was in the best interests of the Company.

(c) *By Executive for Good Reason.* The Executive may terminate Executive's employment and the Period of Agreement for Good Reason upon at least thirty (30) days' prior written notice from the Executive to the President and Chief Executive Officer of the Company. For purposes of this Agreement, "Good Reason" means, without the Executive's prior written consent, the occurrence of (i) a demotion or removal of the Executive from any of the Executive's positions, (ii) a material adverse change by the Company in the Executive's duties or responsibilities, (iii) a decrease in the Executive's Base Salary or the Company's failure to provide an opportunity to earn performance bonuses and other compensation as provided in Sections 4 and 5, above, and Section 10, below, or (iv) any other material breach of this Agreement by the Company which is not cured within thirty (30) days' prior written notice by the Executive to the Company specifying such breach. "Good Reason" does not include (A) any failure to extend the term of this Agreement at the conclusion of the Period of Agreement, (B) the failure of the Company to grant any annual equity award if established performance standards are satisfied, provided equivalent compensation is provided, (C) implementation of any changes in corporate governance required as part of the SEC settlement or any other actions by the Company to comply with the Permanent Injunction or any other order binding on the Company issued by the Court or to comply with any provision of law, or (D) any adverse change in compensation or benefits applicable to all senior executives which is proportionate to each such executive's compensation or benefits, as the case may be, immediately prior to such change. The Executive shall be required to make any assertion of "Good Reason" within 45 days of the events allegedly giving rise to "Good Reason".

(d) *Other than for Cause or Good Reason.* The Executive or the Company may terminate the Executive's employment and the Period of Agreement for any reason other than for Good Reason or other than for Cause, respectively, upon fifteen (15) days' prior written notice to the Company or Executive, as the case may be.

(e) *Notice of Termination.* Any termination of employment by the Company or by the Executive shall be communicated by a notice of termination to the other party hereto given in accordance with Section 19 of this Agreement (the "Notice of Termination"). For purposes of this Agreement, a "Notice of Termination" means a written notice which (i) indicates the specific termination provision in this Agreement relied upon, (ii) sets forth in reasonable detail, if necessary, the facts and circumstances claimed to provide a basis for termination of the Executive's employment under the provision so indicated, and (iii) if the Date of Termination (as defined below) is other than the date of receipt of such notice, specifies the termination date. The failure by the Executive or the Company to set forth in the Notice of Termination any fact or circumstance which contributes to a showing of the basis for termination shall not waive any right of such party hereunder or preclude such party from asserting such fact or circumstance in enforcing his/her or its rights hereunder.

(f) *Date of Termination.* "Date of Termination" means the date specified in the Notice of Termination; provided, however, that if the Executive's employment is terminated by reason of death or Disability, the Date of Termination shall be the date of death of the Executive or the Disability Effective Date, as the case may be.

9. Obligations of the Company Upon Termination. The following provisions describe the obligations of the Company to the Executive upon termination of the Executive's employment during the Period of Agreement. However, except as explicitly provided in this Agreement, nothing in this Agreement shall limit or otherwise adversely affect any rights which the Executive may have under applicable law, under any other written agreement with the Company, or under any compensation or benefit plan, program, policy or practice of the Company.

(a) *Termination not for Cause or for Good Reason.* If the Executive's employment is terminated during the Period of Agreement by Company not for Cause (and other than due to death or Disability) or by the Executive

for Good Reason, the Executive shall, in lieu of any other severance benefits under the Company's severance plans, be entitled to the following:

(i) continuation of the Executive's then–current Base Salary and then –current target bonus for a period of two (2) years after the Date of Termination (the "Salary Continuation Period"), the Base Salary component to be payable as set forth in Section 3, above, and the target bonus component to be payable in monthly installments equal to one–twelfth (1/12) of the Executive's then–current annual target bonus opportunity set forth in Section 4, above; provided that the sum of such payments shall not exceed the maximum amount permitted under the Company's Articles of Incorporation;

(ii) continued health coverage for the Executive and the Executive's eligible dependents at active employee rates for the Salary Continuation Period, with COBRA continuation to begin at the end of such period;

(iii) payment of all accrued but not yet paid Base Salary, accrued vacation, any earned and unpaid bonus for the previous year or other performance period, unreimbursed business expenses (in accordance with Company policy and procedures), and any accrued unpaid benefits under the Company's group benefit plans, payable through the Date of Termination (collectively, "Accrued Obligations"); and

(iv) a bonus (based upon actual performance) for the year (or other performance period) in which the Executive's termination occurs, prorated based on the number of days elapsed during said year (or other performance period) through the Date of Termination, payable at the time bonuses are paid to senior executives generally.

The Executive shall be entitled to the amounts and benefits under this Section 9(a) (other than Accrued Obligations) only upon the Executive's execution (without revocation) of a general release of all claims of the Executive that may be brought against the Company occurring through and including the release date in the form of Appendix 2 hereto (with such changes therein as may be necessary to make it valid and encompassing under applicable law).

(b) *Termination for Cause, for other than Good Reason or at the Expiration of the Period of Agreement.* If the Executive's employment is terminated during the Period of Agreement by the Company for Cause or by the Executive not for Good Reason, or if the Executive's employment is terminated by either party for any reason at the expiration of the Period of Agreement, the Executive will receive the Executive's Accrued Obligations through the Date of Termination (except to the extent subject to disgorgement under any applicable legal requirement). The Company shall be entitled to offset the amount due from the Executive of any repayments of compensation awarded hereunder against any amounts due to the Executive, without waiving or limiting the Company's rights to recover any excess amount due to it.

(c) *Termination Due to Death or Disability.* In the event of the Executive's death or termination of employment due to Disability during the Period of Agreement, the Executive's estate or the Executive, as the case may be, shall be entitled to receive the following:

(i) a bonus (based upon actual performance) for the year (or other performance period) in which the Executive's termination occurs, prorated based on the number of days elapsed during said year (or other performance period) through the Date of Termination, payable at the time bonuses are paid to senior executives generally;

(ii) payment of the Executive's Accrued Obligations; and

(iii) continued health coverage for the Executive and/or the Executive's eligible dependents, as applicable, at active employee rates for eighteen (18) months following the Date of Termination, which will run concurrently with COBRA.

10. Equity Awards. For each full calendar year during the Period of Agreement, the Executive shall be eligible at the targeted performance levels to receive an annual equity award commensurate with the Executive's position as determined by the Board in its discretion.

11. Treatment of Equity Awards on Termination. Upon the termination of Executive's employment, either during, at the expiration of, or after the Period of Agreement, the vesting of any unvested equity awards granted during the Period of Agreement shall be determined as follows:

(a) In the event of termination of the Executive's employment (i) by the Company not for Cause (and other than due to the Executive's death or Disability), or (ii) by the Executive for Good Reason, the Executive shall be deemed to be an active employee of the Company for two (2) years following the Date of Termination for purposes of determining the vesting of each such equity award.

(b) In the event of termination of the Executive's employment (i) by the Executive not for Good Reason or (ii) by the Company for Cause, any such equity awards that are unvested shall be forfeited.

(c) In the event of the Executive's death or termination due to Disability, any such equity awards that are unvested shall immediately fully vest.

12. Non–Competition.

(a) In the event that the Executive's employment is terminated for any reason during the Period of Agreement, but not at or after the expiration of the Period of Agreement, for a period of one (1) year after the Date of Termination, the Executive shall not become an employee, consultant, advisor, director or assume any other position or relationship with the following companies or their subsidiaries and affiliates: AT&T Corporation, SBC Communications, Inc., Sprint Corporation, Qwest, or Verizon Communication.

(b) The Executive agrees to, and shall, execute the Company's Non–Disclosure, Intellectual Property Assignment and Non–Solicitation Agreement, attached hereto as Appendix 3. The terms of the Non–Disclosure, Intellectual Property Assignment and Non–Solicitation Agreement are incorporated herein by this reference and shall survive any termination of the employment relationship created hereunder or the termination of the Period of Agreement.

(c) The Executive acknowledges that the Company has no adequate remedy at law and will be irreparably harmed if the Executive breaches or threatens to breach the provisions of this Section 12, and, therefore, agrees that the Company shall be entitled to injunctive relief to prevent any breach or threatened breach of this Section and that the Company shall be entitled to specific performance of the terms of this Section in addition to any other legal or equitable remedy it may have. Nothing in this Agreement shall be construed as prohibiting the Company from pursuing any other remedies at law or in equity that it may have or any other rights that it may have under any other agreement.

13. Change in Control.

(a) *Definition of "Change in Control."* The definition of Change in Control shall occur upon the occurrence of any one of the following events during the Period of Agreement:

(i) the sale, lease or transfer, in one or a series of related transactions, of all or substantially all of the assets of the Company and its Restricted Subsidiaries (as defined in the indentures pursuant to which senior notes of the Company are to be issued to certain of the Company's creditors in accordance with the Company's Modified Second Amended Joint Plan of Reorganization under chapter 11 of title 11 of the United States Code, as confirmed on October 31, 2003 by the United States Bankruptcy Court for the Southern District of New York) taken as a whole to any other "person" or "group," as that term is used in Section 13(d)(3) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), (other than the Company or any of its Restricted Subsidiaries), other than a creation of a holding company that does not involve a change in the beneficial ownership of the Company as a result of the transaction and other than a creation of a holding company that does not involve a change in the beneficial ownership of the Company as a result of the transaction;

(ii) the adoption of a plan relating to the liquidation or dissolution of the Company;

(iii) any "person" or "group" (as such terms are used in Sections 13(d) and 14(d) of the Exchange Act) is or becomes the "beneficial owner" (as defined in rules 13d–3 and 13d–5 under the Exchange Act (except that a person shall be deemed to have beneficial ownership of all shares that such Person has a right to acquire, whether such right is exercisable immediately or after 60 days), directly or indirectly of more than 50% of the voting power of the voting stock of the Company by way of purchase, merger or consolidation or otherwise;

(iv) the merger or consolidation with or into another Person or merger of another Person into the Company with the effect that immediately after that transaction the existing stockholders of the Company immediately before the transaction hold, directly or indirectly, less than 50% of the total voting power of all securities generally entitled to vote in the election of directors, managers or trustees of the Person surviving the merger or consolidation; or

(v) the first day on which a majority of the members of the Company's Board of Directors are not Continuing Directors. For purposes of the preceding clause (e), "Continuing Directors" means, as of any date of determination, any member of the Company's Board of Directors who: (i) was a member of the Company's Board of Directors on the Effective Date; or (ii) was nominated for election or elected to the Company's Board of Directors with the affirmative vote of, or whose election or appointment was otherwise approved or ratified (whether before or after nomination or election) by, at least a majority of the Continuing Directors who were members of the Company's Board of Directors at the time of the nomination, election or approval, as applicable.

(b) Upon a Change in Control described in Section 13(a)(i), above, all equity awards granted to the Executive shall immediately fully vest and any restrictions on disposition of vested stock or the payment of any deferred stock units shall lapse.

(c) *Impact of Termination by Company or the Executive During Protection Period.* If the Executive's employment is terminated by the Company not for Cause (and other than due to death or Disability) or by the Executive for Good Reason within the two (2)–year period immediately following a Change in Control of the Company (regardless of whether the Period of Agreement would have otherwise expired without the occurrence of a Change in Control) or in the event the Executive's employment is terminated within six (6) months prior to and in anticipation of a Change in Control or is demonstrated to be at the request of a third party that had taken steps reasonably calculated to effect a Change in Control, the Executive shall, in lieu of any other severance benefits and in lieu of benefits provided under Section 9(a), be entitled to the following:

(i) a lump sum payment, to be made within thirty (30) days of the Date of Termination, equal to two (2) times the sum of the Executive's then–current Base Salary and then–current target bonus;

(ii) continued health coverage for the Executive and the Executive's eligible dependents at active employee rates for two (2) years, with COBRA continuation to begin at the end of such period;

(iii) payment of all Accrued Obligations;

(iv) a bonus (based upon actual performance) for the year (or other performance period) in which the Executive's termination occurs, prorated based on the number of days elapsed during said year (or other performance period) through the Date of Termination, payable at the time bonuses are paid to senior executives generally;

(v) all unvested equity awards shall immediately vest and any restrictions on disposition of vested stock or on the payment of any deferred stock units shall lapse;

(vi) any deferred compensation shall become payable;

(vii) any amounts "earned" under other incentive plans that have not vested will vest and become payable as follows: (A) if based upon objective factors that can reasonably be determined, payment shall be

based upon actual performance for such period or, if actual performance cannot be determined, pro–rated based on the relevant period of service, and (B) if any other factors or performance measures cannot reasonably be determined, payment shall be at target, pro–rated based on the relevant period of service; and

(viii) the Executive shall receive two (2) years of service and age credit for vesting and eligibility (but not accrual) purposes under Company retirement or welfare programs and other benefit programs, payable outside plans to the extent that the Executive is not eligible for such payment under the terms of such plans, and two (2) years of welfare program coverage at active employee rates.

The Executive shall be entitled to the amounts and benefits under this Section 13(c) (other than Accrued Obligations) only upon the Executive's execution (without revocation) of a general release of all claims of the Executive that may be brought against the Company occurring through and including the release date in the form of Appendix 2 hereto (with such changes therein as may be necessary to make it valid and encompassing under applicable law).

(d) *Parachute Gross–Up*. In the event that the aggregate of all payments or benefits made or provided to, or that may be made or provided to, the Executive under this Agreement and under all other plans, programs and arrangements of the Company (the "Aggregate Payment") is determined to constitute an "excess parachute payment," as such term is defined in Section 280G(b) of the Internal Revenue Code, the Company shall pay to the Executive prior to the time any excise tax imposed by Section 4999 of the Internal Revenue Code ("Excise Tax") is payable with respect to such Aggregate Payment, an additional amount which, after the imposition of all income and excise taxes thereon, is equal to the Excise Tax on the Aggregate Payment. The determination of whether the Aggregate Payment constitutes an excess parachute payment and, if so, the amount to be provided to the Executive and the time of payment pursuant to this Section 13(d) shall be made by an independent auditor (the "Auditor") selected jointly by the Company and the Executive and paid by the Company. The Auditor shall be a nationally recognized United States public accounting firm which has not, during the two (2) years preceding the date of its selection, acted in any way on behalf of the Company or any affiliate thereof. If the Executive and the Company cannot agree on the firm to serve as the Auditor, then the Executive and the Company shall each select one accounting firm and those two firms shall jointly select the accounting firm to serve as the Auditor. Notwithstanding the foregoing, in the event that the amount of the Executive's Excise Tax liability is subsequently determined to be greater than the Excise Tax liability with respect to which any initial payment to the Executive under this Section 13(d) has been made, the Company shall pay to the Executive an additional amount (grossed up for all taxes) with respect to such additional Excise Tax (and any interest and penalties thereon) at the time and in the amount reasonably determined by the Auditor. Similarly, if the amount of the Executive's Excise Tax liability is subsequently determined to be less than the Excise Tax liability with respect to which any prior payment to the Executive has been made under this Section 13(d), the Executive shall refund to the Company the excess amount received, after reduction for any nonrefundable tax, penalties and/or interest incurred by the Executive in connection with the receipt of such excess, and such refund shall be paid promptly after the Executive has received any corresponding refund of excess Excise Tax paid to the Internal Revenue Service. The Executive and the Company shall cooperate with each other in connection with any proceeding or claim relating to the existence or amount of liability for Excise Tax, and all expenses incurred by the Executive in connection therewith shall be paid by the Company promptly upon notice of demand from the Executive.

14. Dispute Resolution. In the event of any dispute between the Company and the Executive, whether arising out of or relating to this Agreement, the breach of this Agreement, or otherwise, including without limitation if the Executive shall assert the existence of Good Reason or any other breach of this Agreement and the Company shall disagree as to the existence of Good Reason or any other asserted breach, the Executive and the Company hereby agree that such dispute shall be resolved by binding arbitration administered by the American Arbitration Association ("AAA") in accordance with its Commercial Arbitration Rules then in effect, and judgment on the award rendered by the arbitrator may be entered in any court having jurisdiction thereof. Any arbitration shall be held before a single arbitrator who shall be selected by the mutual agreement of the Company and the Executive, unless the parties are unable to agree to an arbitrator, in which case, the arbitrator will be selected under the

procedures of the AAA. The arbitrator shall have the authority to award any remedy or relief that a court of competent jurisdiction could order or grant, including, without limitation, the issuance of an injunction, and the parties hereby agree to the emergency procedures of the AAA. However, either party may, without inconsistency with this arbitration provision, apply to any court having jurisdiction over such dispute or controversy and seek interim provisional, injunctive or other equitable relief until the arbitration award is rendered or the controversy is otherwise resolved. Except as necessary in court proceedings to enforce this arbitration provision or an award rendered hereunder, or to obtain interim relief, neither a party nor an arbitrator may disclose the existence, content or results of any arbitration hereunder without the prior written consent of the Company and the Executive. The arbitration proceeding shall be conducted in the Washington, D.C. metropolitan area. In the event of any such proceeding, the losing party shall reimburse the prevailing party upon entry of a final award resolving the subject of the dispute for all reasonable legal expenses incurred, unless the arbitrator determines that to do so would be unjust. This Agreement shall be governed by the substantive provisions of the laws of the State of Delaware.

15. Mutual Cooperation. The parties agree to take reasonable steps (without cost to the Executive) to minimize the Company's tax obligations with respect to annual compensation.

16. Undertaking. Attached hereto as Appendix 4 is a letter constituting an ethics pledge signed by the Executive, which shall be an integral part of this Agreement.

17. Cooperation with Ongoing Investigations. The Executive agrees that the Executive will fully cooperate, and will cause and direct the persons under the Executive's management direction employed by, or consultants or agents to, the Company to cooperate fully, with all governmental investigations of the Company and all orders entered by the Court.

18. Withholding. Anything in this Agreement to the contrary notwithstanding, all payments required to be made by the Company hereunder to the Executive shall be subject to withholding, at the time payments are actually made to the Executive and received by the Executive, of such amounts relating to taxes as the Company may reasonably determine it should withhold pursuant to any applicable law or regulation. In lieu of withholding such amounts, in whole or in part, the Company may, in its sole discretion, accept other provision for payment of taxes as required by law, provided that it is satisfied that all requirements of law as to its responsibilities to withhold such taxes have been satisfied.

19. Notices. Any and all notices required in connection with this Agreement shall be deemed adequately given only if in writing and (a) personally delivered, or sent by first class, registered or certified mail, postage prepaid, return receipt requested, or by recognized overnight courier, (b) sent by facsimile, provided a hard copy is mailed on that date to the party for whom such notices are intended, or (c) sent by other means at least as fast and reliable as first class mail. A written notice shall be deemed to have been given to the recipient party on the earlier of (a) the date it shall be delivered to the address required by this Agreement; (b) the date delivery shall have been refused at the address required by this Agreement; (c) with respect to notices sent by mail or overnight courier, the date as of which the Postal Service or overnight courier, as the case may be, shall have indicated such notice to be undeliverable at the address required by this Agreement; or (d) with respect to a facsimile, the date on which the facsimile is sent and receipt of which is confirmed. Any and all notices referred to in this Agreement, or which either party desires to give to the other, shall be addressed to the Executive's residence in the case of the Executive, or to its principal office in the case of the Company.

20. Waiver of Breach. A waiver by the Company of a breach of any provision of this Agreement by the Executive shall not operate or be construed as a waiver or estoppel of any subsequent breach by the Executive. No waiver shall be valid unless in writing and signed by an authorized officer of the Company.

21. Headings. The headings in this Agreement are inserted for convenience only and are not to be considered a construction of the provisions hereof.

22. Severability. If any provision of this Agreement shall be found invalid or unenforceable for any reason, in whole or in part, then such provision shall be deemed modified, restricted, or reformulated to the extent and in the manner necessary to render the same valid and enforceable, or shall be deemed excised from this Agreement, as the case may require, and this Agreement shall be construed and enforced to the maximum extent permitted by law, as if such provision had been originally incorporated herein as so modified, restricted, or reformulated or as if such provision had not been originally incorporated herein, as the case may be. The parties further agree to seek a lawful substitute for any provision found to be unlawful; provided, that, if the parties are unable to agree upon a lawful substitute, the parties desire and request that a court or other authority called upon to decide the enforceability of this Agreement modify those restrictions in this Agreement that, once modified, will result in an agreement that is enforceable to the maximum extent permitted by the law in existence at the time of the requested enforcement.

23. Successors.

(a) This Agreement is personal to the Executive and without the prior written consent of the Company shall not be assignable by the Executive otherwise than by will or the laws of descent and distribution. This Agreement shall inure to the benefit of and be enforceable by the Executive's heirs and legal representatives.

(b) This Agreement shall inure to the benefit of and be binding upon the Company and its successors and assigns.

(c) The Company shall require any successor (whether direct or indirect, by purchase, merger, reorganization, consolidation, acquisition of property or stock, liquidation, or otherwise) to all or a substantial portion of its assets, by agreement in form and substance reasonably satisfactory to the Executive, expressly to assume and agree to perform this Agreement in the same manner and to the same extent that the Company would be required to perform this Agreement if no such succession had taken place. Regardless of whether such an agreement is executed, this Agreement shall be binding upon any successor of the Company in accordance with the operation of law, and such successor shall be deemed the "Company" for purposes of this Agreement.

(d) As used in this Agreement, the term "Company" shall include any successor to the Company's business and/or assets as aforesaid which assumes and agrees to perform this Agreement by operation of law, or otherwise.

24. Entire Agreement. This Agreement sets forth the entire and final agreement and understanding of the parties and contains all of the agreements made between the parties with respect to the subject matter hereof. This Agreement supersedes any and all other agreements, either oral or in writing, between the parties hereto, with respect to the subject matter hereof. No change or modification of this Agreement shall be valid unless in writing and signed by the Company and the Executive.

25. Survival. The obligations of the parties under Sections 7, 9, 11, 12, 13, 14, 16, 17, 22, 25 and 27 of this Agreement shall survive the termination of the Executive's employment with the Company during the Period of Agreement and the termination or expiration of the Period of Agreement.

26. Counterparts. This Agreement may be executed in several counterparts, each of which shall be considered an original, but which when taken together, shall constitute one agreement.

27. Conflict. In the case of conflict between the terms of this Agreement (the "Agreement Terms") and the provisions of any plan, policy, or practice of the Company as in effect from time to time (the "Standard Provisions"), the Executive's rights or the Company's obligations shall be established by whichever of the Agreement Terms or Standard Provisions would be more beneficial to the Executive.

[Signature Page Follows]

IN WITNESS WHEREOF, the parties have set their signatures as of the date first written above.

COMPANY:

WorldCom, Inc.,
a Georgia corporation

By: _____

Its: _____

EXECUTIVE:

_____

Appendix 1

OTHER COMPENSATION

There is no additional compensation for this Executive.

[1] Applicable to California residents.

Appendix 2

GENERAL RELEASE

WHEREAS, the employment of the undersigned ("Executive") is being terminated under circumstances making Executive eligible for severance benefits under Section [9 or 13] of the Employment Agreement between Executive and WorldCom, Inc., effective as of _____, 2004 (the "Employment Agreement") and Executive wishes to receive the benefits described in Section [9 or 13] of the Employment Agreement, benefits to which Executive is not entitled unless Executive executes a general release and waiver of claims.

NOW, THEREFORE, in consideration for the benefits described in Section [9 or 13] of the Employment Agreement, Executive hereby releases and discharges WorldCom, Inc., and any subsidiaries or affiliates thereof (collectively the "Company"), and their respective directors, officers, employees, benefit plans and administrators, successors and assigns from any and all claims, obligations, and liabilities, whether known or unknown, at law or in equity, arising out of Executive's employment with the Company and the termination thereof. This Release is to be broadly construed so as to resolve all pending or potential disputes including, but without limiting the generality of the foregoing, any and all claims under the Age Discrimination in Employment Act, as amended by the Older Workers Benefit Protection Act of 1990, Title VII of the Civil Rights Act of 1964, the Americans with Disabilities Act, the Employee Retirement Income Security Act of 1974, the Equal Pay Act, the Family and Medical Leave Act, the discrimination and wage payment laws of the state in which Executive rendered services to the Company, and any other statute, regulation, or ordinance, and any and all claims based upon alleged wrongful or retaliatory discharge, negligence, intentional infliction of emotional distress, defamation, invasion of privacy, other torts, harassment, employment discrimination or breach of contract (express or implied). Notwithstanding the foregoing, Executive does not waive any rights Executive may have to enforce the terms of Section [9 or 13] of the Employment Agreement, to benefits available after termination under any Company–sponsored employee benefit plan, to insurance protection and/or indemnification for actions taken by the Executive while an employee, officer and/or director of the Company or to make any claims for workers' compensation.

[Executive hereby expressly waives the benefit of California Civil Code Section 1542, which is set forth below, as well as any other statutory or common laws of like nature concerning the waiver of unknown claims, and specifically agrees that this general release shall extend to claims arising out of transactions occurring prior to the date of its signing which the Executive does not know or expect to exist in the Executive's favor at this time. California Civil Code Section 1542 provides:

> A general release does not extend to claims which the creditor does not know or suspect to exist in his favor at the time of executing the release, which if known by him must have materially affected his settlement with the debtor.][1]

Executive acknowledges and agrees that:

- Executive has read and understands this Release in its entirety;

- Executive has been advised in writing to consult with an attorney concerning this Release before signing it. This subparagraph constitutes such written advice;

- Executive has twenty–one (21) calendar days after receipt of this Release to consider its terms before signing it;

- Executive has the right to revoke this Release in full within seven (7) calendar days of executing it. Any revocation must be personally delivered to the Executive Vice President – Human Resources, or [his/her] designee, or mailed to WorldCom, Inc., [address], and postmarked within seven (7) calendar days

of the date of execution of this Release. None of the terms and provisions of this Release shall become effective or be enforceable until such revocation period has expired;

- Nothing contained in this Release waives any claim that may arise after the date of its execution; and

- Executive executes this Release knowingly and voluntarily, without duress or reservation of any kind, and after having given the matter full and careful consideration.

IN WITNESS WHEREOF, the Executive has executed this Release on the date indicated below and agrees to be bound hereby.

_____

(Signature)

_____

(Print full name)

_____

(Date)

Appendix 3

NON–DISCLOSURE, INTELLECTUAL PROPERTY ASSIGNMENT AND NON–SOLICITATION AGREEMENT

In order for MCI and its operating affiliates and subsidiaries (hereinafter collectively referred to as the "Company") to maintain a competitive edge, the Company must protect its confidential information and customer relationships.

Therefore, as a condition of employment or continued employment with the Company, I agree as follows:

DEFINITIONS

1. "Confidential Information" means information (i) disclosed to or known by me as a consequence of my employment with the Company, (ii) not generally known to others outside the Company, and (iii) which relates to the Company's business. Confidential Information includes but is not limited to the Company's trade secrets, equipment, equipment configuration, research, development efforts, methodologies, testing, engineering, manufacturing, marketing, sales, finances, operations, processes, formulas, methods, techniques, devices, software programs, projections, strategies and plans, personnel information, industry contacts made during my employment, and customer information, including customer needs, contacts, particular projects, and pricing.

2. "Inventions" means any new or useful art, discovery, new contribution, finding or improvement, whether or not patentable, and all know–how related thereto, made, developed or conceived by me (i) in the course of my employment, (ii) relating to the actual or anticipated business of the Company, or (iii) with the use of the Company's time, material, information or facilities.

3. "Works" means any materials for which copyright protection may be obtained, written, made, developed or conceived by me (i) in the course of my employment, (ii) relating to the actual or anticipated business of the Company, or (iii) with the use of the Company's time, material, information or facilities..

NONDISCLOSURE OF CONFIDENTIAL INFORMATION

4. I will not disclose or use any Confidential Information for the benefit of myself or another, unless directed or authorized in writing by the Company to do so, or until such time as the information becomes known to the public through no fault of mine. I will not disclose any Confidential Information to persons inside the Company who do not have a legitimate need to know the information. I will not make copies of Confidential Information except as reasonably necessary to the performance of my duties for the Company.

5. I understand that if I possess any proprietary information of another person or company as a result of prior employment or otherwise, the Company expects and requires that I will honor any and all legal obligations that I have to that person or company with respect to proprietary information, and I will refrain from any unauthorized use or disclosure of such information.

RETURN OF COMPANY PROPERTY

6. All documents and other tangible property relating in any way to the business of the Company are the exclusive property of the Company (even if I authored or created them). I agree to return all such documents and tangible property to the Company upon termination of employment or at such earlier time as the Company may request.

NON–SOLICITATION OF ACCOUNTS

7. During my employment with the Company and for one (1) year after termination of employment with the Company for any reason, I shall not directly or indirectly, provide products or services that are materially similar to the products or services provided by the Company to any customer of the Company with whom I

had direct contact in the course of my employment with the Company or about whom I learned Confidential Information as a result of my employment with the Company, nor will I solicit, induce, or attempt to induce such customers to: (a) stop doing business with or through the Company, or (b) do business with any other person, firm, partnership, corporation or other entity that provides products or services materially similar to those provided by the Company.

NON–SOLICITATION OF EMPLOYEES

8. During my employment and for one (1) year following termination of my employment with the Company for any reason, I shall not, directly or indirectly, assist in the hiring of, or induce or attempt to induce any person who is employed by the Company or was employed by the Company within the prior six months to terminate his/her relationship with the Company or to accept employment or affiliation with any firm or entity of which I am an employee, owner, partner or consultant.

DISCLOSURE AND ASSIGNMENT OF INVENTIONS AND WORKS

9. I will promptly disclose to the Company in writing, all Inventions and Works which are conceived, made, discovered, written or created by me alone or jointly with someone else on the Company's time or on my own time, while I am employed by the Company.

10. All Works created by me, alone or with others, shall be deemed "works made for hire" under the copyright laws and shall be owned by the Company.

11. I hereby assign to the Company all of my rights in all Inventions, and in all Works to the extent such Works may not, by operation of law, be works made for hire.

12. I will, without further compensation, give the Company all assistance it reasonably requires (whether during my employment or after my employment) to perfect, protect, and use its rights to Inventions and Works. In particular, I will sign all documents, do all things, and supply all information that the Company considers necessary or desirable to transfer or record the transfer of my entire right, title and interest in Inventions and Works; and to enable the Company to obtain patent, copyright, or other legal protection for Inventions and Works. Any out–of–pocket expenses will be paid by the Company.

13. An invention for which none of the Company's equipment, supplies, facilities, or Confidential Information was used and which was developed entirely on my own time is exempted from this Agreement so long as it: (1) does not relate in any way to the Company's business, or to the Company's actual or demonstrably anticipated research and development; and (b) does not result in any way from my work for the Company.

14. Also excluded from this Agreement are the following Inventions and Works which I own or control and which were conceived, made, written, or created by me prior to my employment with the Company.

(1) _____

_____

(2) _____

_____

(Attach additional sheets if necessary)

Other than these, I do not claim to own or control rights in any inventions or works subject to copyright and will not assert any such rights against the Company.

IRREPARABLE HARM

15. Irreparable harm would result from any breach by me of the provisions of this Agreement, and monetary damages alone would not provide adequate relief for any such breach. Accordingly, if I breach or threaten to breach this Agreement, injunctive relief in favor of the Company is proper, without the necessity of the

Company posting a bond. Moreover, any award of injunctive relief shall not preclude the Company from seeking or recovering any lawful compensatory damages which may have resulted from a breach of this Agreement, including a forfeiture of any payments not yet made to me and a return of any payments already received by me.

SEVERABILITY/MODIFICATION

16. If a provision of this Agreement is held invalid by a court of competent jurisdiction, the remaining provisions will nonetheless be enforceable according to their terms. Further, if any provision is held to be over broad as written, a court may modify that provision to the extent necessary to make the provision enforceable according to applicable law and enforce the provision as modified.

GOVERNING LAW

17. This Agreement shall be construed, interpreted and enforced in accordance with the internal laws of the State of Delaware.

BURDEN AND BENEFIT

18. The Company may assign its rights under this Agreement to any successor in interest, whether by merger, consolidation, sale of assets, or otherwise. This Agreement shall be binding whether it is between me and the Company or between me and any successor or assign of the Company.

NO EFFECT ON TERM OF EMPLOYMENT

19. Nothing in this Agreement prevents or limits my right to terminate my employment at any time for any reason, and nothing in this Agreement prevents or limits the Company from terminating my employment at any time for any reason. I understand and agree that there exist no promises or guarantees of permanent employment or employment for any specified term by the Company.

ENTIRE AGREEMENT

20. I understand that this Agreement contains the entire agreement and understanding between the Company and me with respect to the provisions contained in this Agreement, and that no representations, promises, agreements, or understandings, written or oral, related thereto which are not contained in this Agreement will be given any force or effect. No change or modification of this Agreement will be valid or binding unless it is in writing and signed by the party against whom the change or modification is sought to be enforced. I further understand that even if the Company waives or fails to enforce any provision of this Agreement in one instance, that will not constitute a waiver of any other provisions of this Agreement at this time, or a waiver of that provision at any other time.

ACKNOWLEDGEMENT

21. I hereby acknowledge and represent that I have fully read and understand this Agreement and that I consider all of the terms of my covenants and agreements set forth in this Agreement to be fair and reasonable and to be necessary to protect the Company's ongoing interests.

COMPANY	EMPLOYEE
_____	_____
By	Signature of Employee
_____	_____
Title	Date
_____	_____
Date	Address – Street
	_____
	Address – City, State, Zip Code

Appendix 4

ETHICS PLEDGE

[Attached]

EMPLOYMENT AGREEMENT

THIS EMPLOYMENT AGREEMENT (the "Agreement") is made and entered into effective as of April 2, 2004 (the "Effective Date"), by and between WorldCom, Inc., a Georgia corporation (the "Company"), and Wayne Huyard (the "Executive"). In consideration of the mutual covenants set forth herein, the Company and the Executive hereby agree as follows:

1. Position; Duties.

(a) During the Period of Agreement (as defined in Section 2), the Executive shall be employed as the President – U.S. Sales and Service of the Company. The Executive shall report directly to President and Chief Executive Officer. The Executive shall have the duties, responsibilities, powers, and authority customarily associated with the position of President – U.S. Sales and Service and shall perform such other and unrelated services and duties as may be assigned to the Executive from time to time by the President and Chief Executive Officer consistent with the Executive's position as President – U.S. Sales and Service.

(b) The Executive shall diligently, competently, and faithfully perform all duties, and shall devote the Executive's entire business time, energy, attention, and skill to the performance of duties for the Company and its subsidiaries and affiliates and will use the Executive's best efforts to promote the interests of the Company. It shall not be considered a violation of the foregoing for the Executive to serve on industry, civic, religious or charitable boards or committees, so long as such activities do not individually or in the aggregate significantly interfere with the performance of the Executive's responsibilities as an employee of the Company in accordance with this Agreement.

2. Term. The initial term of this Agreement shall commence on the Effective Date and continue through December 31, 2006, unless terminated prior to such date as provided at Section 8 hereof (the "Period of Agreement"). The Period of Agreement may be extended upon the written agreement of the parties as approved by the Board of Directors of the Company (the "Board"). Upon the expiration of the Period of Agreement, except as provided herein, this Agreement shall terminate, and any continuation of the Executive's employment with the Company thereafter shall be "at–will."

3. Base Salary. The Executive's annual base salary (the "Base Salary") shall be $700,000, which amount shall not be decreased except upon mutual consent or due to a decrease generally applicable to all senior executives of the Company. The Board or, if so delegated by the Board, the Compensation Committee shall review the Base Salary annually, but shall not have any obligation to increase such amount. No increase in the Executive's Base Salary may be implemented prior to review and approval by the Board or, if so delegated by the Board, the Compensation Committee. Any increase in Base Salary shall constitute the Executive's "Base Salary" thereafter under this Agreement. The Base Salary shall be payable in substantially equal installments in accordance with the Company's payroll policy in effect from time to time and shall be subject to any payroll or other deductions as may be required to be made pursuant to law, government or court order or by agreement with, or consent of, the Executive.

4. Bonus. The Executive shall be eligible to receive a bonus equal to 100% of the Executive's Base Salary for performance at target levels based upon performance standards, with smaller or greater bonus opportunities for performance below or above target levels, all as determined by the Board.

5. Benefits and Perquisites. The Executive shall be entitled to participate in such life insurance, disability, medical, dental, pension, profit sharing and retirement plans and other programs as may be made generally available from time to time by the Company for the benefit of executives at the Executive's level and its employees generally. The Company shall provide the Executive with such perquisites as are provided from time to time by the Company to its executives generally. The Executive shall be entitled to receive such other compensation, benefits and perquisites as set forth on Appendix 1 to this Agreement.

6. Expenses. The Company shall reimburse the Executive for all reasonable expenses reasonably incurred by the Executive in performing services hereunder, which are incurred and accounted for in accordance with the Company's policies and procedures applicable thereto.

7. Liability Insurance; Indemnification. The Company shall maintain officers' liability insurance coverage for Executive in reasonable amounts during the Period of Agreement and, for any act or omission occurring during the Period of Agreement, at all times thereafter for the duration of any period of limitations during which any action may be brought against the Executive, in the same amount and to the same extent as the Company covers members of the Board. The Executive shall be indemnified and held harmless to the fullest extent permitted under the Company's Articles of Incorporation, Bylaws, and applicable law, including the U.S. Bankruptcy Code (11 U.S.C. § 101 *et seq.*), from any and all claims, lawsuits, losses, damages, assessments, amounts paid in settlement, penalties, expenses, costs and liabilities of any kind or nature, including without limitation, court costs and reasonable attorneys' fees, which the Executive may sustain directly as a result of, or in connection with, any act or omission by the Company or its employees or any claim, suit or other proceeding brought or threatened by a third party (including but not limited to governmental or regulatory agencies or bodies) in connection with the Executive's employment with the Company or any subsidiary or affiliate thereof.

8. Termination of Employment.

(a) *Death or Disability.* The Period of Agreement shall terminate automatically upon the Executive's death. If the Company determines in good faith that the Disability of the Executive has occurred (pursuant to the definition of "Disability" set forth below), it may give to the Executive written notice of its intention to terminate the Executive's employment. In such event, the Period of Agreement and the Executive's employment with the Company shall terminate effective on the thirtieth (30th) day after receipt by the Executive of such notice given at any time after the date of the Executive's Disability, while such Disability is continuing ("Disability Effective Date"); provided that, within the thirty (30) days after such receipt, the Executive shall not have returned to full-time performance of the Executive's duties. For purposes of this Agreement, "Disability" means the completion of a period of the Executive's physical or mental incapacity which continues for not less than six (6) consecutive months or six (6) months in any twelve (12)-month period, as determined by a doctor mutually agreeable to the Executive and the Board. Until the Disability Effective Date, the Executive shall be entitled to all compensation provided for under this Agreement. It is understood that nothing in this Section 8(a) shall serve to limit the Company's obligations under Section 9(c) hereof.

(b) *By the Company for Cause.* The Company may terminate the Executive's employment and the Period of Agreement immediately for "Cause." For purposes of this Agreement, "Cause" means (i) the commission of (x) a felony or (y) a misdemeanor (excluding a petty misdemeanor) involving dishonesty, fraud, financial impropriety, or moral turpitude; (ii) any knowing or deliberate violation of a requirement of the Sarbanes-Oxley Act of 2002 or other material provision of the federal securities laws; (iii) willful neglect or willful misconduct in the discharge of the Executive's duties (after receiving written notice from the Board specifying the manner in which the Executive is alleged to have willfully failed properly to discharge the Executive's duties and after having had the opportunity to cure such failure within thirty (30) days from receipt of such notice), (iv) any willful conduct that could reasonably be anticipated to result in or materially contribute to (whether by act or by omission to act) a violation by the Company of the Permanent Injunction dated November 26, 2002 (the "Permanent Injunction") or other orders binding on the Company issued by the Honorable Jed S. Rakoff of the U.S. District Court of the Southern District of New York (the "Court"), or (v) material breach by the Executive of this Agreement, including any of the covenants contained herein. In the event that the Company asserts that grounds exist for termination with Cause, prior to such termination, it shall so notify the Executive and within fifteen (15) days shall afford the Executive a hearing before the Board regarding any disputed facts. The Board shall make a final determination regarding the existence of "Cause" upon completion of any such hearing, provided, however, that any determination that "Cause" exists shall require an affirmative vote of two-thirds (2/3) of the non-employee directors of the Company. If any such determination remains pending after such fifteen (15)-day period, the Company shall be entitled to suspend the Executive's duties (with full pay) pending determination of the existence of "Cause"; provided that such period of suspension shall not exceed thirty (30) days. The Executive's

acts or omissions shall not be "willful" if conducted in good faith and with a reasonable belief that such conduct was in the best interests of the Company.

(c) *By Executive for Good Reason.* The Executive may terminate Executive's employment and the Period of Agreement for Good Reason upon at least thirty (30) days' prior written notice from the Executive to the President and Chief Executive Officer of the Company. For purposes of this Agreement, "Good Reason" means, without the Executive's prior written consent, the occurrence of (i) a demotion or removal of the Executive from any of the Executive's positions, (ii) a material adverse change by the Company in the Executive's duties or responsibilities, (iii) a decrease in the Executive's Base Salary or the Company's failure to provide an opportunity to earn performance bonuses and other compensation as provided in Sections 4 and 5, above, and Section 10, below, or (iv) any other material breach of this Agreement by the Company which is not cured within thirty (30) days' prior written notice by the Executive to the Company specifying such breach. "Good Reason" does not include (A) any failure to extend the term of this Agreement at the conclusion of the Period of Agreement, (B) the failure of the Company to grant any annual equity award if established performance standards are satisfied, provided equivalent compensation is provided, (C) implementation of any changes in corporate governance required as part of the SEC settlement or any other actions by the Company to comply with the Permanent Injunction or any other order binding on the Company issued by the Court or to comply with any provision of law, or (D) any adverse change in compensation or benefits applicable to all senior executives which is proportionate to each such executive's compensation or benefits, as the case may be, immediately prior to such change. The Executive shall be required to make any assertion of "Good Reason" within 45 days of the events allegedly giving rise to "Good Reason".

(d) *Other than for Cause or Good Reason.* The Executive or the Company may terminate the Executive's employment and the Period of Agreement for any reason other than for Good Reason or other than for Cause, respectively, upon fifteen (15) days' prior written notice to the Company or Executive, as the case may be.

(e) *Notice of Termination.* Any termination of employment by the Company or by the Executive shall be communicated by a notice of termination to the other party hereto given in accordance with Section 19 of this Agreement (the "Notice of Termination"). For purposes of this Agreement, a "Notice of Termination" means a written notice which (i) indicates the specific termination provision in this Agreement relied upon, (ii) sets forth in reasonable detail, if necessary, the facts and circumstances claimed to provide a basis for termination of the Executive's employment under the provision so indicated, and (iii) if the Date of Termination (as defined below) is other than the date of receipt of such notice, specifies the termination date. The failure by the Executive or the Company to set forth in the Notice of Termination any fact or circumstance which contributes to a showing of the basis for termination shall not waive any right of such party hereunder or preclude such party from asserting such fact or circumstance in enforcing his/her or its rights hereunder.

(f) *Date of Termination.* "Date of Termination" means the date specified in the Notice of Termination; provided, however, that if the Executive's employment is terminated by reason of death or Disability, the Date of Termination shall be the date of death of the Executive or the Disability Effective Date, as the case may be.

9. Obligations of the Company Upon Termination. The following provisions describe the obligations of the Company to the Executive upon termination of the Executive's employment during the Period of Agreement. However, except as explicitly provided in this Agreement, nothing in this Agreement shall limit or otherwise adversely affect any rights which the Executive may have under applicable law, under any other written agreement with the Company, or under any compensation or benefit plan, program, policy or practice of the Company.

(a) *Termination not for Cause or for Good Reason.* If the Executive's employment is terminated during the Period of Agreement by Company not for Cause (and other than due to death or Disability) or by the Executive for Good Reason, the Executive shall, in lieu of any other severance benefits under the Company's severance plans, be entitled to the following:

(i) continuation of the Executive's then–current Base Salary and then –current target bonus for a period of two (2) years after the Date of Termination (the "Salary Continuation Period"), the Base Salary

component to be payable as set forth in Section 3, above, and the target bonus component to be payable in monthly installments equal to one–twelfth (1/12) of the Executive's then–current annual target bonus opportunity set forth in Section 4, above; provided that the sum of such payments shall not exceed the maximum amount permitted under the Company's Articles of Incorporation;

(ii) continued health coverage for the Executive and the Executive's eligible dependents at active employee rates for the Salary Continuation Period, with COBRA continuation to begin at the end of such period;

(iii) payment of all accrued but not yet paid Base Salary, accrued vacation, any earned and unpaid bonus for the previous year or other performance period, unreimbursed business expenses (in accordance with Company policy and procedures), and any accrued unpaid benefits under the Company's group benefit plans, payable through the Date of Termination (collectively, "Accrued Obligations"); and

(iv) a bonus (based upon actual performance) for the year (or other performance period) in which the Executive's termination occurs, prorated based on the number of days elapsed during said year (or other performance period) through the Date of Termination, payable at the time bonuses are paid to senior executives generally.

The Executive shall be entitled to the amounts and benefits under this Section 9(a) (other than Accrued Obligations) only upon the Executive's execution (without revocation) of a general release of all claims of the Executive that may be brought against the Company occurring through and including the release date in the form of Appendix 2 hereto (with such changes therein as may be necessary to make it valid and encompassing under applicable law).

(b) *Termination for Cause, for other than Good Reason or at the Expiration of the Period of Agreement.* If the Executive's employment is terminated during the Period of Agreement by the Company for Cause or by the Executive not for Good Reason, or if the Executive's employment is terminated by either party for any reason at the expiration of the Period of Agreement, the Executive will receive the Executive's Accrued Obligations through the Date of Termination (except to the extent subject to disgorgement under any applicable legal requirement). The Company shall be entitled to offset the amount due from the Executive of any repayments of compensation awarded hereunder against any amounts due to the Executive, without waiving or limiting the Company's rights to recover any excess amount due to it.

(c) *Termination Due to Death or Disability.* In the event of the Executive's death or termination of employment due to Disability during the Period of Agreement, the Executive's estate or the Executive, as the case may be, shall be entitled to receive the following:

(i) a bonus (based upon actual performance) for the year (or other performance period) in which the Executive's termination occurs, prorated based on the number of days elapsed during said year (or other performance period) through the Date of Termination, payable at the time bonuses are paid to senior executives generally;

(ii) payment of the Executive's Accrued Obligations; and

(iii) continued health coverage for the Executive and/or the Executive's eligible dependents, as applicable, at active employee rates for eighteen (18) months following the Date of Termination, which will run concurrently with COBRA.

10. Equity Awards. For each full calendar year during the Period of Agreement, the Executive shall be eligible at the targeted performance levels to receive an annual equity award commensurate with the Executive's position as determined by the Board in its discretion.

11. Treatment of Equity Awards on Termination. Upon the termination of Executive's employment, either during, at the expiration of, or after the Period of Agreement, the vesting of any unvested equity awards granted during the Period of Agreement shall be determined as follows:

(a) In the event of termination of the Executive's employment (i) by the Company not for Cause (and other than due to the Executive's death or Disability), or (ii) by the Executive for Good Reason, the Executive shall be deemed to be an active employee of the Company for two (2) years following the Date of Termination for purposes of determining the vesting of each such equity award.

(b) In the event of termination of the Executive's employment (i) by the Executive not for Good Reason or (ii) by the Company for Cause, any such equity awards that are unvested shall be forfeited.

(c) In the event of the Executive's death or termination due to Disability, any such equity awards that are unvested shall immediately fully vest.

12. Non–Competition.

(a) In the event that the Executive's employment is terminated for any reason during the Period of Agreement, but not at or after the expiration of the Period of Agreement, for a period of one (1) year after the Date of Termination, the Executive shall not become an employee, consultant, advisor, director or assume any other position or relationship with the following companies or their subsidiaries and affiliates: AT&T Corporation, SBC Communications, Inc., Sprint Corporation, Qwest, or Verizon Communications.

(b) The Executive agrees to, and shall, execute the Company's Non–Disclosure, Intellectual Property Assignment and Non–Solicitation Agreement, attached hereto as Appendix 3. The terms of the Non–Disclosure, Intellectual Property Assignment and Non–Solicitation Agreement are incorporated herein by this reference and shall survive any termination of the employment relationship created hereunder or the termination of the Period of Agreement.

(c) The Executive acknowledges that the Company has no adequate remedy at law and will be irreparably harmed if the Executive breaches or threatens to breach the provisions of this Section 12, and, therefore, agrees that the Company shall be entitled to injunctive relief to prevent any breach or threatened breach of this Section and that the Company shall be entitled to specific performance of the terms of this Section in addition to any other legal or equitable remedy it may have. Nothing in this Agreement shall be construed as prohibiting the Company from pursuing any other remedies at law or in equity that it may have or any other rights that it may have under any other agreement.

13. Change in Control.

(a) *Definition of "Change in Control."* The definition of Change in Control shall occur upon the occurrence of any one of the following events during the Period of Agreement:

(i) the sale, lease or transfer, in one or a series of related transactions, of all or substantially all of the assets of the Company and its Restricted Subsidiaries (as defined in the indentures pursuant to which senior notes of the Company are to be issued to certain of the Company's creditors in accordance with the Company's Modified Second Amended Joint Plan of Reorganization under chapter 11 of title 11 of the United States Code, as confirmed on October 31, 2003 by the United States Bankruptcy Court for the Southern District of New York) taken as a whole to any other "person" or "group," as that term is used in Section 13(d)(3) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), (other than the Company or any of its Restricted Subsidiaries), other than a creation of a holding company that does not involve a change in the beneficial ownership of the Company as a result of the transaction and other than a creation of a holding company that does not involve a change in the beneficial ownership of the Company as a result of the transaction;

(ii) the adoption of a plan relating to the liquidation or dissolution of the Company;

(iii) any "person" or "group" (as such terms are used in Sections 13(d) and 14(d) of the Exchange Act) is or becomes the "beneficial owner" (as defined in rules 13d–3 and 13d–5 under the Exchange Act (except that a person shall be deemed to have beneficial ownership of all shares that such Person has a right to acquire, whether such right is exercisable immediately or after 60 days), directly or indirectly of more than 50% of the voting power of the voting stock of the Company by way of purchase, merger or consolidation or otherwise;

(iv) the merger or consolidation with or into another Person or merger of another Person into the Company with the effect that immediately after that transaction the existing stockholders of the Company immediately before the transaction hold, directly or indirectly, less than 50% of the total voting power of all securities generally entitled to vote in the election of directors, managers or trustees of the Person surviving the merger or consolidation; or

(v) the first day on which a majority of the members of the Company's Board of Directors are not Continuing Directors. For purposes of the preceding clause (e), *"Continuing Directors"* means, as of any date of determination, any member of the Company's Board of Directors who: (i) was a member of the Company's Board of Directors on the Effective Date; or (ii) was nominated for election or elected to the Company's Board of Directors with the affirmative vote of, or whose election or appointment was otherwise approved or ratified (whether before or after nomination or election) by, at least a majority of the Continuing Directors who were members of the Company's Board of Directors at the time of the nomination, election or approval, as applicable.

(b) Upon a Change in Control described in Section 13(a)(i), above, all equity awards granted to the Executive shall immediately fully vest and any restrictions on disposition of vested stock or the payment of any deferred stock units shall lapse.

(c) *Impact of Termination by Company or the Executive During Protection Period.* If the Executive's employment is terminated by the Company not for Cause (and other than due to death or Disability) or by the Executive for Good Reason within the two (2)–year period immediately following a Change in Control of the Company (regardless of whether the Period of Agreement would have otherwise expired without the occurrence of a Change in Control) or in the event the Executive's employment is terminated within six (6) months prior to and in anticipation of a Change in Control or is demonstrated to be at the request of a third party that had taken steps reasonably calculated to effect a Change in Control, the Executive shall, in lieu of any other severance benefits and in lieu of benefits provided under Section 9(a), be entitled to the following:

(i) a lump sum payment, to be made within thirty (30) days of the Date of Termination, equal to two (2) times the sum of the Executive's then–current Base Salary and then–current target bonus;

(ii) continued health coverage for the Executive and the Executive's eligible dependents at active employee rates for two (2) years, with COBRA continuation to begin at the end of such period;

(iii) payment of all Accrued Obligations;

(iv) a bonus (based upon actual performance) for the year (or other performance period) in which the Executive's termination occurs, prorated based on the number of days elapsed during said year (or other performance period) through the Date of Termination, payable at the time bonuses are paid to senior executives generally;

(v) all unvested equity awards shall immediately vest and any restrictions on disposition of vested stock or on the payment of any deferred stock units shall lapse;

(vi) any deferred compensation shall become payable;

(vii) any amounts "earned" under other incentive plans that have not vested will vest and become payable as follows: (A) if based upon objective factors that can reasonably be determined, payment shall be

based upon actual performance for such period or, if actual performance cannot be determined, pro–rated based on the relevant period of service, and (B) if any other factors or performance measures cannot reasonably be determined, payment shall be at target, pro–rated based on the relevant period of service; and

(viii) the Executive shall receive two (2) years of service and age credit for vesting and eligibility (but not accrual) purposes under Company retirement or welfare programs and other benefit programs, payable outside plans to the extent that the Executive is not eligible for such payment under the terms of such plans, and two (2) years of welfare program coverage at active employee rates.

The Executive shall be entitled to the amounts and benefits under this Section 13(c) (other than Accrued Obligations) only upon the Executive's execution (without revocation) of a general release of all claims of the Executive that may be brought against the Company occurring through and including the release date in the form of Appendix 2 hereto (with such changes therein as may be necessary to make it valid and encompassing under applicable law).

(d) *Parachute Gross–Up*. In the event that the aggregate of all payments or benefits made or provided to, or that may be made or provided to, the Executive under this Agreement and under all other plans, programs and arrangements of the Company (the "Aggregate Payment") is determined to constitute an "excess parachute payment," as such term is defined in Section 280G(b) of the Internal Revenue Code, the Company shall pay to the Executive prior to the time any excise tax imposed by Section 4999 of the Internal Revenue Code ("Excise Tax") is payable with respect to such Aggregate Payment, an additional amount which, after the imposition of all income and excise taxes thereon, is equal to the Excise Tax on the Aggregate Payment. The determination of whether the Aggregate Payment constitutes an excess parachute payment and, if so, the amount to be provided to the Executive and the time of payment pursuant to this Section 13(d) shall be made by an independent auditor (the "Auditor") selected jointly by the Company and the Executive and paid by the Company. The Auditor shall be a nationally recognized United States public accounting firm which has not, during the two (2) years preceding the date of its selection, acted in any way on behalf of the Company or any affiliate thereof. If the Executive and the Company cannot agree on the firm to serve as the Auditor, then the Executive and the Company shall each select one accounting firm and those two firms shall jointly select the accounting firm to serve as the Auditor. Notwithstanding the foregoing, in the event that the amount of the Executive's Excise Tax liability is subsequently determined to be greater than the Excise Tax liability with respect to which any initial payment to the Executive under this Section 13(d) has been made, the Company shall pay to the Executive an additional amount (grossed up for all taxes) with respect to such additional Excise Tax (and any interest and penalties thereon) at the time and in the amount reasonably determined by the Auditor. Similarly, if the amount of the Executive's Excise Tax liability is subsequently determined to be less than the Excise Tax liability with respect to which any prior payment to the Executive has been made under this Section 13(d), the Executive shall refund to the Company the excess amount received, after reduction for any nonrefundable tax, penalties and/or interest incurred by the Executive in connection with the receipt of such excess, and such refund shall be paid promptly after the Executive has received any corresponding refund of excess Excise Tax paid to the Internal Revenue Service. The Executive and the Company shall cooperate with each other in connection with any proceeding or claim relating to the existence or amount of liability for Excise Tax, and all expenses incurred by the Executive in connection therewith shall be paid by the Company promptly upon notice of demand from the Executive.

14. Dispute Resolution. In the event of any dispute between the Company and the Executive, whether arising out of or relating to this Agreement, the breach of this Agreement, or otherwise, including without limitation if the Executive shall assert the existence of Good Reason or any other breach of this Agreement and the Company shall disagree as to the existence of Good Reason or any other asserted breach, the Executive and the Company hereby agree that such dispute shall be resolved by binding arbitration administered by the American Arbitration Association ("AAA") in accordance with its Commercial Arbitration Rules then in effect, and judgment on the award rendered by the arbitrator may be entered in any court having jurisdiction thereof. Any arbitration shall be held before a single arbitrator who shall be selected by the mutual agreement of the Company and the Executive, unless the parties are unable to agree to an arbitrator, in which case, the arbitrator will be selected under the

procedures of the AAA. The arbitrator shall have the authority to award any remedy or relief that a court of competent jurisdiction could order or grant, including, without limitation, the issuance of an injunction, and the parties hereby agree to the emergency procedures of the AAA. However, either party may, without inconsistency with this arbitration provision, apply to any court having jurisdiction over such dispute or controversy and seek interim provisional, injunctive or other equitable relief until the arbitration award is rendered or the controversy is otherwise resolved. Except as necessary in court proceedings to enforce this arbitration provision or an award rendered hereunder, or to obtain interim relief, neither a party nor an arbitrator may disclose the existence, content or results of any arbitration hereunder without the prior written consent of the Company and the Executive. The arbitration proceeding shall be conducted in the Washington, D.C. metropolitan area. In the event of any such proceeding, the losing party shall reimburse the prevailing party upon entry of a final award resolving the subject of the dispute for all reasonable legal expenses incurred, unless the arbitrator determines that to do so would be unjust. This Agreement shall be governed by the substantive provisions of the laws of the State of Delaware.

15. Mutual Cooperation. The parties agree to take reasonable steps (without cost to the Executive) to minimize the Company's tax obligations with respect to annual compensation.

16. Undertaking. Attached hereto as Appendix 4 is a letter constituting an ethics pledge signed by the Executive, which shall be an integral part of this Agreement.

17. Cooperation with Ongoing Investigations. The Executive agrees that the Executive will fully cooperate, and will cause and direct the persons under the Executive's management direction employed by, or consultants or agents to, the Company to cooperate fully, with all governmental investigations of the Company and all orders entered by the Court.

18. Withholding. Anything in this Agreement to the contrary notwithstanding, all payments required to be made by the Company hereunder to the Executive shall be subject to withholding, at the time payments are actually made to the Executive and received by the Executive, of such amounts relating to taxes as the Company may reasonably determine it should withhold pursuant to any applicable law or regulation. In lieu of withholding such amounts, in whole or in part, the Company may, in its sole discretion, accept other provision for payment of taxes as required by law, provided that it is satisfied that all requirements of law as to its responsibilities to withhold such taxes have been satisfied.

19. Notices. Any and all notices required in connection with this Agreement shall be deemed adequately given only if in writing and (a) personally delivered, or sent by first class, registered or certified mail, postage prepaid, return receipt requested, or by recognized overnight courier, (b) sent by facsimile, provided a hard copy is mailed on that date to the party for whom such notices are intended, or (c) sent by other means at least as fast and reliable as first class mail. A written notice shall be deemed to have been given to the recipient party on the earlier of (a) the date it shall be delivered to the address required by this Agreement; (b) the date delivery shall have been refused at the address required by this Agreement; (c) with respect to notices sent by mail or overnight courier, the date as of which the Postal Service or overnight courier, as the case may be, shall have indicated such notice to be undeliverable at the address required by this Agreement; or (d) with respect to a facsimile, the date on which the facsimile is sent and receipt of which is confirmed. Any and all notices referred to in this Agreement, or which either party desires to give to the other, shall be addressed to the Executive's residence in the case of the Executive, or to its principal office in the case of the Company.

20. Waiver of Breach. A waiver by the Company of a breach of any provision of this Agreement by the Executive shall not operate or be construed as a waiver or estoppel of any subsequent breach by the Executive. No waiver shall be valid unless in writing and signed by an authorized officer of the Company.

21. Headings. The headings in this Agreement are inserted for convenience only and are not to be considered a construction of the provisions hereof.

22. Severability. If any provision of this Agreement shall be found invalid or unenforceable for any reason, in whole or in part, then such provision shall be deemed modified, restricted, or reformulated to the extent and in the manner necessary to render the same valid and enforceable, or shall be deemed excised from this Agreement, as the case may require, and this Agreement shall be construed and enforced to the maximum extent permitted by law, as if such provision had been originally incorporated herein as so modified, restricted, or reformulated or as if such provision had not been originally incorporated herein, as the case may be. The parties further agree to seek a lawful substitute for any provision found to be unlawful; provided, that, if the parties are unable to agree upon a lawful substitute, the parties desire and request that a court or other authority called upon to decide the enforceability of this Agreement modify those restrictions in this Agreement that, once modified, will result in an agreement that is enforceable to the maximum extent permitted by the law in existence at the time of the requested enforcement.

23. Successors.

(a) This Agreement is personal to the Executive and without the prior written consent of the Company shall not be assignable by the Executive otherwise than by will or the laws of descent and distribution. This Agreement shall inure to the benefit of and be enforceable by the Executive's heirs and legal representatives.

(b) This Agreement shall inure to the benefit of and be binding upon the Company and its successors and assigns.

(c) The Company shall require any successor (whether direct or indirect, by purchase, merger, reorganization, consolidation, acquisition of property or stock, liquidation, or otherwise) to all or a substantial portion of its assets, by agreement in form and substance reasonably satisfactory to the Executive, expressly to assume and agree to perform this Agreement in the same manner and to the same extent that the Company would be required to perform this Agreement if no such succession had taken place. Regardless of whether such an agreement is executed, this Agreement shall be binding upon any successor of the Company in accordance with the operation of law, and such successor shall be deemed the "Company" for purposes of this Agreement.

(d) As used in this Agreement, the term "Company" shall include any successor to the Company's business and/or assets as aforesaid which assumes and agrees to perform this Agreement by operation of law, or otherwise.

24. Entire Agreement. This Agreement sets forth the entire and final agreement and understanding of the parties and contains all of the agreements made between the parties with respect to the subject matter hereof. This Agreement supersedes any and all other agreements, either oral or in writing, between the parties hereto, with respect to the subject matter hereof. No change or modification of this Agreement shall be valid unless in writing and signed by the Company and the Executive.

25. Survival. The obligations of the parties under Sections 7, 9, 11, 12, 13, 14, 16, 17, 22, 25 and 27 of this Agreement shall survive the termination of the Executive's employment with the Company during the Period of Agreement and the termination or expiration of the Period of Agreement.

26. Counterparts. This Agreement may be executed in several counterparts, each of which shall be considered an original, but which when taken together, shall constitute one agreement.

27. Conflict. In the case of conflict between the terms of this Agreement (the "Agreement Terms") and the provisions of any plan, policy, or practice of the Company as in effect from time to time (the "Standard Provisions"), the Executive's rights or the Company's obligations shall be established by whichever of the Agreement Terms or Standard Provisions would be more beneficial to the Executive.

[Signature Page Follows]

IN WITNESS WHEREOF, the parties have set their signatures as of the date first written above.

COMPANY:

WorldCom, Inc.,
a Georgia corporation

_____

By: _____

Its: _____

EXECUTIVE:

_____

Appendix 1

OTHER COMPENSATION

There is no additional compensation for this Executive.

Appendix 2

GENERAL RELEASE

WHEREAS, the employment of the undersigned ("Executive") is being terminated under circumstances making Executive eligible for severance benefits under Section [9 or 13] of the Employment Agreement between Executive and WorldCom, Inc., effective as of _____, 2004 (the "Employment Agreement") and Executive wishes to receive the benefits described in Section [9 or 13] of the Employment Agreement, benefits to which Executive is not entitled unless Executive executes a general release and waiver of claims.

NOW, THEREFORE, in consideration for the benefits described in Section [9 or 13] of the Employment Agreement, Executive hereby releases and discharges WorldCom, Inc., and any subsidiaries or affiliates thereof (collectively the "Company"), and their respective directors, officers, employees, benefit plans and administrators, successors and assigns from any and all claims, obligations, and liabilities, whether known or unknown, at law or in equity, arising out of Executive's employment with the Company and the termination thereof. This Release is to be broadly construed so as to resolve all pending or potential disputes including, but without limiting the generality of the foregoing, any and all claims under the Age Discrimination in Employment Act, as amended by the Older Workers Benefit Protection Act of 1990, Title VII of the Civil Rights Act of 1964, the Americans with Disabilities Act, the Employee Retirement Income Security Act of 1974, the Equal Pay Act, the Family and Medical Leave Act, the discrimination and wage payment laws of the state in which Executive rendered services to the Company, and any other statute, regulation, or ordinance, and any and all claims based upon alleged wrongful or retaliatory discharge, negligence, intentional infliction of emotional distress, defamation, invasion of privacy, other torts, harassment, employment discrimination or breach of contract (express or implied). Notwithstanding the foregoing, Executive does not waive any rights Executive may have to enforce the terms of Section [9 or 13] of the Employment Agreement, to benefits available after termination under any Company–sponsored employee benefit plan, to insurance protection and/or indemnification for actions taken by the Executive while an employee, officer and/or director of the Company or to make any claims for workers' compensation.

[Executive hereby expressly waives the benefit of California Civil Code Section 1542, which is set forth below, as well as any other statutory or common laws of like nature concerning the waiver of unknown claims, and specifically agrees that this general release shall extend to claims arising out of transactions occurring prior to the date of its signing which the Executive does not know or expect to exist in the Executive's favor at this time. California Civil Code Section 1542 provides:

> A general release does not extend to claims which the creditor does not know or suspect to exist in his favor at the time of executing the release, which if known by him must have materially affected his settlement with the debtor.][1]

Executive acknowledges and agrees that:

- Executive has read and understands this Release in its entirety;

- Executive has been advised in writing to consult with an attorney concerning this Release before signing it. This subparagraph constitutes such written advice;

- Executive has twenty–one (21) calendar days after receipt of this Release to consider its terms before signing it;

- Executive has the right to revoke this Release in full within seven (7) calendar days of executing it. Any revocation must be personally delivered to the Executive Vice President – Human Resources, or [his/her] designee, or mailed to WorldCom, Inc., [address], and postmarked within seven (7) calendar days

---

[1] Applicable to California residents.

of the date of execution of this Release. None of the terms and provisions of this Release shall become effective or be enforceable until such revocation period has expired;

- Nothing contained in this Release waives any claim that may arise after the date of its execution; and

- Executive executes this Release knowingly and voluntarily, without duress or reservation of any kind, and after having given the matter full and careful consideration.

IN WITNESS WHEREOF, the Executive has executed this Release on the date indicated below and agrees to be bound hereby.

_____

(Signature)

_____

(Print full name)

_____

(Date)

Appendix 3

NON–DISCLOSURE, INTELLECTUAL PROPERTY ASSIGNMENT AND NON–SOLICITATION AGREEMENT

In order for MCI and its operating affiliates and subsidiaries (hereinafter collectively referred to as the "Company") to maintain a competitive edge, the Company must protect its confidential information and customer relationships.

Therefore, as a condition of employment or continued employment with the Company, I agree as follows:

DEFINITIONS

1. "Confidential Information" means information (i) disclosed to or known by me as a consequence of my employment with the Company, (ii) not generally known to others outside the Company, and (iii) which relates to the Company's business. Confidential Information includes but is not limited to the Company's trade secrets, equipment, equipment configuration, research, development efforts, methodologies, testing, engineering, manufacturing, marketing, sales, finances, operations, processes, formulas, methods, techniques, devices, software programs, projections, strategies and plans, personnel information, industry contacts made during my employment, and customer information, including customer needs, contacts, particular projects, and pricing.

2. "Inventions" means any new or useful art, discovery, new contribution, finding or improvement, whether or not patentable, and all know–how related thereto, made, developed or conceived by me (i) in the course of my employment, (ii) relating to the actual or anticipated business of the Company, or (iii) with the use of the Company's time, material, information or facilities.

3. "Works" means any materials for which copyright protection may be obtained, written, made, developed or conceived by me (i) in the course of my employment, (ii) relating to the actual or anticipated business of the Company, or (iii) with the use of the Company's time, material, information or facilities..

NONDISCLOSURE OF CONFIDENTIAL INFORMATION

4. I will not disclose or use any Confidential Information for the benefit of myself or another, unless directed or authorized in writing by the Company to do so, or until such time as the information becomes known to the public through no fault of mine. I will not disclose any Confidential Information to persons inside the Company who do not have a legitimate need to know the information. I will not make copies of Confidential Information except as reasonably necessary to the performance of my duties for the Company.

5. I understand that if I possess any proprietary information of another person or company as a result of prior employment or otherwise, the Company expects and requires that I will honor any and all legal obligations that I have to that person or company with respect to proprietary information, and I will refrain from any unauthorized use or disclosure of such information.

RETURN OF COMPANY PROPERTY

6. All documents and other tangible property relating in any way to the business of the Company are the exclusive property of the Company (even if I authored or created them). I agree to return all such documents and tangible property to the Company upon termination of employment or at such earlier time as the Company may request.

NON–SOLICITATION OF ACCOUNTS

7. During my employment with the Company and for one (1) year after termination of employment with the Company for any reason, I shall not directly or indirectly, provide products or services that are materially similar to the products or services provided by the Company to any customer of the Company with whom I

had direct contact in the course of my employment with the Company or about whom I learned Confidential Information as a result of my employment with the Company, nor will I solicit, induce, or attempt to induce such customers to: (a) stop doing business with or through the Company, or (b) do business with any other person, firm, partnership, corporation or other entity that provides products or services materially similar to those provided by the Company.

NON–SOLICITATION OF EMPLOYEES

8. During my employment and for one (1) year following termination of my employment with the Company for any reason, I shall not, directly or indirectly, assist in the hiring of, or induce or attempt to induce any person who is employed by the Company or was employed by the Company within the prior six months to terminate his/her relationship with the Company or to accept employment or affiliation with any firm or entity of which I am an employee, owner, partner or consultant.

DISCLOSURE AND ASSIGNMENT OF INVENTIONS AND WORKS

9. I will promptly disclose to the Company in writing, all Inventions and Works which are conceived, made, discovered, written or created by me alone or jointly with someone else on the Company's time or on my own time, while I am employed by the Company.

10. All Works created by me, alone or with others, shall be deemed "works made for hire" under the copyright laws and shall be owned by the Company.

11. I hereby assign to the Company all of my rights in all Inventions, and in all Works to the extent such Works may not, by operation of law, be works made for hire.

12. I will, without further compensation, give the Company all assistance it reasonably requires (whether during my employment or after my employment) to perfect, protect, and use its rights to Inventions and Works. In particular, I will sign all documents, do all things, and supply all information that the Company considers necessary or desirable to transfer or record the transfer of my entire right, title and interest in Inventions and Works; and to enable the Company to obtain patent, copyright, or other legal protection for Inventions and Works. Any out–of–pocket expenses will be paid by the Company.

13. An invention for which none of the Company's equipment, supplies, facilities, or Confidential Information was used and which was developed entirely on my own time is exempted from this Agreement so long as it: (1) does not relate in any way to the Company's business, or to the Company's actual or demonstrably anticipated research and development; and (b) does not result in any way from my work for the Company.

14. Also excluded from this Agreement are the following Inventions and Works which I own or control and which were conceived, made, written, or created by me prior to my employment with the Company.

(1) _____

_____

(2) _____

_____

(Attach additional sheets if necessary)

Other than these, I do not claim to own or control rights in any inventions or works subject to copyright and will not assert any such rights against the Company.

IRREPARABLE HARM

15. Irreparable harm would result from any breach by me of the provisions of this Agreement, and monetary damages alone would not provide adequate relief for any such breach. Accordingly, if I breach or threaten to breach this Agreement, injunctive relief in favor of the Company is proper, without the necessity of the Company posting a bond. Moreover, any award of injunctive relief shall not preclude the Company from seeking or recovering any lawful compensatory damages which may have resulted from a breach of this Agreement, including a forfeiture of any payments not yet made to me and a return of any payments already received by me.

SEVERABILITY/MODIFICATION

16. If a provision of this Agreement is held invalid by a court of competent jurisdiction, the remaining provisions will nonetheless be enforceable according to their terms. Further, if any provision is held to be over broad as written, a court may modify that provision to the extent necessary to make the provision enforceable according to applicable law and enforce the provision as modified.

GOVERNING LAW

17. This Agreement shall be construed, interpreted and enforced in accordance with the internal laws of the State of Delaware.

BURDEN AND BENEFIT

18. The Company may assign its rights under this Agreement to any successor in interest, whether by merger, consolidation, sale of assets, or otherwise. This Agreement shall be binding whether it is between me and the Company or between me and any successor or assign of the Company.

NO EFFECT ON TERM OF EMPLOYMENT

19. Nothing in this Agreement prevents or limits my right to terminate my employment at any time for any reason, and nothing in this Agreement prevents or limits the Company from terminating my employment at any time for any reason. I understand and agree that there exist no promises or guarantees of permanent employment or employment for any specified term by the Company.

ENTIRE AGREEMENT

20. I understand that this Agreement contains the entire agreement and understanding between the Company and me with respect to the provisions contained in this Agreement, and that no representations, promises, agreements, or understandings, written or oral, related thereto which are not contained in this Agreement will be given any force or effect. No change or modification of this Agreement will be valid or binding unless it is in writing and signed by the party against whom the change or modification is sought to be enforced. I further understand that even if the Company waives or fails to enforce any provision of this Agreement in one instance, that will not constitute a waiver of any other provisions of this Agreement at this time, or a waiver of that provision at any other time.

ACKNOWLEDGEMENT

21. I hereby acknowledge and represent that I have fully read and understand this Agreement and that I consider all of the terms of my covenants and agreements set forth in this Agreement to be fair and reasonable and to be necessary to protect the Company's ongoing interests.

COMPANY	EMPLOYEE
_____	_____
By	Signature of Employee
_____	_____
Title	Date
_____	_____
Date	Address – Street
	_____
	Address – City, State, Zip Code

Appendix 4

ETHICS PLEDGE

[Attached]

EMPLOYMENT AGREEMENT

THIS EMPLOYMENT AGREEMENT (the "Agreement") is made and entered into effective as of April 2, 2004 (the "Effective Date"), by and between WorldCom, Inc., a Georgia corporation (the "Company"), and Anastasia Kelly (the "Executive"). In consideration of the mutual covenants set forth herein, the Company and the Executive hereby agree as follows:

1. Position; Duties.

(a) During the Period of Agreement (as defined in Section 2), the Executive shall be employed as the Executive Vice President and General Counsel of the Company. The Executive shall report directly to President and Chief Executive Officer. The Executive shall have the duties, responsibilities, powers, and authority customarily associated with the position of Executive Vice President and General Counsel and shall perform such other and unrelated services and duties as may be assigned to the Executive from time to time by the President and Chief Executive Officer consistent with the Executive's position as Executive Vice President and General Counsel.

(b) The Executive shall diligently, competently, and faithfully perform all duties, and shall devote the Executive's entire business time, energy, attention, and skill to the performance of duties for the Company and its subsidiaries and affiliates and will use the Executive's best efforts to promote the interests of the Company. It shall not be considered a violation of the foregoing for the Executive to serve on industry, civic, religious or charitable boards or committees, so long as such activities do not individually or in the aggregate significantly interfere with the performance of the Executive's responsibilities as an employee of the Company in accordance with this Agreement.

2. Term. The initial term of this Agreement shall commence on the Effective Date and continue through December 31, 2006, unless terminated prior to such date as provided at Section 8 hereof (the "Period of Agreement"). The Period of Agreement may be extended upon the written agreement of the parties as approved by the Board of Directors of the Company (the "Board"). Upon the expiration of the Period of Agreement, except as provided herein, this Agreement shall terminate, and any continuation of the Executive's employment with the Company thereafter shall be "at–will."

3. Base Salary. The Executive's annual base salary (the "Base Salary") shall be $650,000, which amount shall not be decreased except upon mutual consent or due to a decrease generally applicable to all senior executives of the Company. The Board or, if so delegated by the Board, the Compensation Committee shall review the Base Salary annually, but shall not have any obligation to increase such amount. No increase in the Executive's Base Salary may be implemented prior to review and approval by the Board or, if so delegated by the Board, the Compensation Committee. Any increase in Base Salary shall constitute the Executive's "Base Salary" thereafter under this Agreement. The Base Salary shall be payable in substantially equal installments in accordance with the Company's payroll policy in effect from time to time and shall be subject to any payroll or other deductions as may be required to be made pursuant to law, government or court order or by agreement with, or consent of, the Executive.

4. Bonus. The Executive shall be eligible to receive a bonus equal to 75% of the Executive's Base Salary for performance at target levels based upon performance standards, with smaller or greater bonus opportunities for performance below or above target levels, all as determined by the Board.

5. Benefits and Perquisites. The Executive shall be entitled to participate in such life insurance, disability, medical, dental, pension, profit sharing and retirement plans and other programs as may be made generally available from time to time by the Company for the benefit of executives at the Executive's level and its employees generally. The Company shall provide the Executive with such perquisites as are provided from time to time by the Company to its executives generally. The Executive shall be entitled to receive such other compensation, benefits and perquisites as set forth on Appendix 1 to this Agreement.

6. Expenses. The Company shall reimburse the Executive for all reasonable expenses reasonably incurred by the Executive in performing services hereunder, which are incurred and accounted for in accordance with the Company's policies and procedures applicable thereto.

7. Liability Insurance; Indemnification. The Company shall maintain officers' liability insurance coverage for Executive in reasonable amounts during the Period of Agreement and, for any act or omission occurring during the Period of Agreement, at all times thereafter for the duration of any period of limitations during which any action may be brought against the Executive, in the same amount and to the same extent as the Company covers members of the Board. The Executive shall be indemnified and held harmless to the fullest extent permitted under the Company's Articles of Incorporation, Bylaws, and applicable law, including the U.S. Bankruptcy Code (11 U.S.C. § 101 *et seq.*), from any and all claims, lawsuits, losses, damages, assessments, amounts paid in settlement, penalties, expenses, costs and liabilities of any kind or nature, including without limitation, court costs and reasonable attorneys' fees, which the Executive may sustain directly as a result of, or in connection with, any act or omission by the Company or its employees or any claim, suit or other proceeding brought or threatened by a third party (including but not limited to governmental or regulatory agencies or bodies) in connection with the Executive's employment with the Company or any subsidiary or affiliate thereof.

8. Termination of Employment.

(a) *Death or Disability.* The Period of Agreement shall terminate automatically upon the Executive's death. If the Company determines in good faith that the Disability of the Executive has occurred (pursuant to the definition of "Disability" set forth below), it may give to the Executive written notice of its intention to terminate the Executive's employment. In such event, the Period of Agreement and the Executive's employment with the Company shall terminate effective on the thirtieth (30th) day after receipt by the Executive of such notice given at any time after the date of the Executive's Disability, while such Disability is continuing ("Disability Effective Date"); provided that, within the thirty (30) days after such receipt, the Executive shall not have returned to full-time performance of the Executive's duties. For purposes of this Agreement, "Disability" means the completion of a period of the Executive's physical or mental incapacity which continues for not less than six (6) consecutive months or six (6) months in any twelve (12)-month period, as determined by a doctor mutually agreeable to the Executive and the Board. Until the Disability Effective Date, the Executive shall be entitled to all compensation provided for under this Agreement. It is understood that nothing in this Section 8(a) shall serve to limit the Company's obligations under Section 9(c) hereof.

(b) *By the Company for Cause.* The Company may terminate the Executive's employment and the Period of Agreement immediately for "Cause." For purposes of this Agreement, "Cause" means (i) the commission of (x) a felony or (y) a misdemeanor (excluding a petty misdemeanor) involving dishonesty, fraud, financial impropriety, or moral turpitude; (ii) any knowing or deliberate violation of a requirement of the Sarbanes-Oxley Act of 2002 or other material provision of the federal securities laws; (iii) willful neglect or willful misconduct in the discharge of the Executive's duties (after receiving written notice from the Board specifying the manner in which the Executive is alleged to have willfully failed properly to discharge the Executive's duties and after having had the opportunity to cure such failure within thirty (30) days from receipt of such notice), (iv) any willful conduct that could reasonably be anticipated to result in or materially contribute to (whether by act or by omission to act) a violation by the Company of the Permanent Injunction dated November 26, 2002 (the "Permanent Injunction") or other orders binding on the Company issued by the Honorable Jed S. Rakoff of the U.S. District Court of the Southern District of New York (the "Court"), or (v) material breach by the Executive of this Agreement, including any of the covenants contained herein. In the event that the Company asserts that grounds exist for termination with Cause, prior to such termination, it shall so notify the Executive and within fifteen (15) days shall afford the Executive a hearing before the Board regarding any disputed facts. The Board shall make a final determination regarding the existence of "Cause" upon completion of any such hearing, provided, however, that any determination that "Cause" exists shall require an affirmative vote of two-thirds (2/3) of the non-employee directors of the Company. If any such determination remains pending after such fifteen (15)-day period, the Company shall be entitled to suspend the Executive's duties (with full pay) pending determination of the existence of "Cause"; provided that such period of suspension shall not exceed thirty (30) days. The Executive's

acts or omissions shall not be "willful" if conducted in good faith and with a reasonable belief that such conduct was in the best interests of the Company.

(c) *By Executive for Good Reason.* The Executive may terminate Executive's employment and the Period of Agreement for Good Reason upon at least thirty (30) days' prior written notice from the Executive to the President and Chief Executive Officer of the Company. For purposes of this Agreement, "Good Reason" means, without the Executive's prior written consent, the occurrence of (i) a demotion or removal of the Executive from any of the Executive's positions, (ii) a material adverse change by the Company in the Executive's duties or responsibilities, (iii) a decrease in the Executive's Base Salary or the Company's failure to provide an opportunity to earn performance bonuses and other compensation as provided in Sections 4 and 5, above, and Section 10, below, or (iv) any other material breach of this Agreement by the Company which is not cured within thirty (30) days' prior written notice by the Executive to the Company specifying such breach. "Good Reason" does not include (A) any failure to extend the term of this Agreement at the conclusion of the Period of Agreement, (B) the failure of the Company to grant any annual equity award if established performance standards are satisfied, provided equivalent compensation is provided, (C) implementation of any changes in corporate governance required as part of the SEC settlement or any other actions by the Company to comply with the Permanent Injunction or any other order binding on the Company issued by the Court or to comply with any provision of law, or (D) any adverse change in compensation or benefits applicable to all senior executives which is proportionate to each such executive's compensation or benefits, as the case may be, immediately prior to such change. The Executive shall be required to make any assertion of "Good Reason" within 45 days of the events allegedly giving rise to "Good Reason".

(d) *Other than for Cause or Good Reason.* The Executive or the Company may terminate the Executive's employment and the Period of Agreement for any reason other than for Good Reason or other than for Cause, respectively, upon fifteen (15) days' prior written notice to the Company or Executive, as the case may be.

(e) *Notice of Termination.* Any termination of employment by the Company or by the Executive shall be communicated by a notice of termination to the other party hereto given in accordance with Section 19 of this Agreement (the "Notice of Termination"). For purposes of this Agreement, a "Notice of Termination" means a written notice which (i) indicates the specific termination provision in this Agreement relied upon, (ii) sets forth in reasonable detail, if necessary, the facts and circumstances claimed to provide a basis for termination of the Executive's employment under the provision so indicated, and (iii) if the Date of Termination (as defined below) is other than the date of receipt of such notice, specifies the termination date. The failure by the Executive or the Company to set forth in the Notice of Termination any fact or circumstance which contributes to a showing of the basis for termination shall not waive any right of such party hereunder or preclude such party from asserting such fact or circumstance in enforcing his/her or its rights hereunder.

(f) *Date of Termination.* "Date of Termination" means the date specified in the Notice of Termination; provided, however, that if the Executive's employment is terminated by reason of death or Disability, the Date of Termination shall be the date of death of the Executive or the Disability Effective Date, as the case may be.

9. Obligations of the Company Upon Termination. The following provisions describe the obligations of the Company to the Executive upon termination of the Executive's employment during the Period of Agreement. However, except as explicitly provided in this Agreement, nothing in this Agreement shall limit or otherwise adversely affect any rights which the Executive may have under applicable law, under any other written agreement with the Company, or under any compensation or benefit plan, program, policy or practice of the Company.

(a) *Termination not for Cause or for Good Reason.* If the Executive's employment is terminated during the Period of Agreement by Company not for Cause (and other than due to death or Disability) or by the Executive for Good Reason, the Executive shall, in lieu of any other severance benefits under the Company's severance plans, be entitled to the following:

(i) continuation of the Executive's then–current Base Salary and then–current target bonus for a period of two (2) years after the Date of Termination (the "Salary Continuation Period"), the Base Salary

component to be payable as set forth in Section 3, above, and the target bonus component to be payable in monthly installments equal to one-twelfth (1/12) of the Executive's then-current annual target bonus opportunity set forth in Section 4, above; provided that the sum of such payments shall not exceed the maximum amount permitted under the Company's Articles of Incorporation;

(ii) continued health coverage for the Executive and the Executive's eligible dependents at active employee rates for the Salary Continuation Period, with COBRA continuation to begin at the end of such period;

(iii) payment of all accrued but not yet paid Base Salary, accrued vacation, any earned and unpaid bonus for the previous year or other performance period, unreimbursed business expenses (in accordance with Company policy and procedures), and any accrued unpaid benefits under the Company's group benefit plans, payable through the Date of Termination (collectively, "Accrued Obligations"); and

(iv) a bonus (based upon actual performance) for the year (or other performance period) in which the Executive's termination occurs, prorated based on the number of days elapsed during said year (or other performance period) through the Date of Termination, payable at the time bonuses are paid to senior executives generally.

The Executive shall be entitled to the amounts and benefits under this Section 9(a) (other than Accrued Obligations) only upon the Executive's execution (without revocation) of a general release of all claims of the Executive that may be brought against the Company occurring through and including the release date in the form of Appendix 2 hereto (with such changes therein as may be necessary to make it valid and encompassing under applicable law).

(b) *Termination for Cause, for other than Good Reason or at the Expiration of the Period of Agreement.* If the Executive's employment is terminated during the Period of Agreement by the Company for Cause or by the Executive not for Good Reason, or if the Executive's employment is terminated by either party for any reason at the expiration of the Period of Agreement, the Executive will receive the Executive's Accrued Obligations through the Date of Termination (except to the extent subject to disgorgement under any applicable legal requirement). The Company shall be entitled to offset the amount due from the Executive of any repayments of compensation awarded hereunder against any amounts due to the Executive, without waiving or limiting the Company's rights to recover any excess amount due to it.

(c) *Termination Due to Death or Disability.* In the event of the Executive's death or termination of employment due to Disability during the Period of Agreement, the Executive's estate or the Executive, as the case may be, shall be entitled to receive the following:

(i) a bonus (based upon actual performance) for the year (or other performance period) in which the Executive's termination occurs, prorated based on the number of days elapsed during said year (or other performance period) through the Date of Termination, payable at the time bonuses are paid to senior executives generally;

(ii) payment of the Executive's Accrued Obligations; and

(iii) continued health coverage for the Executive and/or the Executive's eligible dependents, as applicable, at active employee rates for eighteen (18) months following the Date of Termination, which will run concurrently with COBRA.

10. Equity Awards. For each full calendar year during the Period of Agreement, the Executive shall be eligible at the targeted performance levels to receive an annual equity award commensurate with the Executive's position as determined by the Board in its discretion.

11. Treatment of Equity Awards on Termination. Upon the termination of Executive's employment, either during, at the expiration of, or after the Period of Agreement, the vesting of any unvested equity awards granted during the Period of Agreement shall be determined as follows:

(a) In the event of termination of the Executive's employment (i) by the Company not for Cause (and other than due to the Executive's death or Disability), or (ii) by the Executive for Good Reason, the Executive shall be deemed to be an active employee of the Company for two (2) years following the Date of Termination for purposes of determining the vesting of each such equity award.

(b) In the event of termination of the Executive's employment (i) by the Executive not for Good Reason or (ii) by the Company for Cause, any such equity awards that are unvested shall be forfeited.

(c) In the event of the Executive's death or termination due to Disability, any such equity awards that are unvested shall immediately fully vest.

12. Non–Competition.

(a) In the event that the Executive's employment is terminated for any reason during the Period of Agreement, but not at or after the expiration of the Period of Agreement, for a period of one (1) year after the Date of Termination, the Executive shall not become an employee, consultant, advisor, director or assume any other position or relationship with the following companies or their subsidiaries and affiliates: AT&T Corporation, SBC Communications, Inc., Sprint Corporation, Qwest, or Verizon Communications.

(b) The Executive agrees to, and shall, execute the Company's Non–Disclosure, Intellectual Property Assignment and Non–Solicitation Agreement, attached hereto as Appendix 3. The terms of the Non–Disclosure, Intellectual Property Assignment and Non–Solicitation Agreement are incorporated herein by this reference and shall survive any termination of the employment relationship created hereunder or the termination of the Period of Agreement.

(c) The Executive acknowledges that the Company has no adequate remedy at law and will be irreparably harmed if the Executive breaches or threatens to breach the provisions of this Section 12, and, therefore, agrees that the Company shall be entitled to injunctive relief to prevent any breach or threatened breach of this Section and that the Company shall be entitled to specific performance of the terms of this Section in addition to any other legal or equitable remedy it may have. Nothing in this Agreement shall be construed as prohibiting the Company from pursuing any other remedies at law or in equity that it may have or any other rights that it may have under any other agreement.

13. Change in Control.

(a) *Definition of "Change in Control."* The definition of Change in Control shall occur upon the occurrence of any one of the following events during the Period of Agreement:

(i) the sale, lease or transfer, in one or a series of related transactions, of all or substantially all of the assets of the Company and its Restricted Subsidiaries (as defined in the indentures pursuant to which senior notes of the Company are to be issued to certain of the Company's creditors in accordance with the Company's Modified Second Amended Joint Plan of Reorganization under chapter 11 of title 11 of the United States Code, as confirmed on October 31, 2003 by the United States Bankruptcy Court for the Southern District of New York) taken as a whole to any other "person" or "group," as that term is used in Section 13(d)(3) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), (other than the Company or any of its Restricted Subsidiaries), other than a creation of a holding company that does not involve a change in the beneficial ownership of the Company as a result of the transaction and other than a creation of a holding company that does not involve a change in the beneficial ownership of the Company as a result of the transaction;

(ii) the adoption of a plan relating to the liquidation or dissolution of the Company;

(iii) any "person" or "group" (as such terms are used in Sections 13(d) and 14(d) of the Exchange Act) is or becomes the "beneficial owner" (as defined in rules 13d–3 and 13d–5 under the Exchange Act (except that a person shall be deemed to have beneficial ownership of all shares that such Person has a right to acquire, whether such right is exercisable immediately or after 60 days), directly or indirectly of more than 50% of the voting power of the voting stock of the Company by way of purchase, merger or consolidation or otherwise;

(iv) the merger or consolidation with or into another Person or merger of another Person into the Company with the effect that immediately after that transaction the existing stockholders of the Company immediately before the transaction hold, directly or indirectly, less than 50% of the total voting power of all securities generally entitled to vote in the election of directors, managers or trustees of the Person surviving the merger or consolidation; or

(v) the first day on which a majority of the members of the Company's Board of Directors are not Continuing Directors. For purposes of the preceding clause (e), *"Continuing Directors"* means, as of any date of determination, any member of the Company's Board of Directors who: (i) was a member of the Company's Board of Directors on the Effective Date; or (ii) was nominated for election or elected to the Company's Board of Directors with the affirmative vote of, or whose election or appointment was otherwise approved or ratified (whether before or after nomination or election) by, at least a majority of the Continuing Directors who were members of the Company's Board of Directors at the time of the nomination, election or approval, as applicable.

(b) Upon a Change in Control described in Section 13(a)(i), above, all equity awards granted to the Executive shall immediately fully vest and any restrictions on disposition of vested stock or the payment of any deferred stock units shall lapse.

(c) *Impact of Termination by Company or the Executive During Protection Period.* If the Executive's employment is terminated by the Company not for Cause (and other than due to death or Disability) or by the Executive for Good Reason within the two (2)–year period immediately following a Change in Control of the Company (regardless of whether the Period of Agreement would have otherwise expired without the occurrence of a Change in Control) or in the event the Executive's employment is terminated within six (6) months prior to and in anticipation of a Change in Control or is demonstrated to be at the request of a third party that had taken steps reasonably calculated to effect a Change in Control, the Executive shall, in lieu of any other severance benefits and in lieu of benefits provided under Section 9(a), be entitled to the following:

(i) a lump sum payment, to be made within thirty (30) days of the Date of Termination, equal to two (2) times the sum of the Executive's then–current Base Salary and then–current target bonus;

(ii) continued health coverage for the Executive and the Executive's eligible dependents at active employee rates for two (2) years, with COBRA continuation to begin at the end of such period;

(iii) payment of all Accrued Obligations;

(iv) a bonus (based upon actual performance) for the year (or other performance period) in which the Executive's termination occurs, prorated based on the number of days elapsed during said year (or other performance period) through the Date of Termination, payable at the time bonuses are paid to senior executives generally;

(v) all unvested equity awards shall immediately vest and any restrictions on disposition of vested stock or on the payment of any deferred stock units shall lapse;

(vi) any deferred compensation shall become payable;

(vii) any amounts "earned" under other incentive plans that have not vested will vest and become payable as follows: (A) if based upon objective factors that can reasonably be determined, payment shall be

based upon actual performance for such period or, if actual performance cannot be determined, pro–rated based on the relevant period of service, and (B) if any other factors or performance measures cannot reasonably be determined, payment shall be at target, pro–rated based on the relevant period of service; and

(viii) the Executive shall receive two (2) years of service and age credit for vesting and eligibility (but not accrual) purposes under Company retirement or welfare programs and other benefit programs, payable outside plans to the extent that the Executive is not eligible for such payment under the terms of such plans, and two (2) years of welfare program coverage at active employee rates.

The Executive shall be entitled to the amounts and benefits under this Section 13(c) (other than Accrued Obligations) only upon the Executive's execution (without revocation) of a general release of all claims of the Executive that may be brought against the Company occurring through and including the release date in the form of Appendix 2 hereto (with such changes therein as may be necessary to make it valid and encompassing under applicable law).

(d) *Parachute Gross–Up*. In the event that the aggregate of all payments or benefits made or provided to, or that may be made or provided to, the Executive under this Agreement and under all other plans, programs and arrangements of the Company (the "Aggregate Payment") is determined to constitute an "excess parachute payment," as such term is defined in Section 280G(b) of the Internal Revenue Code, the Company shall pay to the Executive prior to the time any excise tax imposed by Section 4999 of the Internal Revenue Code ("Excise Tax") is payable with respect to such Aggregate Payment, an additional amount which, after the imposition of all income and excise taxes thereon, is equal to the Excise Tax on the Aggregate Payment. The determination of whether the Aggregate Payment constitutes an excess parachute payment and, if so, the amount to be provided to the Executive and the time of payment pursuant to this Section 13(d) shall be made by an independent auditor (the "Auditor") selected jointly by the Company and the Executive and paid by the Company. The Auditor shall be a nationally recognized United States public accounting firm which has not, during the two (2) years preceding the date of its selection, acted in any way on behalf of the Company or any affiliate thereof. If the Executive and the Company cannot agree on the firm to serve as the Auditor, then the Executive and the Company shall each select one accounting firm and those two firms shall jointly select the accounting firm to serve as the Auditor. Notwithstanding the foregoing, in the event that the amount of the Executive's Excise Tax liability is subsequently determined to be greater than the Excise Tax liability with respect to which any initial payment to the Executive under this Section 13(d) has been made, the Company shall pay to the Executive an additional amount (grossed up for all taxes) with respect to such additional Excise Tax (and any interest and penalties thereon) at the time and in the amount reasonably determined by the Auditor. Similarly, if the amount of the Executive's Excise Tax liability is subsequently determined to be less than the Excise Tax liability with respect to which any prior payment to the Executive has been made under this Section 13(d), the Executive shall refund to the Company the excess amount received, after reduction for any nonrefundable tax, penalties and/or interest incurred by the Executive in connection with the receipt of such excess, and such refund shall be paid promptly after the Executive has received any corresponding refund of excess Excise Tax paid to the Internal Revenue Service. The Executive and the Company shall cooperate with each other in connection with any proceeding or claim relating to the existence or amount of liability for Excise Tax, and all expenses incurred by the Executive in connection therewith shall be paid by the Company promptly upon notice of demand from the Executive.

14. Dispute Resolution. In the event of any dispute between the Company and the Executive, whether arising out of or relating to this Agreement, the breach of this Agreement, or otherwise, including without limitation if the Executive shall assert the existence of Good Reason or any other breach of this Agreement and the Company shall disagree as to the existence of Good Reason or any other asserted breach, the Executive and the Company hereby agree that such dispute shall be resolved by binding arbitration administered by the American Arbitration Association ("AAA") in accordance with its Commercial Arbitration Rules then in effect, and judgment on the award rendered by the arbitrator may be entered in any court having jurisdiction thereof. Any arbitration shall be held before a single arbitrator who shall be selected by the mutual agreement of the Company and the Executive, unless the parties are unable to agree to an arbitrator, in which case, the arbitrator will be selected under the

procedures of the AAA. The arbitrator shall have the authority to award any remedy or relief that a court of competent jurisdiction could order or grant, including, without limitation, the issuance of an injunction, and the parties hereby agree to the emergency procedures of the AAA. However, either party may, without inconsistency with this arbitration provision, apply to any court having jurisdiction over such dispute or controversy and seek interim provisional, injunctive or other equitable relief until the arbitration award is rendered or the controversy is otherwise resolved. Except as necessary in court proceedings to enforce this arbitration provision or an award rendered hereunder, or to obtain interim relief, neither a party nor an arbitrator may disclose the existence, content or results of any arbitration hereunder without the prior written consent of the Company and the Executive. The arbitration proceeding shall be conducted in the Washington, D.C. metropolitan area. In the event of any such proceeding, the losing party shall reimburse the prevailing party upon entry of a final award resolving the subject of the dispute for all reasonable legal expenses incurred, unless the arbitrator determines that to do so would be unjust. This Agreement shall be governed by the substantive provisions of the laws of the State of Delaware.

15. Mutual Cooperation. The parties agree to take reasonable steps (without cost to the Executive) to minimize the Company's tax obligations with respect to annual compensation.

16. Undertaking. Attached hereto as Appendix 4 is a letter constituting an ethics pledge signed by the Executive, which shall be an integral part of this Agreement.

17. Cooperation with Ongoing Investigations. The Executive agrees that the Executive will fully cooperate, and will cause and direct the persons under the Executive's management direction employed by, or consultants or agents to, the Company to cooperate fully, with all governmental investigations of the Company and all orders entered by the Court.

18. Withholding. Anything in this Agreement to the contrary notwithstanding, all payments required to be made by the Company hereunder to the Executive shall be subject to withholding, at the time payments are actually made to the Executive and received by the Executive, of such amounts relating to taxes as the Company may reasonably determine it should withhold pursuant to any applicable law or regulation. In lieu of withholding such amounts, in whole or in part, the Company may, in its sole discretion, accept other provision for payment of taxes as required by law, provided that it is satisfied that all requirements of law as to its responsibilities to withhold such taxes have been satisfied.

19. Notices. Any and all notices required in connection with this Agreement shall be deemed adequately given only if in writing and (a) personally delivered, or sent by first class, registered or certified mail, postage prepaid, return receipt requested, or by recognized overnight courier, (b) sent by facsimile, provided a hard copy is mailed on that date to the party for whom such notices are intended, or (c) sent by other means at least as fast and reliable as first class mail. A written notice shall be deemed to have been given to the recipient party on the earlier of (a) the date it shall be delivered to the address required by this Agreement; (b) the date delivery shall have been refused at the address required by this Agreement; (c) with respect to notices sent by mail or overnight courier, the date as of which the Postal Service or overnight courier, as the case may be, shall have indicated such notice to be undeliverable at the address required by this Agreement; or (d) with respect to a facsimile, the date on which the facsimile is sent and receipt of which is confirmed. Any and all notices referred to in this Agreement, or which either party desires to give to the other, shall be addressed to the Executive's residence in the case of the Executive, or to its principal office in the case of the Company.

20. Waiver of Breach. A waiver by the Company of a breach of any provision of this Agreement by the Executive shall not operate or be construed as a waiver or estoppel of any subsequent breach by the Executive. No waiver shall be valid unless in writing and signed by an authorized officer of the Company.

21. Headings. The headings in this Agreement are inserted for convenience only and are not to be considered a construction of the provisions hereof.

22. Severability. If any provision of this Agreement shall be found invalid or unenforceable for any reason, in whole or in part, then such provision shall be deemed modified, restricted, or reformulated to the extent and in the manner necessary to render the same valid and enforceable, or shall be deemed excised from this Agreement, as the case may require, and this Agreement shall be construed and enforced to the maximum extent permitted by law, as if such provision had been originally incorporated herein as so modified, restricted, or reformulated or as if such provision had not been originally incorporated herein, as the case may be. The parties further agree to seek a lawful substitute for any provision found to be unlawful; provided, that, if the parties are unable to agree upon a lawful substitute, the parties desire and request that a court or other authority called upon to decide the enforceability of this Agreement modify those restrictions in this Agreement that, once modified, will result in an agreement that is enforceable to the maximum extent permitted by the law in existence at the time of the requested enforcement.

23. Successors.

(a) This Agreement is personal to the Executive and without the prior written consent of the Company shall not be assignable by the Executive otherwise than by will or the laws of descent and distribution. This Agreement shall inure to the benefit of and be enforceable by the Executive's heirs and legal representatives.

(b) This Agreement shall inure to the benefit of and be binding upon the Company and its successors and assigns.

(c) The Company shall require any successor (whether direct or indirect, by purchase, merger, reorganization, consolidation, acquisition of property or stock, liquidation, or otherwise) to all or a substantial portion of its assets, by agreement in form and substance reasonably satisfactory to the Executive, expressly to assume and agree to perform this Agreement in the same manner and to the same extent that the Company would be required to perform this Agreement if no such succession had taken place. Regardless of whether such an agreement is executed, this Agreement shall be binding upon any successor of the Company in accordance with the operation of law, and such successor shall be deemed the "Company" for purposes of this Agreement.

(d) As used in this Agreement, the term "Company" shall include any successor to the Company's business and/or assets as aforesaid which assumes and agrees to perform this Agreement by operation of law, or otherwise.

24. Entire Agreement. This Agreement sets forth the entire and final agreement and understanding of the parties and contains all of the agreements made between the parties with respect to the subject matter hereof. This Agreement supersedes any and all other agreements, either oral or in writing, between the parties hereto, with respect to the subject matter hereof. No change or modification of this Agreement shall be valid unless in writing and signed by the Company and the Executive.

25. Survival. The obligations of the parties under Sections 7, 9, 11, 12, 13, 14, 16, 17, 22, 25 and 27 of this Agreement shall survive the termination of the Executive's employment with the Company during the Period of Agreement and the termination or expiration of the Period of Agreement.

26. Counterparts. This Agreement may be executed in several counterparts, each of which shall be considered an original, but which when taken together, shall constitute one agreement.

27. Conflict. In the case of conflict between the terms of this Agreement (the "Agreement Terms") and the provisions of any plan, policy, or practice of the Company as in effect from time to time (the "Standard Provisions"), the Executive's rights or the Company's obligations shall be established by whichever of the Agreement Terms or Standard Provisions would be more beneficial to the Executive.

[Signature Page Follows]

IN WITNESS WHEREOF, the parties have set their signatures as of the date first written above.

COMPANY:

WorldCom, Inc.,
a Georgia corporation

_____

By: _____

Its: _____

EXECUTIVE:

_____

Appendix 1

OTHER COMPENSATION

1. Bonus. A bonus equal to 75 percent of Base Salary will be guaranteed pro rata (taking the number of days worked out of a year of 365 days) for the period between July 30, 2003 and December 31, 2003, and such bonus shall be paid in the first quarter of 2004 (but no later than the date that senior executive bonuses are paid generally).

2. Signing Bonus. The Executive received a signing bonus of $300,000, paid on August 22, 2003. The signing bonus shall be subject to proportionate clawback (based on the number of full calendar months of elapsed service divided by [41] calendar months) in the event the Executive does not complete the initial term of employment for any reason other than termination of the Executive by the Company without Cause, by the Executive for Good Reason, or by death or disability; provided, however, that the full signing bonus shall be repaid within ten days in the event of the Executive's termination by the Company for Cause.

3. Restricted Stock. Upon the Company's emergence from bankruptcy, the Executive will be entitled to receive an initial equity award of restricted stock valued at $1.625 million at the date of emergence. The value of the restricted stock will be determined by Lazard LLC, financial advisor to the Company (or if Lazard LLC shall not at that time continue to be the Company's financial advisor such other firm as shall be mutually acceptable to the Company and the Executive) (the" Financial Advisor") and, absent manifest error, the Financial Advisor's determination of the value of such securities shall be binding upon the Company and the Executive. All such restricted shares shall vest ratably over a period of three years from date of issuance. After releasing such number of shares as shall be necessary to cover taxes due as a result of vesting, 75 percent of remaining shares shall be restricted as to resale until a date that shall be 6 months following the Executive's termination of employment with the Company. With the prior consent of the Company and the Executive, awards may be made in form of restricted deferred stock units rather than restricted stock.

In the case of conflict between the terms of this Appendix 1 (the "Terms") and the provisions of the Agreement to which this Appendix 1 is attached (the "Provisions"), the Executive's rights or the Company's obligations shall be established by whichever of the Terms or Provisions would be more beneficial to the Executive.

[1] Applicable to California residents.

Appendix 2

GENERAL RELEASE

WHEREAS, the employment of the undersigned ("Executive") is being terminated under circumstances making Executive eligible for severance benefits under Section [9 or 13] of the Employment Agreement between Executive and WorldCom, Inc., effective as of _____, 2004 (the "Employment Agreement") and Executive wishes to receive the benefits described in Section [9 or 13] of the Employment Agreement, benefits to which Executive is not entitled unless Executive executes a general release and waiver of claims.

NOW, THEREFORE, in consideration for the benefits described in Section [9 or 13] of the Employment Agreement, Executive hereby releases and discharges WorldCom, Inc., and any subsidiaries or affiliates thereof (collectively the "Company"), and their respective directors, officers, employees, benefit plans and administrators, successors and assigns from any and all claims, obligations, and liabilities, whether known or unknown, at law or in equity, arising out of Executive's employment with the Company and the termination thereof. This Release is to be broadly construed so as to resolve all pending or potential disputes including, but without limiting the generality of the foregoing, any and all claims under the Age Discrimination in Employment Act, as amended by the Older Workers Benefit Protection Act of 1990, Title VII of the Civil Rights Act of 1964, the Americans with Disabilities Act, the Employee Retirement Income Security Act of 1974, the Equal Pay Act, the Family and Medical Leave Act, the discrimination and wage payment laws of the state in which Executive rendered services to the Company, and any other statute, regulation, or ordinance, and any and all claims based upon alleged wrongful or retaliatory discharge, negligence, intentional infliction of emotional distress, defamation, invasion of privacy, other torts, harassment, employment discrimination or breach of contract (express or implied). Notwithstanding the foregoing, Executive does not waive any rights Executive may have to enforce the terms of Section [9 or 13] of the Employment Agreement, to benefits available after termination under any Company–sponsored employee benefit plan, to insurance protection and/or indemnification for actions taken by the Executive while an employee, officer and/or director of the Company or to make any claims for workers' compensation.

[Executive hereby expressly waives the benefit of California Civil Code Section 1542, which is set forth below, as well as any other statutory or common laws of like nature concerning the waiver of unknown claims, and specifically agrees that this general release shall extend to claims arising out of transactions occurring prior to the date of its signing which the Executive does not know or expect to exist in the Executive's favor at this time. California Civil Code Section 1542 provides:

> A general release does not extend to claims which the creditor does not know or suspect to exist in his favor at the time of executing the release, which if known by him must have materially affected his settlement with the debtor.][1]

Executive acknowledges and agrees that:

- Executive has read and understands this Release in its entirety;

- Executive has been advised in writing to consult with an attorney concerning this Release before signing it. This subparagraph constitutes such written advice;

- Executive has twenty–one (21) calendar days after receipt of this Release to consider its terms before signing it;

- Executive has the right to revoke this Release in full within seven (7) calendar days of executing it. Any revocation must be personally delivered to the Executive Vice President – Human Resources, or [his/her] designee, or mailed to WorldCom, Inc., [address], and postmarked within seven (7) calendar days

of the date of execution of this Release. None of the terms and provisions of this Release shall become effective or be enforceable until such revocation period has expired;

- Nothing contained in this Release waives any claim that may arise after the date of its execution; and

- Executive executes this Release knowingly and voluntarily, without duress or reservation of any kind, and after having given the matter full and careful consideration.

IN WITNESS WHEREOF, the Executive has executed this Release on the date indicated below and agrees to be bound hereby.

_____

(Signature)

_____

(Print full name)

_____

(Date)

Appendix 3

NON–DISCLOSURE, INTELLECTUAL PROPERTY ASSIGNMENT AND NON–SOLICITATION AGREEMENT

In order for MCI and its operating affiliates and subsidiaries (hereinafter collectively referred to as the "Company") to maintain a competitive edge, the Company must protect its confidential information and customer relationships.

Therefore, as a condition of employment or continued employment with the Company, I agree as follows:

DEFINITIONS

1. "Confidential Information" means information (i) disclosed to or known by me as a consequence of my employment with the Company, (ii) not generally known to others outside the Company, and (iii) which relates to the Company's business. Confidential Information includes but is not limited to the Company's trade secrets, equipment, equipment configuration, research, development efforts, methodologies, testing, engineering, manufacturing, marketing, sales, finances, operations, processes, formulas, methods, techniques, devices, software programs, projections, strategies and plans, personnel information, industry contacts made during my employment, and customer information, including customer needs, contacts, particular projects, and pricing.

2. "Inventions" means any new or useful art, discovery, new contribution, finding or improvement, whether or not patentable, and all know–how related thereto, made, developed or conceived by me (i) in the course of my employment, (ii) relating to the actual or anticipated business of the Company, *or (iii)* with the use of the Company's time, material, information or facilities.

3. "Works" means any materials for which copyright protection may be obtained, written, made, developed or conceived by me (i) in the course of my employment, (ii) relating to the actual or anticipated business of the Company, or (iii) with the use of the Company's time, material, information or facilities.

NONDISCLOSURE OF CONFIDENTIAL INFORMATION

4. I will not disclose or use any Confidential Information for the benefit of myself or another, unless directed or authorized in writing by the Company to do so, or until such time as the information becomes known to the public through no fault of mine. I will not disclose any Confidential Information to persons inside the Company who do not have a legitimate need to know the information. I will not make copies of Confidential Information except as reasonably necessary to the performance of my duties for the Company.

5. I understand that if I possess any proprietary information of another person or company as a result of prior employment or otherwise, the Company expects and requires that I will honor any and all legal obligations that I have to that person or company with respect to proprietary information, and I will refrain from any unauthorized use or disclosure of such information.

RETURN OF COMPANY PROPERTY

6. All documents and other tangible property relating in any way to the business of the Company are the exclusive property of the Company (even if I authored or created them). I agree to return all such documents and tangible property to the Company upon termination of employment or at such earlier time as the Company may request.

NON–SOLICITATION OF ACCOUNTS

7. During my employment with the Company and for one (1) year after termination of employment with the Company for any reason, I shall not directly or indirectly, provide products or services that are materially

similar to the products or services provided by the Company to any customer of the Company with whom I had direct contact in the course of my employment with the Company or about whom I learned Confidential Information as a result of my employment with the Company, nor will I solicit, induce, or attempt to induce such customers to: (a) stop doing business with or through the Company, or (b) do business with any other person, firm, partnership, corporation or other entity that provides products or services materially similar to those provided by the Company.

NON–SOLICITATION OF EMPLOYEES

8. During my employment and for one (1) year following termination of my employment with the Company for any reason, I shall not, directly or indirectly, assist in the hiring of, or induce or attempt to induce any person who is employed by the Company or was employed by the Company within the prior six months to terminate his/her relationship with the Company or to accept employment or affiliation with any firm or entity of which I am an employee, owner, partner or consultant.

DISCLOSURE AND ASSIGNMENT OF INVENTIONS AND WORKS

9. I will promptly disclose to the Company in writing, all Inventions and Works which are conceived, made, discovered, written or created by me alone or jointly with someone else on the Company's time or on my own time, while I am employed by the Company.

10. All Works created by me, alone or with others, shall be deemed "works made for hire" under the copyright laws and shall be owned by the Company.

11. I hereby assign to the Company all of my rights in all Inventions, and in all Works to the extent such Works may not, by operation of law, be works made for hire.

12. I will, without further compensation, give the Company all assistance it reasonably requires (whether during my employment or after my employment) to perfect, protect, and use its rights to Inventions and Works. In particular, I will sign all documents, do all things, and supply all information that the Company considers necessary or desirable to transfer or record the transfer of my entire right, title and interest in Inventions and Works; and to enable the Company to obtain patent, copyright, or other legal protection for Inventions and Works. Any out–of–pocket expenses will be paid by the Company.

13. An invention for which none of the Company's equipment, supplies, facilities, or Confidential Information was used and which was developed entirely on my own time is exempted from this Agreement so long as it: (1) does not relate in any way to the Company's business, or to the Company's actual or demonstrably anticipated research and development; and (b) does not result in any way from my work for the Company.

14. Also excluded from this Agreement are the following Inventions and Works which I own or control and which were conceived, made, written, or created by me prior to my employment with the Company.

(1) _____

_____

(2) _____

_____

(Attach additional sheets if necessary)

Other than these, I do not claim to own or control rights in any inventions or works subject to copyright and will not assert any such rights against the Company.

IRREPARABLE HARM

15. Irreparable harm would result from any breach by me of the provisions of this Agreement, and monetary damages alone would not provide adequate relief for any such breach. Accordingly, if I breach or threaten to breach this Agreement, injunctive relief in favor of the Company is proper, without the necessity of the Company posting a bond. Moreover, any award of injunctive relief shall not preclude the Company from seeking or recovering any lawful compensatory damages which may have resulted from a breach of this Agreement, including a forfeiture of any payments not yet made to me and a return of any payments already received by me.

SEVERABILITY/MODIFICATION

16. If a provision of this Agreement is held invalid by a court of competent jurisdiction, the remaining provisions will nonetheless be enforceable according to their terms. Further, if any provision is held to be over broad as written, a court may modify that provision to the extent necessary to make the provision enforceable according to applicable law and enforce the provision as modified.

GOVERNING LAW

17. This Agreement shall be construed, interpreted and enforced in accordance with the internal laws of the State of Delaware.

BURDEN AND BENEFIT

18. The Company may assign its rights under this Agreement to any successor in interest, whether by merger, consolidation, sale of assets, or otherwise. This Agreement shall be binding whether it is between me and the Company or between me and any successor or assign of the Company.

NO EFFECT ON TERM OF EMPLOYMENT

19. Nothing in this Agreement prevents or limits my right to terminate my employment at any time for any reason, and nothing in this Agreement prevents or limits the Company from terminating my employment at any time for any reason. I understand and agree that there exist no promises or guarantees of permanent employment or employment for any specified term by the Company.

ENTIRE AGREEMENT

20. I understand that this Agreement contains the entire agreement and understanding between the Company and me with respect to the provisions contained in this Agreement, and that no representations, promises, agreements, or understandings, written or oral, related thereto which are not contained in this Agreement will be given any force or effect. No change or modification of this Agreement will be valid or binding unless it is in writing and signed by the party against whom the change or modification is sought to be enforced. I further understand that even if the Company waives or fails to enforce any provision of this Agreement in one instance, that will not constitute a waiver of any other provisions of this Agreement at this time, or a waiver of that provision at any other time.

21. I hereby acknowledge and represent that I have fully read and understand this Agreement and that I consider all of the terms of my covenants and agreements set forth in this Agreement to be fair and reasonable and to be necessary to protect the Company's ongoing interests.

COMPANY

By

Title

Date

EMPLOYEE

Signature of Employee

Date

Address – Street

Address – City, State, Zip Code

Appendix 4

ETHICS PLEDGE

[Attached]

MCI Corporate Variable Pay Plan

Effective January 1, 2005

I. Purpose

The company believes in pay for contribution. The MCI Corporate Variable Pay Plan (the "plan") provides variable compensation tied to the achievement of Board approved corporate business plans to eligible MCI management staff and selected named individual contributors. It is intended that successful individual performance and contribution will relate directly to the company's attainment of corporate financial, operational and customer satisfaction goals.

II. Plan Period

There are two performance periods each year. The first Plan Period is January through June; the second Plan Period is July through December.

III. Eligibility

All full–time, non–commissioned managerial employees or equivalent technical ladder Individual Contributors are eligible for participation in the plan. Participants will be named prior to the beginning of each Plan Period and must remain continuously employed through the date of award payment to receive an award.

Participants who do not work throughout the Plan Period, due to death, disability, leave of absence or retirement will have their award prorated for the period of time they worked. Newly hired employees participation will be prorated for the number of months of employment during the Plan Period.

Employees who participate in the Sales Commission Plan and this plan during the Plan Period will earn an award in each based upon their performance in each and prorated for the time of participation in each. Participation and receipt of an award under this plan for a Plan Period does not guarantee continued participation in future Plan Periods.

Participants whose performance does not meet performance standards, or whose behavior is not in keeping with the Guiding Principles or who have been terminated for cause may have their award reduced or forfeited at the discretion of executive management.

IV. Plan Methodology

The Plan utilizes a balanced scorecard methodology. All participants will establish four Key Results Areas (KRAs) with metrics at the beginning of the Plan Period. The KRAs will consist of financial measures or other key performance indicators around customer perspectives, business processes and organizational growth and innovation as determined by the CEO to contribute to the achievement of the company business plans.

The Compensation Committee will approve target incentive compensation award levels for each category of participant at the start of the Plan Period. The target award is expressed as a percentage of base salary.

The Committee will approve the threshold level for any payments under the plan, the performance targets for baseline awards and the performance level at which the maximum payout can be earned at the beginning of each Plan Period.

At the discretion of the CEO, additional thresholds, targets or payout criteria may be established for each business unit or staff functions.

V. Funding the Corporate Variable Pay Plan Pools

For each Plan Period, the company must meet the threshold established by the Compensation Committee to pay out any variable pay awards. Each business unit or staff function must also meet the thresholds or targets established by the CEO for payout.

The award pools will be determined by the sum of all Participants' base salaries multiplied by the Participant's target award. This sum or "baseline pool" will then be adjusted up or down at the end of the Plan Period based on the financial performance of the company and, if appropriate, a business unit. The maximum adjustment is 150% of the baseline pool.

VI. Determination of Individual Awards

At the end of the Plan Period, each participant's target award is formulaically adjusted up or down based on the financial performance of the company or business unit such that the sum of these adjusted targets equals the amount of the adjusted baseline pool.

The participant's manager will evaluate each of the participant's KRAs and make adjustments up or down for individual performance. These adjustments will range from 0 to 150%. However, increases in one participant's award must be offset by reductions in others such that the adjusted baseline pool is not exceeded. In no event will the result of the pool adjustment or an individual performance adjustment cause any individual's award to be more than twice the individual's target award.

In the case of a transfer from one business unit to another mid–PlanPeriod, the financial measure used will be prorated for the time spent in each unit during the plan period.

VII. Payout of Awards

The CEO will approve the award proposals for all participants in the plan. The Compensation Committee will approve aggregate payments under this plan and will specifically approve awards to the direct reports of the CEO. The Committee will rely upon the Chief Financial Officer's certification of corporate and business unit financial performance in their administration of the plan. The Executive Vice President, Human Resources will arrange payment of these awards, resolve any disputes on award calculation or eligibility, perfect any administrative oversight in accord with the terms of the plan and implement resultant adjustments in pool size and individual award.

Awards will be paid out as soon as practical following the approval of the Compensation Committee. Employees on leave of absence status at the time of payout may receive their bonus when they return to active employment status.

VIII. Amendment or Termination of the Plan

This Plan is not intended to create a term of employment between the employee and the company; and the company may amend, supplement, supersede or terminate this Plan at any time at the discretion of executive management with approval of the Committee.

Exhibit 10.13

Board of Directors

Amendments to the MCI, Inc. 2003 Employee Stock Purchase Plan

WHEREAS, pursuant to Section 9.01 of the MCI, Inc. 2003 Employee Stock Purchase Plan (the "Plan"), the Board of Directors of MCI, Inc. has the power to amend the Plan; and

WHEREAS, the Board of Directors desires to amend the Plan to clarify certain provisions of the Plan;

NOW THEREFORE BE IT,

RESOLVED, that the Plan is amended in accordance with the Exhibit A attached hereto, effective as of the date on which all conditions to the effectiveness of the Company's plan of reorganization have been satisfied or waived; and

FURTHER RESOLVED, that the appropriate officers of the Company be, and each of them hereby is, authorized to execute any amendment, document, certificate or other instrument and to do all such acts and things as they or counsel for the Company may deem necessary or advisable to carry out the purposes of the foregoing resolutions.

Exhibit A

FIRST AMENDMENT
TO THE
MCI, INC. 2003
EMPLOYEE STOCK PURCHASE PLAN

Pursuant to the power reserved to it in Section 9.01 of the MCI, Inc. 2003 Employee Stock Purchase Plan (the "Plan"), MCI, Inc. (the "Company") hereby amends the Plan, effective as of the date on which all the conditions to the effectiveness of the Company's plan of reorganization have been satisfied, as follows:

1. Section 2.01, "Adoption by Subsidiaries" is hereby amended in its entirety to read as follows:

The Company's Board of Directors may authorize the adoption of the Stock Purchase Plan by, or offer of participation in the Stock Purchase Plan to employees of, one or more subsidiary corporations of the Company ("**Participating Subsidiaries**"), including subsidiaries in nations other than the United States.

2. Section 3.01, "Payroll Deductions" is hereby amended in its entirety to read as follows:

You may accumulate savings to purchase Ordinary Shares of Company stock ("**Shares**") in an Offering by authorizing payroll deductions pursuant to a Participation Agreement executed by you prior to the Offering, subject to such minimum and maximum limits (expressed in dollars or as a percentage of base salary or base wages) as the most senior human resources officer of the Company (the "**HRO**") may impose. Such savings shall be credited to your Account with respect to the Offering to which they relate. Payroll deductions for an Offering shall commence with the first paycheck you receive during such Offering and shall end with the last paycheck you receive during such Offering. Paychecks will be treated as having been received when they are sent out or otherwise distributed.

3. Section 4.04, "Individual Limit on Options" is hereby amended in its entirety to read as follows:

In no event shall the fair market value (measured on the applicable date of grant) of Shares subject to options under the Stock Purchase Plan (and shares of the Company, any parent or subsidiary company subject to options under any other stock purchase plans qualifying under Section 423 of the US Tax Code) during any calendar year exceed $25,000 in the aggregate for any individual. In addition, the HRO may impose a limit on the number of Shares that any individual may purchase under the Stock Purchase Plan during any Offering.

4. Section 7.01, "Committee" is hereby amended in its entirety to read as follows:

The Stock Purchase Plan shall be administered by the Committee, which shall consist of such members as determined by the Company. The Committee shall interpret and apply the provisions of the Stock Purchase Plan in its good faith discretion, and the Committee's decision is final and binding. The Committee may establish rules for the administration of the Stock Purchase Plan. The Committee may offer participation in the Stock Purchase Plan to employees of subsidiaries of the Company in nations other than the United States on such terms and conditions as determined by the Committee to be (a) necessary to comply with applicable foreign laws or business practices, (b) necessary to avoid unfavorable tax treatment for such participation, or (c) otherwise appropriate. The HRO may also make the same types of modifications to the terms and conditions of participation for such employees. Any such terms and conditions established by the Committee or the HRO shall be contained in an Appendix to the Stock Purchase Plan.

* * *

Adopted effective the __ day of _____, 2004.

WORLDCOM, INC. as the
sole stockholder of MCI, Inc.

Attest: _____

By: _____

Exhibit 10.14

MCI, Inc.
Board of Directors

Amendment to the MCI, Inc. 2003 Employee Stock Purchase Plan

WHEREAS, pursuant to Section 9.01 of the MCI, Inc. 2003 Employee Stock Purchase Plan (the "Plan"), the Board of Directors of MCI, Inc. has the power to amend the Plan; and

WHEREAS, the Board of Directors desires to amend the Plan to clarify certain provisions of the Plan;

NOW THEREFORE BE IT,

RESOLVED, that the Plan is amended in accordance with the Exhibit A attached hereto, effective as of June 25, 2004; and

FURTHER RESOLVED, that the appropriate officers of the Company be, and each of them hereby is, authorized to execute any amendment, document, certificate or other instrument and to do all such acts and things as they or counsel for the Company may deem necessary or advisable to carry out the purposes of the foregoing resolutions; and

FURTHER RESOLVED, that the appropriate officers of the Company be, and each of them hereby is, authorized to execute any amendments to (1) the Registration Statement on Form S-8 previously filed by the Company registering shares on behalf the Plan; and (2) any Plan prospectus.

Exhibit A

SECOND AMENDMENT
TO THE
MCI, INC. 2003 EMPLOYEE STOCK PURCHASE PLAN

Pursuant to the power reserved to it in Section 9.01 of the MCI, Inc. 2003 Employee Stock Purchase Plan (the "**Plan**"), the Board of Directors of MCI, Inc. hereby amends the Plan as follows:

Section 4.06, "Source of Shares" is hereby amended and restated in its entirety to read as follows:

Shares offered under the Stock Purchase Plan may be (i) authorized and issued Shares purchased in open market transactions by a Broker pursuant to directions from the Committee and at the market price prevailing on the applicable exchange or (ii) treasury Shares.

* * *

This amendment is hereby adopted effective this __ day of _____, 2004.

MCI, INC.

By: _____

Title:

Exhibit 10.15

MCI, Inc.
Board of Directors

Amendment to the MCI, Inc. 2003 Employee Stock Purchase Plan

WHEREAS, pursuant to Section 9.01 of the MCI, Inc. 2003 Employee Stock Purchase Plan (the "Plan"), the Board of Directors of MCI, Inc. has the power to amend the Plan; and

WHEREAS, the Board of Directors desires to amend the Plan to clarify certain provisions of the Plan;

NOW THEREFORE BE IT,

RESOLVED, that the Plan is amended in accordance with the Exhibit A attached hereto, effective as of September 10, 2004; and

FURTHER RESOLVED, that the appropriate officers of the Company be, and each of them hereby is, authorized to execute any amendment, document, certificate or other instrument and to do all such acts and things as they or counsel for the Company may deem necessary or advisable to carry out the purposes of the foregoing resolutions; and

FURTHER RESOLVED, that the appropriate officers of the Company be, and each of them hereby is, authorized to execute any amendments to (1) the Registration Statement on Form S-8 previously filed by the Company registering shares on behalf the Plan; and (2) any Plan prospectus.

Exhibit A

THIRD AMENDMENT
TO THE
MCI, INC. 2003 EMPLOYEE STOCK PURCHASE PLAN

Pursuant to the power reserved to it in Section 9.01 of the MCI, Inc. 2003 Employee Stock Purchase Plan (the "**Plan**"), the Board of Directors of MCI, Inc. hereby amends the Plan as follows:

Section 4.06, "Source of Shares" is hereby amended and restated in its entirety to read as follows:

Shares offered under the Stock Purchase Plan may be authorized and newly issued Shares, authorized and previously issued Shares purchased in open market transactions by a Broker pursuant to directions from the Committee and at the market price prevailing on the applicable exchange or treasury Shares.

* * *

This amendment is hereby adopted effective this __ day of _____, 2004.

MCI, INC.

By: _____

Title: Executive Vice President –
Human Resources

Exhibit 21.1

SUBSIDIARIES OF MCI, INC.
12/31/04

Advantage Company Limited (Bermuda)
ANS Communications Europe Ltd. (United Kingdom)
ANS France (France)
Atlantic Ocean Cables Limited (50% owned) (Bermuda)
Avantel, S.A. (Mexico)
CMIST Pty Limited (Australia)
Corporacion ABC lnternacional, S. de R.L. de C.V. (Mexico)
D–Comm, Inc. (Delaware)
Debrant Limited (New Zealand)
DFRS Frame Relay Services (Pty) Ltd (South Africa)
Digex (Netherlands) B.V. (Netherlands)
Digex (UK) Limited (United Kingdom)
Digex Germany GmbH (Germany)
Fox Court Nominees Limited (United Kingdom)
Gemini Submarine Cable System (UK) Limited (United Kingdom)
Gemini Submarine Cable System Limited (Bermuda)
Gemini Submarine Cable System, Inc. (Delaware)
IDB Communications Group Limited (United Kingdom)
IDB London Gateway Limited (50% owned) (United Kingdom)
Innet Luxembourg S.A. (Luxembourg)
Innet N.V. (Belgium)
Intermedia Communications LLC (Delaware)
Intermedia Communications of Virginia, Inc. (Virginia)
International TTI, Inc. (Delaware)
IP Data Networks Limited (Mauritius)
lnterNLnet B.V. (45% owned) (Netherlands)
MCI (CIS) LLC (Russia)
MCI Asia Pacific Holdings Pte Limited (Singapore)
MCI Asia Pacific Limited (Hong Kong)
MCI Capital Gmbh (Germany)
MCI Columbia S.A. (Colombia)
MCI Communications Corporation (Delaware)
MCI de Venezuela, S.A. (Venezuela)
MCI Deutschland GmbH (Germany)
MCI European Holdings Limited (United Kingdom)
MCI Finance Limited (United Kingdom)
MCI France (France)
MCI Holding do Brasil Ltda. (Brazil)
MCI Holding France (France)
MCI Holding GmbH (Austria)
MCI International (Argentina) S.A. (Argentina)
MCI International (Chile) S.A. (Chile)
MCI International (Ireland) Limited (Ireland)
MCI International (Italy) S.R.L. (Italy)
MCI International (Japan) Co., Ltd. (Japan)
MCI International (Portugal) Telecommunicacoes, Lda (Portugal)
MCI International Guatemala S.A. (Guatemala)

SUBSIDIARIES OF MCI, INC.
12/31/04

MCI International Panama, S.A. (Panama)
MCI International Peru SRL (Peru)
MCI International Telecommunications Corporation (Delaware)
MCI International, Inc. (Delaware)
MCI Italia S.p.A. (Italy)
MCI Nederlands B.V. (Netherlands)
MCI Payroll Services, LLC (Delaware)
MCI Telecommunications (Israel) Limited (Israel)
MCI Telecommunications (South Africa) (Proprietary) Limited (South Africa)
MCI Telecommunications Limited (United Kingdom)
MCI Telecomunicaoes do Brasil Ltda. (Brazil)
MCI WorldCom (Ireland) Limited (Ireland)
MCI WorldCom (Spain), S.A. (Spain)
MCI WorldCom A.G. (Switzerland)
MCI WorldCom AS (Norway)
MCI WorldCom Asia Pacific Limited (Cayman Islands)
MCI WorldCom Asia Pte. Limited (Singapore)
MCI WorldCom Australia Pty Limited (Australia)
MCI WorldCom Communications (Ireland) Limited (Ireland)
MCI WorldCom Communications Japan Ltd. (Japan)
MCI WORLDCOM Communications of Virginia (Virginia)
MCI WORLDCOM Communications, Inc. (Delaware)
MCI WORLDCOM Financial Management Corporation (Delaware)
MCI WorldCom Finland Oy (Finland)
MCI WorldCom Holding B.V. (Netherlands)
MCI WorldCom India Private Limited (India)
MCI WorldCom International (Hungary) Telecommunications Ltd. (Hungary)
MCI WORLDCOM International, Inc. (Delaware)
MCI WorldCom Japan Limited (Japan)
MCI WorldCom Korea Limited (Korea)
MCI WorldCom Limited (United Kingdom)
MCI WorldCom Malaysia SDN.BHD (Malaysia)
MCI WORLDCOM Network Services of Virginia, Inc. (Virginia)
MCI WORLDCOM Network Services, Inc. (Delaware)
MCI WorldCom Philippines, Inc. (Philippines)
MCI WorldCom Taiwan Co. Ltd. (Taiwan, ROC)
MCI WorldCom Telecommunication Services Austria Gesellschaft m.b.H. (Austria)
MCI WorldCom Telecommunications (Czech Republic), s.r.o. (Czech Republic)
MCI WorldCom Telecommunications (Hellas) Single–Member Limited Liability Company (Greece)
MCI WorldPhone Limited (United Kingdom)
MCImetro Access Transmission Services LLC (Delaware)
MCImetro Access Transmission Services of Massachusetts, Inc. (Delaware)
MCImetro Access Transmission Services of Virginia, Inc. (Virginia)
Metropolitan Fiber Systems of New York, Inc. d/b/a MFS Telecom of New York (Delaware)
MFS CableCo U.S., Inc. (Delaware)
MFS Communications of Canada, Inc. (Canada)
MFS Globenet, Inc. (Delaware)
Military Communications Center, Inc (Delaware)

SUBSIDIARIES OF MCI, INC.
12/31/04

MK International Limited (UK) (United Kingdom)
MK International Project Management Pty Limited (Australia)
MK International Project Management, Inc. (Delaware)
MK International S.r.l. (Italy)
MK International SA (France)
MKI Project Management Private Limited (India)
Moneyline (Pty) Ltd (South Africa)
Mtel (UK) Limited (United Kingdom)
Mtel Chile S.A. (Chile)
Mtel Latin America, Inc. (Delaware)
Mtel Uruguay S.A. (Uruguay)
N.V. WorldCom S.A. (Belgium)
networkMCI, Inc. (Delaware)
Nubal S.A. (Uruguay)
OzEmail Fax Investments Pty Limited (Australia)
OzEmail Pty Limited (Australia)
Pacific Carriage Holdings Limited (10% owned) (Bermuda)
Power Up Pty Limited (Australia)
PT MCI WorldCom Indonesia (Indonesia)
Satalite Data Networks (Ghana) Ltd (Ghana)
Satalite Data Networks (Pty) Ltd (South Africa)
Satalite Data Networks Ltd. (60% owned) (Mauritius)
SE Network Access Pty Limited (Australia)
SkyTel Corp. (Delaware)
SkyTel Payroll Services, LLC (Delaware)
Sociedad Espanola de Servicios de Internet, UUNET, S.L. (Spain)
Southernnet, Inc. (Georgia)
Telecom*USA, Inc. (Iowa)
Telecommunicacines Skytel C.A. (Venezuela)
Teleconnect Company (Iowa)
Teleconnect Long Distance Services & Systems Company (Iowa)
The Public IP Exchange Limited (United Kingdom)
TRANSCALL AMERICA, INC. (Georgia)
TTI National, Inc. (Delaware)
Unipalm Group plc (United Kingdom)
Unipalm Limited (United Kingdom)
UUNET ApS (Denmark)
UUNET Argentina S.R.L. (Argentina)
UUNET Austria GmbH (Austria)
UUNET Botswana (Pty) Ltd. (Botswana)
UUNET Brasil Ltda (Brazil)
UUNET Czech, s.r.o. (Czech Republic)
UUNET Equipment Singapore Pte. Ltd. (Singapore)
UUNET Finland Oy (Finland)
UUNET Hellas EPE (Greece)
UUNET Holdings Australia Pty Ltd. (Australia)
UUNET Hong Kong Limited (Hong Kong)
UUNET Hungary Kft (Hungary)
UUNET International (Chile) Limitada (Chile)
UUNET International Panama, S.A. (Panama)
UUNET Ireland Limited (Ireland)

SUBSIDIARIES OF MCI, INC.
12/31/04

UUNET Israel Internet Service Provider Ltd. (Israel)
UUNET Italia S.R.L. (Italy)
UUNET Japan, Inc. (Japan)
UUNET Kenya Ltd. (Kenya)
UUNET Mexico, S. de R. L. de C.V. (Mexico)
UUNET Namibia (Pty) Ltd. (Namibia)
UUNET Nigeria Limited (Nigeria)
UUNET Norway AS (Norway)
UUNET Payroll Services, LLC (Delaware)
UUNET Peru S.R.L. (Peru)
UUNET Pipex B.V. (Netherlands)
UUNET Polska Sp. z o.o. (Poland)
UUNET Portugal Sociedade Unipessoal Lda (Portugal)
UUNET SA Pty Limited (South Africa)
UUNET Schweiz GmbH (Switzerland)
UUNET Singapore Pte. Ltd. (Singapore)
UUNET Sweden AB (Sweden)
UUNET Tanzania Ltd (Tanzania)
UUNET Uganda Ltd (Uganda)
UUNET Venezuela C.A. (Venezuela)
UUNET Vostok OOO (Russian Federation)
UUNET Zambia Ltd. (60% owned) (Zambia)
Wireless One of Bryan, Texas, Inc. (Delaware)
Wireless One of North Carolina, LLC (Delaware)
WorldCom AB (Sweden)
WorldCom Advanced Networks Limited (United Kingdom)
WorldCom Brands, Inc. (Delaware)
WorldCom Broadband Solutions, Inc. (Delaware)
WorldCom Canada Ltd. (Canada)
WorldCom Communications India Private Limited (India)
WorldCom Development S.A. (Belgium)
WorldCom Egypt LLC (Egypt)
WorldCom Funding Corporation (Delaware)
WorldCom Global Networks Limited (Bermuda)
WorldCom Intermedia Communications Corporation (Delaware)
WorldCom Intermedia Telecom, Inc. (Delaware)
WorldCom Intermedia, Inc. (Delaware)
WorldCom International El Salvador, S.A. de C.V. (El Salvador)
WorldCom International Internet and Telecommunication Services LLC (Turkey)
WorldCom International Mobile Services, Inc. (Delaware)
WorldCom International, Inc. (Delaware)
WorldCom New Zealand Limited (f/k/a Voyager NZ Limited) (New Zealand)
WorldCom Payroll Services, LLC (Delaware)
WorldCom Purchasing, LLC (Delaware)
WorldCom Telecommunications A/S (Denmark)
WorldCom West Indies Limited (Trinidad & Tobago)
WorldCom Wireless (UK) Limited (United Kingdom)

Exhibit 23.1

Consent of Independent Registered Public Accounting Firm

The Board of Directors
MCI, Inc.:

We consent to the incorporation by reference in the registration statements (Nos. 333–115305, 333–115307, and 333–115308) on Form S–8 of MCI, Inc. and subsidiaries of our reports dated March 15, 2005, with respect to the consolidated balance sheets of MCI, Inc. and subsidiaries as of December 31, 2004 and 2003 (Successor Company), and the related consolidated statements of operations, shareholders' equity (deficit) and comprehensive (loss) income, and cash flows for the years ended December 31, 2004 (Successor Company), 2003 and 2002 (Predecessor Company) (collectively, the Company), management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2004 and the effectiveness of internal control over financial reporting as of December 31, 2004, which reports appear in the December 31, 2004 annual report on Form 10–K of the Company.

Our report dated March 15, 2005, with respect to the consolidated financial statements discussed above, is qualified due to the omission of earnings per share disclosures as required by Statement of Financial Accounting Standard ("SFAS") No. 128, *Earnings Per Share* for the years ended December 31, 2003 and 2002 (Predecessor). Our report also contains explanatory paragraphs that describe: the Company's filing for reorganization under Chapter 11 of the United States Bankruptcy Code discussed in Note 5 to the consolidated financial statements and the Company's adoption of fresh–start reporting pursuant to the American Institute of Certified Public Accountants Statement of Position 90–7, *Financial Reporting by Entities in Reorganization Under the Bankruptcy Code*, as of December 31, 2003 as further described in Note 4 to the consolidated financial statements. As a result, the consolidated financial statements of the Successor Company are presented on a different basis than those of the Predecessor Company and, therefore, are not comparable in all respects. In addition, our report indicates that the Company adopted new accounting pronouncements as discussed in Note 2 to the consolidated financial statements as follows: in 2003, SFAS No. 143, *Accounting for Asset Retirement Obligations*; in 2002, SFAS No. 142, *Goodwill and Other Intangible Assets* and SFAS No. 144, *Accounting for the Impairment or Disposal of Long–Lived Assets*.

Our report dated March 15, 2005, on management's assessment of the effectiveness of internal control over financial reporting and the effectiveness of internal control over financial reporting as of December 31, 2004, expresses our opinion that the Company did not maintain effective internal control over financial reporting as of December 31, 2004 because of the effect of a material weakness on the achievement of the objectives of the control criteria and contains an explanatory paragraph that states that a material weakness has been identified and included in management's assessment related to the accounting for income taxes due to a lack of personnel with adequate expertise in income tax accounting matters, a lack of documentation, insufficient historical analysis and ineffective reconciliation procedures. Because of these deficiencies, there is more than a remote likelihood that a material misstatement in the Company's annual or interim financial statements due to errors in accounting for income taxes could occur and not be prevented or detected by its internal control over financial reporting.

/s/ KPMG LLP

McLean, Virginia
March 15, 2005

Exhibit 23.2

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statements (No. 333–115305, 333–115307 and 333–115308) on Form S–8 of our report relating to the financial statements of Embratel Participações S.A. dated March 17, 2004 (except with respect to the matters discussed in Note 30 and 31, as to which the date is May 21, 2004), appearing in the Annual Report on Form 10–K of MCI Inc. for the year ended December 31, 2004.

/s/ DELOITTE TOUCHE TOHMATSU AUDITORES INDEPENDENTES

Rio de Janeiro, Brazil
February 21, 2005

Exhibit 31.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Michael D. Capellas, certify that:

1. I have reviewed this Annual Report on Form 10–K of MCI, Inc.;

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 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a–15(f) and 15d–15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) 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

   (d) 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 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: March 16, 2005

/s/ Michael D. Capellas
Michael D. Capellas
Chief Executive Officer

Exhibit 31.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Robert T. Blakely, certify that:

1. I have reviewed this Annual Report on Form 10–K of MCI, Inc.;

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 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a–15(f) and 15d–15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) 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

   (d) 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 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: March 16, 2005

/s/ Robert T. Blakely
Robert T. Blakely
Chief Financial Officer

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES–OXLEY ACT OF 2002

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 MCI, Inc. (the "Company"), that, to his knowledge, the Annual Report on Form 10–K of the Company for the period ended December 31, 2004 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 the Company. This written statement is being furnished to the Securities and Exchange Commission as an exhibit to such report. A signed original of this statement has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

Date: March 16, 2005

/s/ Michael D. Capellas
Michael D. Capellas
Chief Executive Officer

/s/ Robert T. Blakely
Robert T. Blakely
Chief Financial Officer

Created by 10KWizard Technology www.10KWizard.com

EXHIBIT 4

10kWIZARD
SEC POWER SEARCH

FORM 10-Q

MCI INC - MCIP

Filed: November 04, 2004 (period: September 30, 2004)

Quarterly report which provides a continuing view of a company's financial position

Table of Contents

PART I

Item 1. Condensed Consolidated Financial Statements (Unaudited)

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

ITEM 4. CONTROLS AND PROCEDURES

PART II

ITEM 1. LEGAL PROCEEDINGS

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

ITEM 5. OTHER INFORMATION

ITEM 6. EXHIBITS

SIGNATURE

EXHIBIT INDEX

EX-31.1

EX-31.2

EX-32 (Certifications required under Section 906 of the Sarbanes-Oxley Act of 2002)

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

FORM 10–Q

(Mark One)

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

For the quarterly period ending September 30, 2004

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 Number 001–10415

MCI, Inc.
(Exact name of registrant as specified in its charter)

Delaware	**20–0533283**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
22001 Loudoun County Parkway, Ashburn, Virginia	**20147**
(Address of principal executive offices)	**(Zip Code)**

Registrant's telephone number, including area code: (703) 886–5600

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 an accelerated filer (as defined in Rule 12b–2 of the Act). Yes ☒ No ☐

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes ☒ No ☐

As of September 30, 2004, there were 317,883,234 shares of MCI common stock outstanding.

TABLE OF CONTENTS

		Page
	PART I	
FINANCIAL INFORMATION		
Item 1.	Condensed Consolidated Financial Statements (Unaudited)	
	Condensed consolidated statements of operations for the three and nine-month periods ended September 30, 2004 and 2003	3
	Condensed consolidated balance sheets as of September 30, 2004 and December 31, 2003	4
	Condensed consolidated statements of cash flows for the nine-month periods ended September 30, 2004 and 2003	5
	Notes to condensed consolidated financial statements	6
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	32
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	57
Item 4.	Controls and Procedures	57
	PART II	
OTHER INFORMATION		
Item 1.	Legal Proceedings	59
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	60
Item 3.	Defaults Upon Senior Securities	60
Item 4.	Submission of Matters to a Vote of Security Holders	60
Item 5.	Other Information	60
Item 6.	Exhibits	60
Signature		61

MCI, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In Millions, Except Per Share Data)

	Successor Company	Predecessor Company	Successor Company	Predecessor Company
	Three-Month Period Ended September 30,		Nine-Month Period Ended September 30,	
	2004	2003	2004	2003
Revenues	$ 5,076	$ 5,969	$15,716	$ 18,720
Operating expenses:				
Access costs	2,580	2,989	8,156	9,067
Costs of services and products	629	646	1,915	2,084
Selling, general and administrative	1,246	1,647	4,174	4,843
Depreciation and amortization	493	602	1,583	1,720
Loss on property dispositions	7	8	—	14
Impairment charges related to property, plant and equipment	2,775	—	2,775	—
Impairment charges related to intangible assets	738	—	738	—
Total operating expenses	8,468	5,892	19,341	17,728
Operating (loss) income	(3,392)	77	(3,625)	992
Other (expense) income, net:				
Interest expense (contractual interest of $601 and $1,824 for the three and nine-month periods ended September 30, 2003, respectively)	(104)	(19)	(299)	(80)
Miscellaneous income, net	35	87	60	28
Reorganization items, net	—	(110)	—	(470)
(Loss) income from continuing operations before income taxes, minority interests and cumulative effect of a change in accounting principle	(3,461)	35	(3,864)	470
Income tax (benefit) expense	(61)	80	(8)	252
Minority interests, net of tax	—	—	—	(6)
(Loss) income from continuing operations before cumulative effect of a change in accounting principle	(3,400)	(45)	(3,856)	224
Net income (loss) from discontinued operations	2	(10)	(1)	(4)
(Loss) income before cumulative effect of a change in accounting principle	(3,398)	(55)	(3,857)	220
Cumulative effect of a change in accounting principle	—	—	—	(215)
Net (loss) income	$(3,398)	$ (55)	$ (3,857)	$ 5
Basic and diluted (loss) income per share:				
Continuing operations	$(10.66)		$ (12.00)	
Discontinued operations	0.01		—	
Loss per share	$(10.65)		$ (12.00)	
Basic and diluted shares used in calculation	319.1		321.4	

See accompanying notes to unaudited condensed consolidated financial statements.

MCI, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(In Millions, Except Share Data)

	Successor Company	
	As of September 30, 2004	As of December 31, 2003
ASSETS		
Current assets:		
Cash and cash equivalents	$ 5,588	$ 6,178
Accounts receivable, net of allowance for doubtful accounts of $889 as of September 30, 2004 and $1,762 as of December 31, 2003	2,972	4,348
Deferred taxes	964	990
Other current assets	718	836
Assets held for sale	33	176
Total current assets	10,275	12,528
Property, plant and equipment, net	6,234	11,538
Intangible assets, net	1,076	2,085
Deferred taxes	1	608
Other assets	306	711
	$17,892	$ 27,470
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 880	$ 1,722
Accrued access costs	1,783	2,349
Current portion of long-term debt	35	330
Accrued interest	197	25
Other current liabilities	2,907	4,361
Liabilities of assets held for sale	28	23
Total current liabilities	5,830	8,810
Long-term debt, excluding current portion	5,903	7,117
Deferred taxes	1,096	1,207
Other liabilities	561	714
Commitments and contingencies (Note 13)		
Minority interests	—	1,150
Shareholders' equity:		
MCI common stock, par value $0.01 per share; authorized: 3,000,000,000; issued and outstanding 317,883,234 as of September 30, 2004 and 314,856,250 as of December 31, 2003	3	3
Additional paid-in capital	8,496	8,639
Deferred stock-based compensation	(131)	(170)
Accumulated deficit	(3,857)	—
Accumulated other comprehensive loss	(9)	—
Total shareholders' equity	4,502	8,472
	$17,892	$ 27,470

See accompanying notes to unaudited condensed consolidated financial statements.

MCI, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Millions)

	Successor Company	Predecessor Company
	Nine-Month Period Ended September 30,	
	2004	2003
OPERATING ACTIVITIES		
Net (loss) income	$(3,857)	$ 5
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	1,583	1,720
Charges related to impairment of property, plant and equipment and intangible assets	3,513	—
Cumulative effect of a change in accounting principle	—	215
Minority interests, net of tax	—	(6)
Net realized gain on sale of investments	(5)	—
Bad debt provision	514	679
Loss on sale of property, plant and equipment	—	14
Gain on sale of assets held for sale	(9)	—
Deferred tax provision	(98)	3
Non-cash reorganization charges	—	312
Amortization of debt discount	114	—
Stock-based compensation expense	23	—
Loss (income) from equity investments	25	(8)
Other	(60)	181
Changes in assets and liabilities:		
Accounts receivable	300	(206)
Other current assets	92	(42)
Non-current assets	38	237
Accounts payable and accrued access costs	(787)	(353)
Other current liabilities	(991)	(54)
Other liabilities	29	(14)
Net cash provided by operating activities	424	2,683
INVESTING ACTIVITIES		
Additions to property, plant and equipment	(650)	(379)
Proceeds from sale of property, plant and equipment	39	247
Proceeds from the sale of non-core assets	581	—
Proceeds from the sale of investments	9	—
Cash paid for acquisitions, net of cash received	(13)	—
Net cash used in investing activities	(34)	(132)
FINANCING ACTIVITIES		
Principal repayments on debt	(38)	(20)
Cash restricted for line of credit	(141)	—
Dividends paid on common stock	(127)	—
Other	(59)	149
Net cash (used in) provided by financing activities	(365)	129
Net change in cash and cash equivalents	25	2,680
Net change in cash and cash equivalents from discontinued operations	(615)	(9)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	6,178	2,820
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 5,588	$ 5,491
SUPPLEMENTAL CASH FLOW INFORMATION:		
Cash paid for income taxes, net	$ 50	$ 15
Cash paid for interest, net of amounts capitalized	35	—
Cash paid for reorganization items	—	158
Non cash items:		
Conversion of preferred stock to common stock	—	58
Unrealized holding loss (gain) on investments	7	(8)

See accompanying notes to unaudited condensed consolidated financial statements.

MCI, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) The Organization and Description of Business

MCI, Inc., a state of Delaware corporation, (formerly known as WorldCom, Inc., (the "Predecessor Company" or "WorldCom") a public corporation organized in 1983 under the laws of Georgia) serves as a holding company for its direct and indirect domestic subsidiaries and foreign affiliates (collectively, the "Company", "Successor Company" or "MCI"). Prior to and including December 31, 2003, all operations of the business resulted from the operations of the Predecessor Company. All conditions required for adoption of fresh–start reporting were met on December 23, 2003 and the Company selected December 31, 2003 as the date to adopt the accounting provisions of fresh–start reporting. As a result, the fair value of the Predecessor Company's assets became the new basis for the Successor Company's consolidated balance sheet as of December 31, 2003, and all results of operations beginning January 1, 2004 are those of the Successor Company.

The Company is one of the world's leading global telecommunications companies, providing a broad range of communication services. The Company serves thousands of businesses and government entities throughout the world and provides voice and Internet communication services for millions of consumer customers. The Company operates one of the most extensive telecommunications networks in the world, comprising network connections linking metropolitan centers and various regions across North America, Europe, Asia, Latin America, the Middle East, Africa and Australia. The Company began doing business as MCI in 2003.

In March 2004, the Company realigned its operations into three new business segments and began operating under these segments in the second quarter of 2004. Effective with the realignment, the Company's business segments are as follows:

- **Enterprise Markets** serves large customers with complex communication requirements that have previously been served by the Business Markets segment, including Global Accounts, Government Accounts, Conferencing, and MCI Solutions customers, but excluding medium size commercial and wholesale accounts which were previously included in Business Markets.

- **U.S. Sales & Service** serves small, mid–sized and corporate customers. In addition, U.S. Sales & Service comprises MCI's consumer operation which includes telemarketing, customer service and direct response marketing.

- **International & Wholesale Markets** serves businesses, government entities and telecommunications carriers outside the United States as well as the wholesale accounts previously included in Business Markets.

On July 21, 2002 (the "Petition Date"), the Predecessor Company and substantially all of its domestic subsidiaries (the "Debtors") filed voluntary petitions for relief in the U.S. Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court") under Chapter 11 of Title 11 of the U.S. Bankruptcy Code (the "Bankruptcy Code" or "Chapter 11"). The Debtors continued to operate their businesses and manage their properties as debtors–in–possession through the close of business on April 19, 2004. The Predecessor Company filed its joint Plan of Reorganization (the "Plan") with the Bankruptcy Court and, on October 31, 2003, the Bankruptcy Court confirmed the Plan. The Predecessor Company emerged from Chapter 11 on April 20, 2004 (the "Emergence Date") and merged with and into the Successor Company.

(2) Summary of Significant Accounting Policies

Basis of Presentation

The condensed consolidated financial statements and related notes as of September 30, 2004, and for the three and nine–month periods ended September 30, 2004 and 2003, are unaudited and in the opinion of management include all adjustments, consisting of normal recurring adjustments, necessary for a fair

presentation of the financial position and results of operations of the Company. The operating results for the interim periods are not necessarily indicative of the operating results to be expected for a full year or for other interim periods. As a result of the Company's adoption of fresh-start reporting, the consolidated financial statements of the Successor Company are presented on a different basis than those of the Predecessor Company and, therefore, are not comparable in all respects. In addition, the Company's consolidated investment in Embratel Participações S.A. and subsidiaries ("Embratel") was sold during the third quarter of 2004. The Company's statements of operations for the three and nine-month periods ended September 30, 2004 and 2003 and its statements of cash flows for the nine-month periods ended September 30, 2004 and 2003 reflect Embratel's results of operations and cash flows as discontinued operations. Additionally, the condensed consolidated balance sheet as of December 31, 2003 and September 30, 2004 are not comparable due to the removal of these assets and liabilities upon consummation of the sale transaction during the third quarter of 2004.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP") have been condensed or omitted pursuant to instructions, rules and regulations prescribed by the Securities and Exchange Commission ("SEC"). Although management believes that the disclosures provided are adequate to make the information presented not misleading, management recommends that these unaudited condensed consolidated financial statements be read in conjunction with the audited consolidated financial statements and the related footnotes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2003 filed with the SEC on April 29, 2004.

Use of Estimates

The Company uses estimates and assumptions in the preparation of its consolidated financial statements in conformity with GAAP. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates. Estimates are used when accounting for revenues and related allowances, allowance for doubtful accounts, accrued access costs, depreciation and amortization of property, plant and equipment and intangible assets, impairment, income taxes, acquisition related assets and liabilities, contingent liabilities, and fresh-start reporting. The Company evaluates and updates its assumptions and estimates on an ongoing basis and may employ independent third party specialists to assist in its evaluations.

Basis of Financial Statement Preparation

For periods presented subsequent to the Petition Date through December 31, 2003, the accompanying unaudited condensed consolidated financial statements have been prepared in accordance with Statement of Position 90-7, "*Financial Reporting by Entities in Reorganization Under the Bankruptcy Code*" ("SOP 90-7"). Interest was not accrued on debt that was subject to compromise subsequent to the Petition Date. Reorganization items include the expenses, realized gains and losses, and provisions for losses resulting from the reorganization under the Bankruptcy Code, and are reported separately as reorganization items in the Company's unaudited condensed consolidated statements of operations for the three and nine-month periods ended September 30, 2003. Cash used for reorganization items is disclosed as a supplement to the unaudited condensed consolidated statements of cash flows.

Stock-based Compensation

The Company has two stock-based compensation plans, a Management Restricted Stock Plan ("MRSP") and an Employee Stock Purchase Plan ("ESPP"), which provide for the granting of stock-based compensation to

MCI, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

management and employees. The Company records compensation expense in its statements of operations for the MRSP. For the ESPP, the Company accounts for this plan in accordance with the intrinsic value method of Accounting Principles Board Opinion No. 25, *"Accounting for Stock Issued to Employees"* ("APB Opinion No. 25"), and has adopted the disclosure–only provisions of Statement of Financial Accounting Standards ("SFAS") No. 123, *"Accounting for Stock–Based Compensation"* ("SFAS No. 123"). Under the intrinsic value method, compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeds the exercise price of the stock–based award.

In December 2002, the Financial Accounting Standards Board ("FASB") issued SFAS No. 148, *"Accounting for Stock–Based Compensation—Transition and Disclosure"* ("SFAS No. 148"), which became effective for fiscal years ended after December 15, 2002. SFAS No. 148 requires that certain pro forma information be presented in the summary of significant accounting policies note to the consolidated financial statements, assuming the Company recognized its stock–based compensation using the fair value method. The fair value of the stock–based compensation for the Company's ESPP was estimated at the beginning of the offering period using the Black–Scholes option–pricing model and the following assumptions: volatility of 55%, risk–free interest rate of 1.79%, 0.41 year expected life and dividend yield of 10.81%. The Company's MRSP was not included in the Black–Scholes calculation as the fair value of the compensation expense related to the plan is expensed in the Company's condensed consolidated statement of operations.

If compensation costs had been recognized based on the fair value recognition provisions of SFAS No. 123, the pro forma amounts of the Company's net loss for the three and nine–month periods ended September 30, 2004 would have been as follows (in millions, except per share amounts):

	Successor Company	
	Three–Month Period Ended September 30, 2004	Nine–Month Period Ended September 30, 2004
Net loss, as reported	$(3,398)	$ (3,857)
Add: Stock–based employee compensation expense included in reported net loss	12	23
Deduct: Total stock–based employee compensation expense determined under the fair value method for all awards	(14)	(25)
Pro forma net loss	$(3,400)	$ (3,859)
Diluted loss per share:		
Diluted—as reported	$(10.65)	$ (12.00)
Diluted—pro forma	$(10.65)	$ (12.01)

The Company has not provided pro forma disclosures as defined by SFAS No. 148 for 2003 as it does not believe that this information for any compensation plan that was terminated on the Emergence Date is relevant in any material respect for users of its consolidated financial statements because all equity interests existing in 2003, including the interests of the Predecessor Company's WorldCom group common stockholders and MCI group common stockholders, were eliminated (without a distribution) on the Emergence Date.

Consolidation

The condensed consolidated financial statements include the accounts of all controlled subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

MCI, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Other

During the second quarter of 2004, the Company recorded a $95 million reduction in access costs in its condensed consolidated statement of operations for a change in previously recorded expenses regarding contributions to the Universal Service Fund related to 2003 and the first quarter of 2004.

Reclassifications

Certain prior period amounts have been reclassified to conform to current period presentation.

Adjustment to Previously Issued Financial Statements

As reported in the second quarter, the Company determined that it had recorded in error a restatement entry which had the effect of reducing accounts receivable by $301 million through a charge to expense in the year ended December 31, 2000. The reported 2000 net loss of $48.9 billion should have been $48.6 billion, or 0.5% lower, and the Company's assets of $44.2 billion should have been $44.5 billion, or 0.6% higher. In 2001, $35 million of the amount reversed and left a remaining $266 million understatement of accounts receivable as of December 31, 2001. This situation remained unchanged until, as a result of the application of fresh-start accounting as of December 31, 2003, the previously expensed $266 million was reversed in the Company's statement of operations as a component of the $22.3 billion reorganization gain. Without this expense reversal, the Company's 2003 net income of $22.2 billion would have been $21.9 billion, or 1.2% lower. As a result of the reversal of the expense in 2003, the cumulative impact to the Company's December 31, 2003 consolidated retained earnings was zero. The Company has assessed the impact on the 2000, 2001 and 2003 statements of operations as well as the consolidated balance sheets as of December 31, 2000, 2001, 2002 and 2003 and determined that the impact was not material to any period.

The impact of this reduction of accounts receivable in the consolidated balance sheet as of December 31, 2003 resulted in a misclassification of $266 million between accounts receivable and long-lived assets in the Company's allocation of reorganization value under fresh-start accounting. To properly reflect the allocation of reorganization value as of December 31, 2003, the Company has reflected a reclassification entry in its consolidated balance sheet as of December 31, 2003, as presented herein, to reflect an increase of $266 million to its accounts receivable balance and reductions in its property, plant and equipment and intangible assets. The Company's September 30, 2004 consolidated balance sheet reflects the impact of this reclassification.

The adjustment of this item also resulted in a decrease of $6 million to the Company's long-term deferred tax liability which has been reflected in the consolidated balance sheet as of December 31, 2003 and September 30, 2004, as presented herein.

New Accounting Standards

In December 2003, the FASB issued SFAS No. 132 (revised 2003), *"Employers' Disclosures about Pensions and Other Postretirement Benefits"* ("SFAS No. 132 (R)"). SFAS No. 132 (R) revises the annual and interim disclosure requirements about pension and other postretirement benefits. This revision requires disclosures additional to those included in the original SFAS No. 132 about assets, obligations, cash flows and net periodic benefit cost of defined benefit pension plans and other defined benefit postretirement plans. The required information is provided separately for pension plans and for other postretirement benefit plans. The Company adopted the provisions of SFAS No. 132 (R) as of December 31, 2003 without any impact on its consolidated results of operations, financial position and cash flows.

In December 2003, the FASB issued FASB Interpretation No. 46 (Revised December 2003), *"Consolidation of Variable Interest Entities"* ("FIN 46R"). This standard replaces FIN 46, *"Consolidation of Variable Interest*

Entities," that was issued in January 2003 to address certain situations in which a company should include in its financial statements the assets, liabilities and activities of another entity. The Company adopted the provisions of FIN 46R as of December 31, 2003 without any impact on its consolidated results of operations, financial position and cash flows.

(3) Impairment Charges

The Company assesses recoverability of its indefinite–lived and long–lived assets to be held and used whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. Impairment analyses of long–lived and indefinite–lived assets are performed in accordance with SFAS No. 144, *"Accounting for the Impairment or Disposal of Long–Lived Assets"* ("SFAS No. 144"), and SFAS No. 142 *"Goodwill and Other Intangible Assets"* ("SFAS No. 142"). Impairment evaluations are performed at the lowest asset or asset group level for which identifiable cash flows are largely independent of the cash flows of other assets or asset groups. The Company generates most of its cash flows from products and services that are principally delivered to customers over its integrated telecommunications network and related intangible assets. Therefore, evaluations are performed at the entity level, excluding discontinued operations and assets held for sale, as a single group.

The industry is in a state of transition where traditional business lines are facing significant overcapacity in the marketplace, pricing pressures, changes in product mix, and customers' continued efforts to reconfigure and consolidate their networks in order to achieve lower overall costs and better efficiencies. Concurrently, the industry is migrating to more advanced network technologies and primarily focused around IP based platforms, and customers are requiring more advanced network services including network monitoring, traffic analysis, and comprehensive security solutions. The industry has also seen a general migration of customers from dial–up services to broadband and various wireless services. Additionally, the Company's regulatory climate deteriorated due to a decision by the U.S. Court of Appeals for the D.C. Circuit that invalidated the Federal Communications Commission's "Triennial Review" local competition rules, which set prices that incumbent providers could charge competitive providers such as the Company for unbundled network element platforms ("UNE–P"), an essential component of the Company's Mass Market local phone service. Although several petitions were filed at the Supreme Court seeking review of the D.C. Circuit's decision, the Solicitor General and the FCC declined to seek such review, and the Supreme Court subsequently denied the petitions. The FCC has adopted interim unbundling rules (effective September 13, 2004) to maintain certain ILEC unbundling obligations under interconnection agreements as they existed prior to the D.C Circuit's mandate. As a result, the Company's costs for providing this service are expected to increase significantly in 2005. Some of the Company's competitors have announced their intentions to exit from this market, and the cost increases may force the Company to reduce efforts to acquire new customers and withdraw from certain markets. The Company therefore anticipates that revenues from that segment will continue to decline.

Given the market, business and regulatory conditions, the Company reevaluated its financial forecasts and strategy in the third quarter of 2004 when it became apparent that these trends would continue into the future. Updated cash flow and profitability projections and forecasts were developed taking into account both the 2004 changes in the competitive landscape and the regulatory issues facing the Company. The Company's executives reviewed these projections with the Audit Committee of the Board of Directors during the third quarter.

Based on the revised projections, the Company determined that an impairment analysis of its indefinite–lived and long–lived assets was required during the third quarter of 2004. In connection with this analysis, the Company evaluated its property, plant and equipment and definite and indefinite–lived intangible assets, including customer lists. The Company developed estimates of future undiscounted cash flows to test the recoverability of its long–lived and indefinite–lived assets. These estimates were compared to the carrying values

of the assets, which resulted in the conclusion that the Company could not recover its carrying values through projected future operations. With the assistance of an independent third party valuation specialist, the Company further calculated the fair value of its long–lived and indefinite–lived assets based on the discounted cash flow analyses that utilized the revised management projections of revenues and profitability from September 1, 2004 through 2009. These projections were used in various scenarios utilizing a weighted average cost of capital between 10%–14%, a 2% terminal growth rate, certain working capital assumptions and total entity value assumptions.

The Company concluded that the carrying values of its definite–lived assets exceeded their estimated fair values by approximately $3.3 billion ($2.8 billion related to property, plant and equipment and $478 million related to definite–lived intangible assets) and the carrying value of an indefinite–lived asset exceeded its estimated fair value by approximately $260 million. These amounts represented the difference between the calculated fair values of the assets and their associated carrying values, and were recorded as a separate component of operating expenses in the condensed consolidated statements of operations for the three and nine–month periods ended September 30, 2004. The Company's management reviewed the results of the impairment analysis with the Board of Directors, and the Board of Directors approved the impairment charge on October 15, 2004.

As a result of the impairment charge of approximately $260 million to an indefinite–lived intangible asset, the Company recognized a $99 million tax benefit which reduced its long–term deferred tax liability as the impairment reduced the difference between the book and tax basis. The impairment charges, after taxes, contributed approximately $3.4 billion to the Company's net losses for the three and nine–month periods ended September 30, 2004 (loss per share of $(10.70) and $(10.62), respectively).

(4) Voluntary Reorganization under Chapter 11

Bankruptcy Proceedings

On July 21, 2002, the Predecessor Company and substantially all of its direct and indirect domestic subsidiaries (the "Initial Filers") filed voluntary petitions for relief in Bankruptcy Court under Chapter 11. On November 8, 2002, the Predecessor Company filed bankruptcy petitions for an additional 43 of its domestic subsidiaries, most of which were effectively inactive and none of which had significant debt (collectively with the Initial Filers, the "Debtors"). The Debtors continued to operate their businesses and manage their properties as debtors–in–possession. The Bankruptcy Court consolidated the Debtors' Chapter 11 cases for procedural purposes and they were jointly administered. As a consequence of the bankruptcy filing, most litigation against the Debtors was stayed.

The Plan was confirmed by the Bankruptcy Court on October 31, 2003. On the Emergence Date, the provisions of the Plan were implemented. A summary of the significant provisions of the Plan is set forth below:

- The Predecessor Company merged with and into MCI, Inc. whereby the separate existence of the Predecessor Company ceased and MCI is the surviving company;

- All common and preferred equity shares of the Debtors (and all stock options and warrants) including WorldCom group common stock, MCI group common stock, WorldCom series D, E and F preferred stock, WorldCom Synergies Management Company preferred stock, WorldCom quarterly income preferred securities and Intermedia series B preferred stock were cancelled;

- All debt securities of the Debtors were settled and cancelled;

- Unexpired leases and executory contracts of the Debtors were assumed or rejected;

- MCI issued approximately $2.0 billion principal amount of 5.908% Senior Notes due 2007, approximately $2.0 billion principal amount of 6.688% Senior Notes due 2009 and approximately $1.7 billion principal amount of 7.735% Senior Notes due 2014;

- Approximately 296 million shares of new MCI common stock were to be issued to settle claims of debt holders, 10 million shares were issued to settle the SEC civil penalty (as discussed below) and approximately 20 million shares were estimated to be issued to settle the claims of general unsecured creditors;

- Approximately 11 million shares of new MCI common stock were reserved for issuance under the new Management Restricted Stock Plan. In addition, approximately 2 million shares were reserved for issuance under the new Employee Stock Purchase Plan and it is anticipated that such reserved shares will be utilized to fund the Company's obligations under the plan rather than utilizing shares purchased in the open market;

- Total payments of approximately $2.6 billion in cash were estimated in the Plan to be paid to settle certain claims against the Debtors, including the SEC civil penalty claim referred to below; and

- An SEC civil penalty claim was settled by payment of $500 million in cash and, as noted above, the transfer of 10 million shares of new MCI common stock having a value of $250 million (based on the valuation set forth in the Plan). The funds paid and common stock transferred were distributed pursuant to the Fair Funds provisions of the Sarbanes–Oxley Act of 2002.

The Plan also requires pursuant to Section 5.07 that the Board of Directors conduct a reasonable review of the Company's cash needs, including amounts that may be necessary to satisfy all claims to be paid in cash pursuant to the Plan. Accordingly, the Board of Directors commenced a comprehensive review and sought information and guidance from management and financial advisors to determine the amount of excess cash greater than $1 billion. On August 5, 2004, the Board of Directors completed its review of the Company's excess cash pursuant to Section 5.07 of the Plan and declared the amount of excess cash to be $2.2 billion. The Board of Directors decided to distribute a portion of the excess cash through a return of capital to shareholders and declared a cash dividend of $0.40 per share payable on September 15, 2004 to shareholders of record on September 1, 2004. On October 15, 2004, the Board of Directors, pursuant to Section 5.07 of the Plan and continuing its distribution of the Company's excess cash as a return of capital to shareholders, declared another cash dividend of $0.40 per share payable on December 15, 2004 to shareholders of record on December 1, 2004.

Impacts of the Application of the Plan

Creditor Settlements

During the three and nine–month periods ended September 30, 2004, the Company paid approximately $129 million and $1.1 billion, respectively, in cash, and issued a total of approximately 1.2 million and approximately 3.8 million shares of common stock, respectively, to satisfy certain provisions of the Plan. The Company continues its settlement process of outstanding claims. During the three–month period ended September 30, 2004, the Company recorded net settlement losses of $14 million as an increase to selling, general and administrative expenses in its condensed consolidated statement of operations. During the three–month period ended June 30, 2004, the Company recorded net settlement gains of $62 million, which were composed of an increase to revenues of $32 million, a decrease to access costs of $19 million and a decrease to selling, general and administrative expenses of $11 million in its condensed consolidated statement of operations. The net settlement gains and losses reflect the differences between original estimated claim amounts and settlement amounts finalized in the period.

MCI, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Interest expense

No interest expense related to pre–petition debt was accrued following the Petition Date up to the Emergence Date. If the Debtors had recognized interest expense on the basis of the amounts they were contractually required to pay, approximately $601 million would have been recorded in the three–month period ended September 30, 2003, and approximately $701 million and $1.8 billion, respectively, would have been recorded in the nine–month periods ended September 30, 2004 and 2003. The Successor Company did recognize $104 million and $299 million of interest expense in the three and nine–month periods ended September 30, 2004, respectively, that included the accretion of the discount for the new $5.7 billion debt obligations issued on the Emergence Date and interest expense on the senior notes subsequent to the Emergence Date. There was no requirement to pay interest on the debt prior to the Emergence Date since it had not been issued, and as such, the amount is excluded from the contractual interest amounts noted above.

Shares Issued as a result of the Plan

During the second quarter of 2004, in accordance with the Plan, the Company issued approximately 296 million shares of MCI common stock to settle claims of debt holders and 10 million shares to settle the SEC civil penalty. The Company also reserved approximately 11 million shares of MCI common stock for issuance under the new MRSP, of which approximately 8.6 million shares of restricted stock were granted on the Emergence Date. As contemplated in the Plan, the Company expected to issue approximately 20 million shares of MCI common stock pursuant to the Plan to settle claims of general unsecured creditors. This amount has been reduced from 20 million to 8.1 million as of September 30, 2004 as a result of the issuance of approximately 3.8 million shares during the nine–month period ended September 30, 2004, 0.5 million shares that will not be issued related to certain unsecured creditors receiving cash in lieu of stock, and a change in estimate of 7.6 million shares that are no longer expected to be issued.

Reorganization items, net

The Debtors had commenced restructuring efforts prior to the Petition Date. Following the filing of the Chapter 11 cases, the Debtors, together with their financial and legal advisors, reviewed and analyzed their businesses, owned properties, contracts, and leases to determine if any of these owned assets should be divested and which contracts and leases should be rejected or assumed during the Chapter 11 cases. The restructuring efforts include asset dispositions, sale of businesses, rejection of leases and contracts, and other operational changes.

The Company continued to incur reorganization costs during the three and nine–month periods ended September 30, 2004 and will continue to experience reorganization expenses for professional fees and other bankruptcy costs. As the Company adopted the provisions of fresh–start reporting on December 31, 2003, for accounting purposes, reorganization expenses and changes in estimates to reorganization items previously accrued have been included in the appropriate captions within the condensed consolidated statement of operations, primarily selling, general, and administrative expenses. For the three and nine–month periods ended September 30, 2004, the amounts of such expenses were $11 million and $37 million, respectively, and were for professional services related to the Company's bankruptcy proceedings.

MCI, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Reorganization items for the three and nine–month periods ended September 30, 2003 consisted of the following (in millions):

	Predecessor Company	
	Three–Month Period Ended September 30, 2003	Nine–Month Period Ended September 30, 2003
Contract rejections	$ (33)	$ (186)
Employee retention, severance and benefits	(33)	(104)
Loss on disposal of assets	(4)	(22)
Lease terminations	(33)	(165)
Professional fees	(26)	(66)
Gains on settlements with creditors	9	45
Interest income earned by the debtor entities during reorganization	10	28
Expense from reorganization items, net	$(110)	$ (470)

(5) Fresh–Start Reporting

In accordance with SOP 90–7, the Predecessor Company adopted fresh–start reporting as of the close of business on December 31, 2003. Upon applying fresh–start reporting, a new reporting entity (the Successor Company) is deemed to be created and the recorded amounts of assets and liabilities are adjusted to reflect their estimated fair value. Thus, the consolidated balance sheet as of December 31, 2003 gives effect to allocations to the carrying value of assets or amounts and classifications of liabilities that were necessary when adopting fresh–start reporting. During 2004, the Company adjusted the carrying value of certain assets and liabilities from the previously estimated values as appraisals and valuations were completed. As these adjustments were recorded in each quarter, associated year–to–date depreciation and amortization expense amounts were also adjusted for the effects of the changes in carrying values. As of September 30, 2004, the Company completed its assessment of the fair values of its assets and liabilities, and as such, no further adjustments will be recorded, except for adjustments that may be related to deferred tax assets and contingencies as discussed below.

During the second quarter of 2004, the Company determined that approximately $132 million of property tax liabilities and $110 million of other liabilities that should not have been adjusted in fresh–start accounting were reduced by approximately $152 million in the Company's application of fresh–start accounting at December 31, 2003. Due to the application of fresh–start reporting, these errors were offset by fresh–start adjustments and therefore had no impact on the Company's 2003 net income. However, these errors caused both accounts payable and long–lived assets to be understated by approximately $152 million, representing 0.5% of the Company's total assets of $27.5 billion and approximately 0.8% of its $19.0 billion total liabilities as of December 31, 2003, which it determined to be immaterial to its 2003 consolidated balance sheet. The Company's September 30, 2004 consolidated balance sheet reflects the correction of these immaterial errors.

As of December 31, 2003, the Company had various net deferred tax assets and tax contingencies which remain unresolved. In accordance with SFAS No. 109, *"Accounting for Income Taxes,"* any future changes in these balances that existed as of the fresh–start date will be adjusted to intangible assets, until exhausted, then to additional paid–in–capital and not through income.

The estimates and assumptions used in the valuations are inherently subject to uncertainties and contingencies beyond the control of the Company. Accordingly, there can be no assurance that the estimates, assumptions, and values reflected in the valuations will be realized, and actual results could vary materially.

MCI, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table displays the effects of applying fresh-start reporting, giving pro forma effect, retroactive to December 31, 2003, to fair value adjustments recorded to the Company's assets and liabilities during the first nine months of 2004 (in millions):

	Successor Company As of December 31, 2003	Fresh-Start Valuation Adjustments[a]	Successor Company Pro Forma As of December 31, 2003[b]
ASSETS			
Current assets:			
Cash and cash equivalents	$ 6,178	$ —	$ 6,178
Accounts receivable, net	4,348	—	4,348
Deferred taxes	990	—	990
Other current assets	1,012	(25)[c]	987
Total current assets	12,528	(25)	12,503
Property, plant and equipment, net	11,538	183[d]	11,721
Intangible assets, net	2,085	147[e]	2,232
Deferred taxes	608	—	608
Other assets	711	(224)[f]	487
	$ 27,470	$ 81	$ 27,551
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities:			
Accounts payable and accrued access costs	$ 4,071	$ 116[g]	$ 4,187
Current portion of long-term debt	330	—	330
Other current liabilities	4,409	(33)[h]	4,376
Total current liabilities	8,810	83	8,893
Long-term debt, excluding current portion	7,117	—	7,117
Deferred taxes	1,207	(2)	1,205
Other liabilities	714	—	714
Minority interests	1,150	—	1,150
Shareholders' equity:			
MCI common stock	3	—	3
Additional paid-in capital	8,639	—	8,639
Deferred stock-based compensation	(170)	—	(170)
Total shareholders' equity	8,472	—	8,472
	$ 27,470	$ 81	$ 27,551

(a) To adjust the carrying value of the Company's assets and liabilities upon completion, during the first nine months of 2004, of the Company's review in conjunction with an independent third party valuation specialist.

(b) Includes all adjustments recorded during the first nine months of 2004 that were related to the carrying values on the Company's December 31, 2003 balance sheet.

(c) Includes adjustments to decrease prepaid expenses by ($60) million, primarily related to the fair value of certain prepaid indefeasible rights of use agreements, and to increase certain asset carrying values classified in assets held for sale by $35 million.

(d) Includes adjustments which increased property, plant and equipment by $183 million due to increases in the valuation of enterprise license agreements and a decrease in the valuation of indefeasible rights of use impacted by changes in the allocation of the amount of economic obsolescence and negative goodwill.

(e) Includes adjustments which increased intangibles by $46 million due to changes in the allocation of the amount of economic obsolescence and negative goodwill. In addition, the original right of way adjustment of $101 million was reclassified from other assets.

(f) Includes adjustments to reduce the carrying value of certain indefeasible rights of use agreements by ($123) million and a reclassification of the original right of way adjustment to intangible assets, which reduced other assets by ($101) million.

(g) Includes adjustments increasing accounts payable and accrued access costs by $116 million due to property tax and other liabilities that should not have been adjusted in fresh-start reporting.

(h) Includes adjustments decreasing deferred revenues related to certain capacity sales agreements by ($144) million and increasing other liabilities by $111 million, primarily related to the recognition of an unfavorable lease accrual of $91 million as well as increases to property tax and other liabilities of $20 million that should not have been adjusted in fresh-start reporting.

(6) Loss per Share

The Successor Company adopted a new capital structure as of December 31, 2003 upon the adoption of fresh-start reporting. On the Emergence Date, the Successor Company issued approximately 315 million shares of new MCI common stock, which included approximately 8.6 million shares of restricted stock. Under fresh-start reporting, these shares were reflected as outstanding at December 31, 2003. In addition, on the Emergence Date, the Company expected to issue additional shares pursuant to the Plan to unsecured creditors, which were not reflected as outstanding at December 31, 2003, however all conditions of distribution had been met. These shares were considered contingently issuable under SFAS No. 128, *"Earnings per Share."* During the three-month period ended September 30, 2004, share issuances, changes in distribution and changes in estimate reduced the amount of contingently issuable shares to approximately 8.1 million as of September 30, 2004. The Company's calculations of weighted average shares outstanding for the three and nine-month periods ended September 30, 2004 are as follows (in millions):

	Successor Company	
	Three-Month Period Ended September 30, 2004	Nine-Month Period Ended September 30, 2004
Weighted average common shares outstanding	317.5	316.1
Add: Weighted average shares contingently issuable to unsecured creditors	8.9	13.4
Less: Weighted average unvested restricted stock[1]	(7.3)	(8.1)
Weighted average common shares outstanding used in basic calculation	319.1	321.4
Add: Weighted average unvested restricted stock[2]	—	—
Weighted average common shares outstanding used in diluted calculation	319.1	321.4

(1) As these shares were not vested during the period, they have been excluded from the weighted average share calculation used to determine basic loss per share.

(2) Calculation of diluted shares excludes the unvested shares of restricted stock that would be anti-dilutive.

MCI, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The Company's calculations of basic and diluted (loss) income per share for the three and nine-month periods ended September 30, 2004 are as follows (in millions, except per share amounts):

	Successor Company	
	Three-Month Period Ended September 30, 2004	Nine-Month Period Ended September 30, 2004
(Loss) income, as reported:		
Continuing operations	$(3,400)	$ (3,856)
Discontinued operations	2	(1)
Net loss	$(3,398)	$ (3,857)
Basic and diluted (loss) income per share:		
Continuing operations	$(10.66)	$ (12.00)
Discontinued operations	0.01	
Loss per share	$(10.65)	$ (12.00)
Weighted average common shares outstanding used in basic and diluted calculation	319.1	321.4

Historical earnings per share information for the three and nine-month periods ended September 30, 2003 has not been presented. The Company does not believe that this information is relevant in any material respect for users of its financial statements because all equity interests existing in 2003, including the interests of the Predecessor Company's WorldCom group common stockholders and MCI group common stockholders, were eliminated (without a distribution) on the Emergence Date. In addition, because of the creation of the two class common stock structure (WorldCom group common stock and MCI group common stock) by the Predecessor Company in July 2001, in order to present earnings per share information, the Company would be required to determine the net income or loss generated by the WorldCom group and MCI group separately. Primarily as a result of the extensive recreation of many of the Predecessor Company's historical financial entries, many of its revenue and expense items cannot be allocated to the appropriate group, making a determination of separate net income or loss information for each group impracticable.

(7) Severance and Restructuring Programs

During the first nine months of 2004, the Company announced workforce reductions related to all segments of its business which included the impact of closing three consumer call centers and reducing staffing in three others, in large part due to the effects of "Do Not Call" telemarketing laws. As of September 30, 2004, approximately 12,000 individuals in the Company's workforce have been identified and notified that their positions would be eliminated.

In the three and nine-month periods ended September 30, 2004, the Company recorded $12 million and $156 million, respectively, as selling, general and administrative expenses and costs of services and products for employee termination costs in its condensed consolidated statements of operations. In the three and nine-month periods ended September 30, 2003, the Company recorded $23 million and $84 million, respectively, related to employee severance programs as reorganization items, net in its condensed consolidated statements of operations.

MCI, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

During the three and nine-month periods ended September 30, 2004, approximately 2,200 and 9,100 employees, respectively, across all business segments were terminated. Additionally, during 2004, 2,000 employees resigned after notification of termination, but prior to receiving any severance benefits. The following table outlines the Company's accrual of severance expense and payments for terminated employees during the three and nine-month periods ended September 30, 2004 (in millions):

	Successor Company
Accrued severance and termination costs as of January 1, 2004	$ 11
For the three-month period ended March 31, 2004:	
Severance and termination charges	54
Cash payments for terminated employees	(26)
Accrued severance and termination costs as of March 31, 2004	39
For the three-month period ended June 30, 2004:	
Severance and termination charges	90
Cash payments for terminated employees	(59)
Accrued severance and termination costs as of June 30, 2004	70
For the three-month period ended September 30, 2004:	
Severance and termination charges	12
Cash payments for terminated employees	(61)
Accrued severance and termination costs as of September 30, 2004	$ 21

The Company identified certain properties related to the closing of call centers which it planned to vacate and sublease, where possible. In accordance with SFAS No. 146, *"Accounting for Costs Associated with Exit or Disposal Activities,"* the Company recorded a charge of approximately $1 million and $9 million as selling, general and administrative expenses in its condensed consolidated statements of operations for the three and nine-month periods ended September 30, 2004, respectively.

(8) Discontinued Operations and Assets Held for Sale

The Company has identified certain non-core assets that it has determined are not part of its expected future operations. As such, these assets and businesses, once identified and qualifying for discontinued operations under SFAS No. 144, are reflected as discontinued operations in the condensed consolidated statements of operations and as assets held for sale in the condensed consolidated balance sheet.

Discontinued Operations

In May 2002, the Predecessor Company committed to a plan to exit its WorldCom Wireless ("Wireless") resale business because of continuing operating losses. In July 2002, the Predecessor Company sold its wireless customer contracts, with no book value, to several wireless providers and resellers for a total of approximately $34 million, which was recognized as a gain in 2002. All contracts were effectively transitioned to other providers by October 2002. During the nine-month period ended September 30, 2003, the Company recorded $10 million of revenue for amounts received during the period.

In June 2003, the Predecessor Company decided to dispose of its Multichannel Multipoint Distribution Service ("MMDS") business which included network equipment, licenses and leases utilized for the provision of wireless telecommunications services via Multichannel Multipoint Distribution Service. In June 2003, the Predecessor Company received Bankruptcy Court approval to dispose of these assets, and this standalone entity was reclassified to discontinued operations under SFAS No. 144, and related revenues and expenses were reclassified to discontinued operations for all periods presented.

MCI, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

On July 8, 2003, an Asset Purchase Agreement was entered into with Nextel Spectrum Acquisition Corp. ("Nextel") for the sale of substantially all of the assets of MMDS for $144 million in cash. In addition, the Company entered into a three–year extension of a customer contract between subsidiaries of MCI and Nextel. The sale was approved by the Bankruptcy Court on July 22, 2003, as modified in certain respects. The Company completed the sale in May 2004 and received $144 million in cash for the assets which was equal to their carrying value.

In November 2003, the Board of Directors approved a plan to dispose of its 19% economic investment in Embratel, as well as other Latin American entities. On March 15, 2004, the Company announced that it had entered into a definitive agreement to sell its ownership interest in Embratel and other Latin American subsidiaries to Telefonos de Mexico. On April 21, 2004, the agreement was amended which increased the cash purchase price to $400 million from $360 million. On April 27, 2004, these assets qualified as discontinued operations under SFAS No. 144 when the Company received bankruptcy court approval for the sale. Accordingly, the Company has reclassified all revenues and expenses to discontinued operations for all periods presented. On July 23, 2004, the Company completed the divestiture of its 19% equity interest in Embratel and received $350 million, the remaining portion of the $400 million sales price beyond the $50 million deposit previously received. As of the sale date, all obligations under the Share Purchase Agreement were completed. The Company recognized a gain on the sale of approximately $9 million within discontinued operations in its condensed consolidated statement of operations during the three–month period ended September 30, 2004.

In June 2004, the Company decided to dispose of additional Latin American operations and began the marketing of Proceda Tecnologia e Informatica S.A. ("Proceda"), an information technology outsourcing company in Brazil specializing in the following areas: data center services, mainframe services, hosting, technical support, help desk management, integrated solutions, and e–business. These assets qualified as discontinued operations under SFAS No. 144 in June 2004 and, accordingly, the Company has reclassified all revenues and expenses to discontinued operations for all periods presented and reclassified all assets and liabilities as "held for sale" in the condensed consolidated balance sheet as of September 30, 2004. The Company continues its marketing efforts and expects to close the sale of these assets prior to year–end.

In June 2004, the Company commenced its internal evaluation related to OzEmail Pty. Ltd ("Ozemail"), an internet service provider providing dial–up, broadband and wireless products to Australian consumers and small business enterprises. In July 2004, the Company began to market Ozemail for sale. The related assets qualified as discontinued operations under SFAS No. 144 in July 2004 and, accordingly, the Company has reclassified all revenues and expenses to discontinued operations for all periods presented and reclassified all assets and liabilities as "held for sale" in the condensed consolidated balance sheet as of September 30, 2004.

MCI, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The condensed consolidated statements of operations reflect Wireless, MMDS, Embratel (and other companies related to the transaction), Proceda, and Ozemail as discontinued operations for all periods presented. The combined operating results of these entities through the date of disposition are reflected in the condensed consolidated financial statements for the three and nine-month periods ended September 30, 2004 and 2003 as follows (in millions):

	Successor Company	Predecessor Company	Successor Company	Predecessor Company
	Three-Month Period Ended September 30,		Nine-Month Period Ended September 30,	
	2004	2003	2004	2003
Revenues	$ 213	$ 816	$ 1,902	$ 2,205
Operating expenses	210	718	1,807	2,025
Other income (expense)	3	(79)	(71)	39
Minority interests expense	(2)	(20)	(4)	(145)
Income tax expense	2	9	21	78
Net income (loss)	$ 2	$ (10)	$ (1)	$ (4)

As of September 30, 2004, the amounts related to Proceda and Ozemail have been combined and included in assets and liabilities "held for sale" in the condensed consolidated balance sheet as follows (in millions):

	Successor Company
	As of September 30, 2004
Assets:	
Cash	$ 13
Other assets	20
	33
Liabilities:	
Accounts payable and accrued access costs	21
Debt obligations	7
	28
Cumulative translation adjustments	(3)
Net assets of discontinued operations	$ 2

Assets Held for Sale

The Predecessor Company deemed Mr. Bernard J. Ebbers ("Mr. Ebbers"), its former Chief Executive Officer, to be in default of the terms of a Promissory Note he signed to the Company dated April 29, 2002. The Promissory Note was secured by Predecessor Company stock as well as Mr. Ebbers' equity interests in certain enterprises. On May 29, 2003, the Predecessor Company entered into an agreement to sell one of Mr. Ebbers' properties, Douglas Lake, and on July 1, 2003, the Bankruptcy Court approved the sale of the property. As a result, the Predecessor Company reclassified the asset in its consolidated balance sheet as held for sale effective July 1, 2003 under SFAS No. 144. The carrying value of the property was $54 million as of December 31, 2003. The property was sold in February 2004 for approximately $50 million, which was net of disposal costs. The Company received approximately $37 million in net proceeds in connection with the closing, and expects to receive additional proceeds of up to approximately $13 million, pending the resolution of certain tax matters and the final determination of any indemnification claims made by the purchaser pursuant to the purchase agreement.

MCI, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The Company recorded the estimated loss of $4 million as selling, general and administrative expenses in the condensed consolidated statement of operations for the three-month period ended March 31, 2004.

(9) Debt

Debt consisted of the following as of September 30, 2004 and December 31, 2003 (in millions):

	Successor Company	
	As of September 30, 2004	As of December 31, 2003
5.908% Senior Notes Due 2007	$1,983	$ 1,983
6.688% Senior Notes Due 2009	1,983	1,983
7.735% Senior Notes Due 2014	1,699	1,699
Embratel loans	—	1,574
Capital leases and other (maturing through 2023)	273	322
Discount on Senior Notes	—	(114)
Total	5,938	7,447
Less: current portion	35	330
Long-term portion	$5,903	$ 7,117

All of the outstanding debt of Embratel was removed from the Company's condensed consolidated balance sheet when the Company completed its sale of Embratel in July, 2004 (see Note 8).

Senior Notes Due 2007, 2009 and 2014

Pursuant to the Plan, the Company issued approximately $2.0 billion principal amount of 5.908% Senior Notes due 2007 (the "2007 Senior Notes"), approximately $2.0 billion principal amount of 6.688% Senior Notes due 2009 (the "2009 Senior Notes") and approximately $1.7 billion principal amount of 7.735% Senior Notes due 2014 (the "2014 Senior Notes" and, together with the 2007 Senior Notes and the 2009 Senior Notes, the "Senior Notes" or "Indentures"). The Senior Notes are senior unsecured obligations of the Company and are guaranteed by all of the existing and future domestic restricted subsidiaries of the Company.

The 2007 Senior Notes, the 2009 Senior Notes and the 2014 Senior Notes mature on May 1, 2007, May 1, 2009 and May 1, 2014, respectively. Interest on the Senior Notes is payable semi-annually in arrears. The initial interest rates of the Senior Notes are 5.908%, 6.688% and 7.735%, respectively. The initial interest rate is subject to reset after the Company has applied for and received ratings for the Senior Notes from Moody's Investors Service ("Moody's") and Standard & Poor's Corporation ("S&P"). The adjustment could result in a change in the interest rates on the Senior Notes ranging from (a) a decrease of 3.0% if the Senior Notes are rated Baa3 or higher by Moody's and BBB- or higher by S&P to (b) an increase of 3.0% if the Senior Notes are rated lower than B3 by Moody's and lower than B- by S&P. If the Senior Notes are rated between the levels indicated, the interest rates on the Senior Notes will change to a lesser degree. If the Company fails to obtain ratings on the Senior Notes from Moody's and S&P within two years from the date of issue, the interest rate on each of the Senior Note issues shall be increased by 1.0%.

Commencing on May 1, 2005 with respect to the 2007 Senior Notes, May 1, 2006 with respect to the 2009 Senior Notes and May 1, 2009 with respect to the 2014 Senior Notes, the Company will have the right to redeem some or all of the Senior Notes. The initial call prices equal 102.454%, 102.844% and 103.3675% of the principal amount, respectively, plus accrued and unpaid interest. In addition, the call prices for the 2007 Senior Notes, 2009 Senior Notes and the 2014 Senior Notes thereafter decline ratably for a period of one year, two years and three years, respectively, until the call price equals 100% of the principal amount. Prior to the call dates

applicable to the Senior Notes, the Company may redeem some or all of such Senior Notes by paying a "make- whole" premium based on U.S. Treasury rates. At any time prior to May 1, 2007, the Company may redeem up to 35% of the aggregate principal amount of each series of Senior Notes at a price equal to 100% of the principal amount plus a premium equal to the coupon with the net cash proceeds of an equity offering.

Upon the occurrence of a change of control, the Company will be obligated to make an offer to purchase all of the outstanding Senior Notes at a price equal to 101% of par value plus accrued interest. Also, the Company will be required to make an offer to purchase the outstanding Senior Notes at a price equal to 100% of par value plus accrued interest with "excess proceeds" of certain asset sales.

The Senior Notes are subject to typical affirmative and negative covenants for securities of this type, including covenants that limit the amount of debt the Company may incur and restrict the Company's ability to make cash distributions, investments in third parties and engage in asset sales or other specified transactions.

The Senior Notes are subject to customary events of default including any failure to make payments of interest (for a period of 30 days) or principal on the Senior Notes, failure to comply with the affirmative and negative covenants, the occurrence of certain events of bankruptcy involving the Company or the acceleration of other outstanding indebtedness of the Company in excess of $100 million.

The Senior Notes are subject to covenants that limit the Company's ability to make certain cash distributions based on its cumulative net income or loss since the Issue Date. The impairment charges recorded during the third quarter of 2004 will not affect the Company's ability or its current plans to continue to distribute excess cash pursuant to Section 5.07 of the Plan of Reorganization to its shareholders in the form of a quarterly dividend until such excess cash is fully utilized. The impairment charges may, however, restrict the Company's ability to make further cash distributions to its shareholders under the Indentures.

Debtor-in-Possession Facility and Letter of Credit Facilities

On July 23, 2002, the Predecessor Company negotiated its Debtor-in-Possession Agreement ("DIP Agreement") for $750 million in Debtor-in-Possession Financing (the "DIP Facility"). The DIP Facility was amended to the amount of $1.1 billion and was approved by the Bankruptcy Court on October 15, 2002. In January 2004, the Company reduced the size of the DIP Facility to $300 million. As of December 31, 2003, there were no advances outstanding under the DIP Facility. The Company had $77 million of letters of credit outstanding under the DIP Facility, $47 million in undrawn letters of credit that were issued under a $1.6 billion credit facility and Digex had a letter of credit of $1 million under a separate credit facility as of December 31, 2003.

On the Emergence Date, the DIP Facility was terminated. Approximately $100 million in letters of credit were rolled over to new letter of credit facilities entered into on the Emergence Date with JPMorgan Chase Bank, Citibank, N.A. and Bank of America, N.A. (the "Letter of Credit Facilities"). The Letter of Credit Facilities provide for the issuance of letters of credit in an aggregate face amount of up to $150 million (the "Commitment"). In addition, the Company pays a facility fee under the Letter of Credit Facilities equal to .05% per annum of the daily amount of the Commitment (whether used or unused). If any fee or other amount payable under any Letter of Credit Facility is not paid when due, additional interest equal to 2% per annum plus the federal funds rate (determined in accordance with such Letter of Credit Facility) will be incurred on the overdue amount. The Letter of Credit Facilities mature in April 2005. As of September 30, 2004, under the Letter of Credit Facilities, the Company had $124 million letters of credit outstanding, $12 million in availability, and $14 million reserved for issuance. During the nine-month period ended September 30, 2004, the Company pledged $141 million in cash as collateral for its outstanding letters of credit of which $137 million of the cash has been classified as restricted cash in other current assets and $4 million has been classified as restricted cash in other long-term assets in the condensed consolidated balance sheet. On October 12, 2004, the Commitment under the Letter of Credit Facilities was increased from $150 million to $300 million.

MCI, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(10) Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss is comprised of foreign currency translation adjustments and unrealized gain (loss) on available–for–sale securities. The following table sets forth the changes in accumulated other comprehensive loss, net of tax (in millions):

	Successor Company	Predecessor Company	Successor Company	Predecessor Company
	Three–Month Period Ended September 30,		Nine–Month Period Ended September 30,	
	2004	2003	2004	2003
Net (loss) income	$(3,398)	$ (55)	$(3,857)	$ 5
Other comprehensive loss:				
Foreign currency translation adjustments	20	(14)	(2)	(23)
Unrealized (loss) gain on available–for–sale securities	(3)	5	(7)	8
Total comprehensive loss	$(3,381)	$ (64)	$(3,866)	$ (10)

Due to the adoption of fresh–start reporting at December 31, 2003, the Company's accumulated other comprehensive loss was adjusted to zero and, accordingly, other comprehensive loss for the nine–month period ended September 30, 2004 is equal to its accumulated other comprehensive loss in its September 30, 2004 condensed consolidated balance sheet.

(11) Employee Benefit Plans

The Company maintains two defined benefit pension plans, the MCI Communications Corporation Plan and WorldCom International Data Services, Inc. Plan (collectively, the "MCI Plans"), which cover substantially all MCI employees who became WorldCom employees as a result of the Company's merger with MCI Communications, Inc. and who work 1,000 hours or more in a year. Effective January 1, 1999, participants of the MCI Plans no longer earn future compensation credits, although interest accruals and benefit vesting continues.

The Company also maintained a postretirement benefit plan that provides health and life insurance benefits to union members who are either currently retired or in active employee status and have satisfied certain eligibility requirements. Actuarially determined postretirement benefit costs are accrued as active employees earn these benefits.

The Company adopted SFAS No. 132 (R) on December 31, 2003. The components of the net postretirement benefit and pension costs for the three and nine–month periods ended September 30, 2004 and 2003 were as follows (in millions):

	Successor Company		Predecessor Company	
	Three–Month Period Ended September 30, 2004		Three–Month Period Ended September 30, 2003	
	Pension Benefits	Postretirement Benefits	Pension Benefits	Postretirement Benefits
Interest cost on accumulated postretirement benefit obligation	$ 6	$ 1	$ 7	$ 1
Expected return on plan assets	(8)	—	(7)	—
Amortization of net loss	—	—	1	—
Curtailment loss	1	—	—	—
Net periodic benefit (income) expense	$ (1)	$ 1	$ 1	$ 1

	Successor Company		Predecessor Company	
	Nine-Month Period Ended September 30, 2004		Nine-Month Period Ended September 30, 2003	
	Pension Benefits	Postretirement Benefits	Pension Benefits	Postretirement Benefits
Interest cost on accumulated postretirement benefit obligation	$ 20	$ 2	$ 21	$ 2
Expected return on plan assets	(24)	—	(21)	—
Amortization of net loss	—	1	2	—
Curtailment loss	1	—	—	—
Net periodic benefit (income) expense	$ (3)	$ 3	$ 2	$ 2

The Company does not expect to contribute to its defined benefit pension plans in 2004. The Company made contributions of $14 million to these plans in the three and nine-month periods ended September 30, 2003. The Company's estimates of its defined benefit pension plan contributions reflect the provisions of the Pension Funding Equity Act of 2004, which was enacted in April 2004. No contributions were made by the Company to its postretirement benefit plan during the three and nine-month periods ended September 30, 2004 and 2003.

(12) Shareholders' Equity

MCI Common Stock

On April 20, 2004, the Company emerged from Chapter 11. The Successor Company is a Delaware corporation and filed a new certificate of incorporation ("New Articles"). The New Articles authorized 3,000,000,000 shares of new MCI common stock with $0.01 par value. In addition to any other approval required by law, any action to effect a stock split or reverse stock split of the common stock within one year after April 20, 2004 shall require the approval of the holders of at least ninety-five percent (95%) of the shares of common stock then outstanding.

MCI Shareholder Rights Plan

On April 20, 2004, the Board of Directors of MCI declared a dividend of one right ("Right") for each outstanding share of MCI Common Stock to stockholders of record on that date. The Rights become exercisable upon the earlier of: (i) ten days following a public announcement by another person or group that it has acquired beneficial ownership of 15% or more of the outstanding shares of common stock; or (ii) ten business days following the commencement of a tender offer or exchange offer to acquire beneficial ownership of 15% or more of the outstanding shares of common stock. Certain qualifying tender offers made to all stockholders will not trigger the Rights. The Rights expire on the date of the 2007 annual meeting, unless earlier redeemed at a price of $.001 per Right. If the Rights become exercisable, upon payment of the exercise price of the Right (which was initially set at $75.00 per right), holders may receive (a) MCI common stock with a market value equal to twice the exercise price or (b) common stock of an acquirer of MCI with a market value equal to twice the exercise price.

Stock-based Compensation

The Company originally estimated that $184 million of deferred stock-based compensation was required upon the issuance of approximately 8.6 million shares of restricted stock that were granted on the Emergence Date. Based on the fair value of the Company's stock at date of grant, the Company reduced the amount to $170 million. The amount is being amortized over the vesting period of three years on a straight-line basis. The Company recorded approximately $2 million and $4 million to costs of services and products and approximately

$10 million and $19 million to selling, general and administrative expense in its condensed consolidated statements of operations during the three and nine-month periods ended September 30, 2004, respectively. In addition, the Company reversed approximately $6 million and $16 million of deferred stock-based compensation related to shares that will not vest due to employee terminations during the three and nine-month periods ended September 30, 2004, respectively.

On August 18, 2004, the individual award agreements under the MRSP were amended to allow for the conversion of Restricted Stock Units into shares of Restricted Stock (with one Stock Unit converting to one share of Restricted Stock) and the payment of dividends on unvested Restricted Stock shares. The conversion from Restricted Stock Units into shares of Restricted Stock was not allowed for any units held internationally or that had been deferred under the Deferred Stock Unit Plan. Dividends paid on unvested shares of Restricted Stock are considered compensation to the employee.

Employee Stock Purchase Plan

During the third quarter of 2004, the Company initiated its ESPP. Under the terms of the ESPP, a maximum of 2.2 million shares of MCI common stock are authorized for issuance. All eligible employees, during a period prior to the offering date of the ESPP, were allowed to elect to purchase shares of MCI common stock at 85% of the lower of the closing price on the beginning of the offering period of August 2, 2004 or on the exercise date of December 31, 2004. Contributions are made through payroll deductions, and they cannot exceed 15% of the employee's compensation. Contributions are held in escrow until December 31, 2004, when the accumulated contributions will be applied to the distribution of shares. The ESPP is accounted for using the intrinsic-value-based method of APB No. 25 and no compensation expense was recorded. However, the ESPP does not meet the criteria as set forth in SFAS No. 123 for noncompensatory plans and therefore is deemed compensatory for disclosure purposes only.

Dividends

On August 5, 2004, the Board of Directors declared a cash dividend of $0.40 per share. On September 15, 2004, the Company paid $127 million to shareholders of record on September 1, 2004. As the cash dividend was a return of shareholder capital, it was recorded as a reduction of additional paid-in capital in the shareholders' equity section of the Company's condensed consolidated balance sheet. On October 15, 2004, the Board of Directors, pursuant to Section 5.07 of the Plan and continuing its distribution of the Company's excess cash as a return of capital to shareholders, declared another cash dividend of $0.40 per share payable on December 15, 2004 to shareholders of record on December 1, 2004.

(13) Commitments and Contingencies

The filing of the Chapter 11 cases automatically stayed proceedings in private lawsuits relating to pre-petition claims as to the Debtors. The Plan specifies how pre-petition litigation claims against the Debtors will be treated following the Debtors' emergence from bankruptcy. Claims arising after the filing date will not be discharged following emergence.

Right-of-Way Litigation. Between September 1998 and February 2000, the Predecessor Company was named as a defendant in three putative nationwide and thirteen putative state class actions involving fiber optic cable on railroad, pipeline and utility rights-of-way. The complaints allege that the railroad, utility and/or pipeline companies from which the Predecessor Company obtained consent to install its fiber optic cable held only an easement in the right-of-way, and that the consent of the adjoining landowners holding the fee interest in the right-of-way did not authorize installation. The complaints allege that because such consent was not obtained,

the fiber optic network owned and operated by the Predecessor Company trespasses on the property of putative class members. The complaints allege causes of action for trespass, unjust enrichment and slander of title, and seek compensatory damages, punitive damages and declaratory relief.

The Predecessor Company executed a settlement agreement in February 2002 regarding all right-of-way litigation in Louisiana and in June 2002 regarding all other railroad right-of-way litigation nationwide. However, following the Petition Date the Predecessor Company opted out of the nationwide settlement agreement because the Oregon court did not approve it, and the Predecessor Company did not elect to proceed to seek approval in Illinois. During the bankruptcy proceedings, the Predecessor Company rejected the Louisiana right-of-way settlement agreement. The Company accrued for its estimate to settle the litigation as of September 30, 2004 and December 31, 2003.

SEC Lawsuit. The Predecessor Company and various current or former directors, officers and advisors were named as defendants in a number of lawsuits alleging violations of federal and state securities laws and related claims.

On June 26, 2002, the SEC filed suit against the Predecessor Company and certain members of former management for violations of sections 10(b) and 13(a) of the Exchange Act and SEC Rules 10b-5, 12b-20, 13a-1 and 13a-13, alleging that from at least the first quarter of 2001 through the first quarter of 2002, WorldCom defrauded investors by disguising its true operating performance via improper accounting methods that materially overstated its income by approximately $3.9 billion. On November 5, 2002, the SEC filed an amended complaint that broadened the scope of the claims, including a claim under section 17(a) of the Securities Act, to reflect among other things the Predecessor Company's disclosure that the overall restatements could total in excess of $9 billion. On May 19, 2003, the SEC filed a second amended complaint that added a claim for disgorgement of unlawful gains obtained as a result of the alleged misstatements.

On November 26, 2002, the Predecessor Company consented to the entry of a permanent injunction that partially resolved claims brought in this suit. The injunction imposes certain ongoing obligations on the Predecessor Company and permitted the SEC to seek a civil penalty from the Predecessor Company.

On May 19, 2003, the Predecessor Company announced a proposed settlement with the SEC regarding a civil penalty. Pursuant to the initial proposed settlement, the Predecessor Company would satisfy the SEC's civil penalty claim by payment of $500 million upon the effective date of the Predecessor Company's emergence from Chapter 11 protection. On June 11, 2003, the Predecessor Company consented to the entry of two orders dealing with internal controls and corporate governance issues that modified certain of the ongoing obligations imposed in the permanent injunction entered on November 26, 2002. On July 2 and 3, 2003, the Predecessor Company filed documents in the District Court modifying the proposed settlement. Pursuant to the revised proposed settlement, the Predecessor Company would satisfy the SEC's civil penalty claim by payment of $500 million upon the effective date of the Predecessor Company's emergence from Chapter 11 protection and by transfer of common stock in the reorganized company having an agreed value of $250 million (based upon the value set forth in the Plan). On July 7, 2003, the District Court issued an order approving the proposed settlement. On September 3, 2003, one of the Predecessor Company's creditors filed a notice of appeal of this order to the U.S. Court of Appeals for the Second Circuit. On August 6, 2003, the U.S. Bankruptcy Court for the Southern District of New York issued an order approving the proposed settlement. On August 18, 2003, certain creditors filed a notice of appeal of this order to the U.S. District Court. Pursuant to agreements entered into in connection with the Second Amended Plan of Reorganization, those creditors withdrew their appeals upon the consummation of the Plan. The District Court's order provides that the funds paid and common stock transferred by the Predecessor Company in satisfaction of the SEC's penalty claim of $2.25 billion will be distributed pursuant to the Fair Funds provisions of the Sarbanes-Oxley Act of 2002. The Company paid $500 million on the Emergence Date and transferred 10 million shares shortly thereafter.

On December 17, 2003, the United States District Court for the Southern District of New York issued an order further modifying its November 26, 2002 order. The December 17, 2003 order directed the Predecessor Company to submit a report describing the status of certain of the Predecessor Company's internal control efforts to the District Court, Corporate Monitor Richard Breeden, and the SEC; and directed the Predecessor Company to cause Deloitte & Touche LLP ("Deloitte"), which has acted as a consultant to the Predecessor Company with respect to internal controls, to submit a similar report. The Predecessor Company and Deloitte submitted their reports on December 24, 2003.

The Company has resolved all claims brought by the SEC in this suit. The Company remains subject to the ongoing obligations imposed by the permanent injunction entered by the Court on November 26, 2002, as modified, including the oversight of Corporate Monitor Richard Breeden.

ERISA Litigation. On March 18, 2002, one current and one former employee filed suit in federal court in California against the Predecessor Company and two of its former executive officers on behalf of a putative class of participants in the WorldCom 401(k) plan and its predecessor plans, claiming that defendants breached their fiduciary duties under the Employee Retirement Income Security Act ("ERISA") with respect to the administration of the plans by, among other things, misrepresenting the Predecessor Company's financial results and by allowing plan participants to continue to invest in the Predecessor Company's stock as one of their plan options. Following the Predecessor Company's June 25, 2002, restatement announcement, participants in 401(k) plans for the Predecessor Company and various of its affiliates filed approximately 15 additional putative class action suits against the Predecessor Company and certain of its executive officers in federal courts in New York, Mississippi, Florida, Oklahoma, and the District of Columbia.

On July 10, 2002, certain of the Predecessor Company's directors submitted to the Judicial Panel on Multidistrict Litigation (the "Panel") motions to centralize these actions. On October 8, 2002, the Panel issued an order centralizing 39 cases arising under the federal securities and ERISA laws before Judge Denise L. Cote in the United States District Court for the Southern District of New York. On September 18, 2002, Judge Cote entered an order consolidating the ERISA cases pending in the Southern District of New York, and thereafter designated lead plaintiffs for the consolidated cases. The Panel subsequently entered final orders transferring initial and additional cases to Judge Cote for consolidated or coordinated pretrial proceedings.

On December 20, 2002, the lead plaintiffs filed a consolidated complaint alleging that defendants breached their fiduciary duties under ERISA and seeking damages and other relief. The complaint, which was amended January 24, 2003, sought to certify a class of persons who participated in the WorldCom 401(k) plan and certain predecessor plans during the period from at least September 14, 1998, to the present. On January 24, 2003, defendants filed motions to dismiss the amended complaint pursuant to Fed.R.Civ.P. 8(a), 9(b), and 12(b)(6), asserting that the complaint failed to allege that the individual defendants were ERISA fiduciaries of the 401(k) Salary Savings Plan and, therefore, cannot be liable for fiduciary breach claims. On June 17, 2003, Judge Cote issued a decision granting the motion to dismiss filed by the former directors and certain employees and denying the motions, in whole or in part, filed by other defendants.

On July 25, 2003, Judge Cote issued an order establishing a schedule for class certification proceedings, initial discovery and the filing of an amended complaint. Lead plaintiffs subsequently filed second and third amended complaints pursuant to Judge Cote's July 25 order. The third amended complaint charges the defendants with breaching their fiduciary duties under ERISA. Certain individual defendants filed a joint motion to dismiss the third amended complaint on October 13, 2003. Briefing on the motion to dismiss was completed on November 14, 2003. On January 15, 2004, the U.S. Department of Labor filed an amicus brief in opposition to the individual defendants' motion to dismiss. The individual defendants filed a response to the Secretary's Amicus brief on January 30, 2004.

MCI, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

On September 12, 2003, lead plaintiffs also filed a motion for class certification on their claims. The defendants filed a joint motion opposing class certification on October 31, 2003.

On July 6, 2004, plaintiffs filed a Motion for Order Preliminarily Approving Settlement, Certifying a Class, and Setting a Fairness Hearing (the "Motion"). Attached to the Motion was a fully executed Settlement Agreement between the plaintiffs and the Company, the Company's fiduciary liability insurance carriers, and all of the individual defendants, with the exception of Scott Sullivan and Merrill Lynch Trust Company, F.S.B. (the "Settlement Agreement").

The Settlement Agreement provides for the creation of a Settlement Fund consisting of the following: (1) approximately $47 million in cash, and (2) another potential amount between $450,000 and $4 million in a promissory note from former WorldCom, Inc. Chief Executive Officer, Mr. Ebbers. The cash will be put into the fund by the Company, Mr. Ebbers, and the Company's fiduciary liability insurance carriers, both primary and excess. The Company's contribution to the settlement fund was approximately $23 million which was paid in September 2004.

The Settlement Agreement was approved by the Bankruptcy Court and an independent fiduciary for the 401(k) Plan. On October 15, 2004, Judge Cote approved the settlement.

State Tax. In conjunction with the Predecessor Company's bankruptcy claims resolution proceeding, certain states have filed claims concerning the Predecessor Company's state income tax filings and its approach to related–party charges. To date, various states have filed proofs of claims in the aggregate amount of approximately $750 million. In addition, the State of Mississippi has filed a claim in the aggregate amount of approximately $2 billion. The Company is in discussions with the appropriate state taxing officials on these and other similar issues related to state income taxes owed by the Company and its subsidiaries.

On March 17, 2004, the Commonwealth of Massachusetts on behalf of itself and thirteen other states filed a motion to disqualify KPMG LLP ("KPMG") from serving as the Company's accountant, auditor and tax advisor on the grounds that KPMG is not disinterested as required by Section 327(a) of the Bankruptcy Code. The Company believes that the filing of this motion is merely a litigation tactic and that the motion has no merit. The bankruptcy court held hearings on the motion, at the conclusion of which the bankruptcy court took the matter under advisement. On June 30, 2004, the bankruptcy court denied this motion and the states have appealed the order denying the motion.

Other. The Company provides indemnifications of varying scope and size to certain customers against claims of intellectual property infringement made by third parties arising from the use of its products as are usual and customary in the Company's business. Additionally, the Company provides indemnifications in certain lease agreements in which it agrees to absorb the increased cost to the lessor resulting from an adverse change in certain tax laws, which are usual and customary in leases of these types. The Company evaluates estimated losses for such indemnifications under FASB Interpretation No. 45, "*Guarantors' Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others.*" In relation to the indemnification in certain lease agreements, as the indemnifications are contingent on tax law changes, the maximum amount of loss cannot be estimated until there is actually a change in tax law. To date, the Company has not incurred significant costs as a result of such obligations and has not accrued any liabilities related to such indemnifications in the condensed consolidated financial statements.

In the normal course of business, the Company is subject to other proceedings, lawsuits and claims, including proceedings under government laws and regulations related to environmental and other matters. Such matters are subject to many uncertainties and outcomes are not predictable with assurance. Consequently, the Company is unable to ascertain the ultimate aggregate amount of monetary liability or financial impact with

respect to these matters at September 30, 2004. While these matters could affect operating results when resolved in future periods, based on current information, the Company does not believe any monetary liability or financial impact would be material to its consolidated financial condition, results of operations, or cash flows. The Company, where appropriate, accrued for its estimates to settle outstanding litigation as of September 30, 2004 and December 31, 2003.

(14) Business Segment Information

The Company's business segments represent strategic business units based on the types of customers each segment serves. These business segments consist of Enterprise Markets, U.S. Sales & Service, and International & Wholesale Markets. These business segments were determined in accordance with how the Company's executive management analyzed, evaluated and operated the Company's entire global operations since the second quarter of 2004.

In March 2004, the Company changed its segment reporting by realigning its previous business segments into three new business segments: Enterprise Markets, U.S. Sales & Service, and International & Wholesale Markets. Enterprise Markets serves the following customers which had been served by Business Markets in the past: global accounts, government accounts, conferencing and MCI Solutions customers. U.S. Sales & Service serves the previous Mass Markets accounts and certain commercial accounts. International & Wholesale Markets serves customers internationally, as well as the Company's wholesale accounts that were previously included in Business Markets. The Company began operating under these new segments in the second quarter of 2004.

In addition, the Company developed methodologies to fully allocate indirect costs that were previously reported in Corporate and Other to the new business segments. These costs include expenses associated with the operation of the Company's network, access costs and costs of services and products, indirect selling, general and administrative expenses, depreciation and amortization, impairment charges, and corporate functions. The Company allocated the third quarter impairment charges using the same methodology used for depreciation and amortization expense. The allocation methodologies are based on statistical and operational data that is generated from the Company's continuing operations. These amounts can fluctuate based upon the performance of the individual segments.

As a result of the realignment of its segments and the allocation of indirect costs on a segment basis, the Company changed the way it manages its business to utilize operating income (loss) information to evaluate the performance of its business segments and to allocate resources to them. The Company has restated the results of its business segment data for the three and nine–month periods of 2003 into the new business segments for comparability with current presentation.

Embratel's results of operations, which were previously reported in a separate business segment, have been reclassified to discontinued operations for all periods, and therefore have been excluded from this business segment information for the three and nine–month periods ended September 30, 2004 and 2003.

Business Segments

The following is a description of the Company's business segments:

- Enterprise Markets includes Global and Government Accounts, as well as Conferencing and MCI Solutions businesses. Global Accounts provides telecommunications services to large global customers requiring international and complex network services. Government Accounts provides similar services to various government agencies. In both cases, these services include local–to–global business data, Internet, voice services and managed network services.

- U.S. Sales & Service segment serves Mass Markets accounts which include subscription–based residential and very small business accounts, and transactional products including 10–10–987,

10-10-220, 1-800-COLLECT, MCI Prepaid card, as well as Commercial Accounts which serves small to medium-size business accounts. Commercial Accounts also includes the Company's Skytel business, which provides wireless email, interactive two-way messaging, wireless telemetry services and traditional text and numeric paging to customers throughout the United States.

- International & Wholesale Markets provides telecommunications services to business customers and telecommunications carriers in Europe, the Middle East and Africa (collectively "EMEA"), the Asia Pacific region, Latin America and Canada. These services include voice telecommunications, data services, Internet and managed network services. This segment also serves the Company's domestic and international wholesale accounts.

All revenues for the Company's products and services are generated through external customers. The Company has three main product and service categories: Voice, Data and Internet.

As of September 30, 2004, the Company had not developed a methodology to allocate assets among its business segments. As such, no segment asset amounts have been reported in the tables below. Financial information for each of the Company's reportable business segments is as follows (in millions):

	Three-Month Period Ended September 30, 2004 (Successor Company)			
	Enterprise Markets	U.S. Sales & Service	International & Wholesale Markets	Total
Revenues:				
Voice	$ 454	$ 1,672	$ 990	$ 3,116
Data	577	383	347	1,307
Internet	161	183	309	653
Total revenues	1,192	2,238	1,646	5,076
Costs of sales and services	719	1,184	1,306	3,209
Selling, general and administrative expenses	238	726	282	1,246
Depreciation and amortization expenses	127	227	139	493
Loss on property dispositions	3	2	2	7
Impairment charges	870	1,627	1,016	3,513
Operating loss	$ (765)	$ (1,528)	$ (1,099)	$(3,392)

	Three-Month Period Ended September 30, 2003 (Predecessor Company)			
	Enterprise Markets	U.S. Sales & Service	International & Wholesale Markets	Total
Revenues:				
Voice	$ 465	$ 2,034	$ 1,150	$ 3,649
Data	622	482	459	1,563
Internet	206	175	376	757
Total revenues	1,293	2,691	1,985	5,969
Costs of sales and services	779	1,394	1,462	3,635
Selling, general and administrative expenses	287	980	380	1,647
Depreciation and amortization expenses	167	218	217	602
Loss on property dispositions	4	1	3	8
Operating income (loss)	$ 56	$ 98	$ (77)	$ 77

MCI, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	Nine-Month Period Ended September 30, 2004 (Successor Company)			
	Enterprise Markets	U.S. Sales & Service	International & Wholesale Markets	Total
Revenues:				
Voice	$1,375	$ 5,180	$ 3,119	$ 9,674
Data	1,723	1,226	1,090	4,039
Internet	506	550	947	2,003
Total revenues	3,604	6,956	5,156	15,716
Costs of sales and services	2,215	3,770	4,086	10,071
Selling, general and administrative expenses	814	2,400	960	4,174
Depreciation and amortization expenses	404	660	519	1,583
Loss (gain) on property dispositions	1	(1)	—	—
Impairment charges	870	1,627	1,016	3,513
Operating loss	$ (700)	$ (1,500)	$ (1,425)	$ (3,625)

	Nine-Month Period Ended September 30, 2003 (Predecessor Company)			
	Enterprise Markets	U.S. Sales & Service	International & Wholesale Markets	Total
Revenues:				
Voice	$1,460	$ 6,481	$ 3,332	$11,273
Data	1,960	1,568	1,483	5,011
Internet	668	573	1,195	2,436
Total revenues	4,088	8,622	6,010	18,720
Costs of sales and services	2,412	4,375	4,364	11,151
Selling, general and administrative expenses	824	2,939	1,080	4,843
Depreciation and amortization expenses	480	626	614	1,720
Loss on property dispositions	8	4	2	14
Operating income (loss)	$ 364	$ 678	$ (50)	$ 992

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

The following statements (and other statements made by us) are or may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995:

(i) any statements contained or incorporated herein regarding possible or assumed future results of operations of our business, pricing trends, the markets for our services and products, anticipated capital expenditures, our cost reduction and operational restructuring initiatives, regulatory developments, or competition;

(ii) any statements preceded by, followed by, or that include the words "intends," "estimates," "believes," "expects," "anticipates," "plans," "projects," "should," "could" or similar expressions; and

(iii) other statements contained or incorporated by reference herein regarding matters that are not historical facts.

You are cautioned not to place undue reliance on these statements, which speak only as of the date this document is filed. These statements are based on management's current expectations and are subject to uncertainty and changes in circumstances. Factors that may cause actual results to differ materially from management's expectations include, but are not limited to:

- economic uncertainty;
- the effects of vigorous competition, including price compression;
- the impact of technological change on our business and alternative technologies;
- the availability of transmission facilities;
- the impact of oversupply of capacity resulting from excess deployment of network capacity;
- the ongoing global and domestic trend toward consolidation in the telecommunications industry;
- risks of international business;
- regulatory risks in the United States and internationally;
- contingent liabilities;
- uncertainties regarding the collectibility of receivables;
- the availability and cost of capital;
- the outcome of pending class action and other lawsuits;
- the findings and outcome of investigations of the Predecessor Company's past accounting practices and our call routing practices;

- uncertainties associated with the success of acquisitions; and

- each of the factors discussed under "Item 1—Business—Risk Factors" in our Annual Report on Form 10–K for the year ended December 31, 2003.

The cautionary statements contained or referred to in this section also should be considered in connection with any subsequent written or oral forward–looking statements that may be issued by us or persons acting on our behalf. We undertake no duty to update these forward–looking statements, even though our situation may change in the future.

The following discussion should be read in conjunction with the unaudited condensed consolidated financial statements and related notes provided in Part 1, Item 1 herein, and with the Management's Discussion and Analysis of Financial Condition and Results of Operations and audited consolidated financial statements and related notes included in our Annual Report on Form 10–K for the year ended December 31, 2003.

Business Overview

We are one of the world's leading global communication companies, providing a broad range of communication services in over 200 countries on six continents. Each day, we serve thousands of businesses and government entities throughout the world and provide voice and Internet communication services for millions of consumer customers. We operate one of the most extensive communications networks in the world, comprising approximately 100,000 route miles of network connections linking metropolitan centers and various regions across North America, Europe, Asia, Latin America, the Middle East, Africa and Australia. We own one of the most extensive Internet protocol backbones, and we are one of the largest carriers of international voice traffic. Our global Internet Protocol ("IP") network has been recognized for the fourth consecutive year by TeleGeography, a research division PriMetrica, Inc. as the world's most connected Internet backbone playing a critical role in the movement of Internet traffic. Our expansive IP footprint, coupled with our direct interconnections, enables our customers to reach more destinations directly through our global IP backbone than any other communications provider.

Since April 2003, we have conducted our business primarily using the brand name "MCI." As part of our financial reorganization, our predecessor company, WorldCom, was merged with and into MCI in April 2004. References herein to MCI, we, our and us are to MCI, Inc. and its subsidiaries and the Predecessor Company unless the context otherwise requires.

In March 2004, we realigned our operations into three new business segments and began operating under these segments in the second quarter of 2004. Effective with the realignment, our business segments are as follows:

- **Enterprise Markets** serves large customers with complex communication requirements that have previously been served by the Business Markets segment, including Global Accounts, Government Accounts, Conferencing, and MCI Solutions customers, but excluding medium size commercial and wholesale accounts which were previously included in Business Markets.

- **U.S. Sales & Service** serves small, mid-sized and corporate customers. In addition, U.S. Sales & Service comprises MCI's consumer operation which includes telemarketing, customer service and direct response marketing.

- **International & Wholesale Markets** serves businesses, government entities and telecommunications carriers outside the United States as well as the wholesale accounts previously included in Business Markets.

Our industry is undergoing significant changes. On March 2, 2004, the U.S. Court of Appeals for the D.C. Circuit (the "D.C. Circuit") issued a decision which vacates and remands many key portions of the Federal Communication Commission's ("FCC") Triennial Review Order that had established new federal rules governing local telephony competition. In particular, pursuant to challenges by the incumbent local exchange carriers ("ILECs"), the D.C. Circuit vacated the unbundling of local switching, which is a critical component of the unbundled network element platform ("UNE-P") used to serve residential and small business customers. The D.C. Circuit's decision also affirmed the portions of the FCC's Order that had not required the ILECs to lease unbundled elements for the provision of broadband services. Although several petitions were filed at the Supreme Court seeking review of the D.C. Circuit's decision, the Solicitor General and the FCC declined to seek such review. On October 12, 2004, the Supreme Court denied the petitions. On remand from the D.C. Circuit, the FCC has commenced rulemaking proceedings with the goal of adopting new unbundling rules by December 2004 or early 2005. Until those new rules are in effect, the FCC has adopted interim unbundling rules (effective September 13, 2004) to maintain certain ILEC unbundling obligations under interconnection agreements as they existed prior to the D.C Circuit's mandate. ILECs are challenging the interim rules in the D.C. Circuit as a violation of the D.C. Circuit's decision and otherwise unlawful, though a ruling on their challenges is not expected in 2004.

As a result of such decision, MCI will be forced to raise residential phone services prices in some markets and pull out of others, and has reduced its sales efforts pending clarity on its future pricing structure. We may take more significant action once final rulemaking on the matter has been completed.

Voluntary Reorganization under Chapter 11

On July 21, 2002, (the "Petition Date") WorldCom, Inc. and substantially all of its direct and indirect domestic subsidiaries (the "Initial Filers") filed voluntary petitions for relief in Bankruptcy Court under Chapter 11. On November 8, 2002, WorldCom filed bankruptcy petitions for an additional 43 of its domestic subsidiaries, most of which were effectively inactive and none of which had significant debt (collectively with the Initial Filers, the "Debtors"). Between the Petition Date and the Emergence Date, the Debtors continued to operate their businesses and manage their properties as debtors-in-possession. In addition, most litigation against the Debtors was stayed. We emerged from bankruptcy on April 20, 2004.

Impairment Charges

We assess recoverability of our indefinite-lived and long-lived assets to be held and used whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. Impairment analyses of long-lived and indefinite-lived assets are performed in accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, *"Accounting for the Impairment or Disposal of Long-Lived Assets"* ("SFAS No. 144"), and SFAS No. 142 *"Goodwill and Other Intangible Assets"* ("SFAS No. 142"). Impairment evaluations are performed at the lowest asset or asset group level for which identifiable cash flows are largely independent of the cash flows of other assets or asset groups. We generate most of our cash flows from products and services that are principally delivered to customers over our integrated telecommunications network and related intangible assets. Therefore, evaluations are performed at the entity level, excluding discontinued operations and assets held for sale, as a single group.

The industry is in a state of transition where traditional business lines are facing significant overcapacity in the marketplace, pricing pressures, changes in product mix, and customers' continued efforts to reconfigure and consolidate their networks in order to achieve lower overall costs and better efficiencies. Concurrently, the industry is migrating to more advanced network technologies and primarily focused around IP based platforms, and customers are requiring more advanced network services including network monitoring, traffic analysis, and comprehensive security solutions. The industry has also seen a general migration of customers from dial-up services to broadband and various wireless services. Additionally, our regulatory climate deteriorated due to a decision by the U.S. Court of Appeals for the D.C. Circuit that invalidated the Federal Communications Commission's "Triennial Review" local competition rules, which set prices that incumbent providers could charge competitive providers such as the Company for UNE-P, an essential component of our Mass Market local phone service. Although several petitions were filed at the Supreme Court seeking review of the D.C. Circuit's decision, the Solicitor General and the FCC declined to seek such review, and the Supreme Court subsequently denied the petitions. The FCC has adopted interim unbundling rules (effective September 13, 2004) to maintain certain ILEC unbundling obligations under interconnection agreements as they existed prior to the D.C Circuit's mandate. As a result, our costs for providing this service are expected to increase significantly in 2005. Some of our competitors have announced their intentions to exit from this market, and the cost increases may force us to reduce efforts to acquire new customers and withdraw from certain markets. We therefore anticipate that revenues from that segment will continue to decline.

Given the market, business and regulatory conditions, we reevaluated our financial forecasts and strategy in the third quarter of 2004 when it became apparent that these trends would continue into the future. Updated cash flow and profitability projections and forecasts were developed taking into account both the 2004 changes in the competitive landscape and the regulatory issues facing us. Our executives reviewed these projections with the Audit Committee of the Board of Directors during the third quarter.

Based on the revised projections, we determined that an impairment analysis of our indefinite-lived and long-lived assets was required during the third quarter of 2004. In connection with this analysis, we evaluated our property, plant and equipment and definite and indefinite-lived intangible assets, including customer lists. We developed estimates of future undiscounted cash flows to test the recoverability of our long-lived and indefinite-lived assets. These estimates were compared to the carrying values of the assets, which resulted in the conclusion

that we could not recover our carrying values through projected future operations. With the assistance of an independent third party valuation specialist, we further calculated the fair value of our long-lived and indefinite-lived assets based on the discounted cash flow analyses that utilized the revised management projections of revenues and profitability from September 1, 2004 through 2009. These projections were used in various scenarios utilizing a weighted average cost of capital between 10%-14%, a 2% terminal growth rate, certain working capital assumptions and total entity value assumptions.

We concluded that the carrying values of our definite-lived assets exceeded their estimated fair values by approximately $3.3 billion ($2.8 billion related to property, plant and equipment and $478 million related to definite-lived intangible assets) and the carrying value of an indefinite-lived asset exceeded its estimated fair value by approximately $260 million. These amounts represented the difference between the calculated fair values of the assets and their associated carrying values, and were recorded as a separate component of operating expenses in the condensed consolidated statements of operations for the three and nine-month periods ended September 30, 2004. Our management reviewed the results of the impairment analysis with the Board of Directors, and the Board of Directors approved the impairment charge on October 15, 2004.

As a result of the impairment charge of approximately $260 million to an indefinite-lived intangible asset, we recognized a $99 million tax benefit which reduced our long-term deferred tax liability as the impairment reduced the difference between the book and tax basis. The impairment charges, after taxes, contributed approximately $3.4 billion to our net losses for the three and nine-month periods ended September 30, 2004 (loss per share of $(10.70) and $(10.62), respectively).

Fresh-Start Reporting

In accordance with Statement of Position 90-7, "*Financial Reporting by Entities in Reorganization Under the Bankruptcy Code*" ("SOP 90-7"), we adopted fresh-start reporting as of the close of business on December 31, 2003. Upon applying fresh-start reporting, a new reporting entity (the Successor Company) is deemed to be created and the recorded amounts of assets and liabilities are adjusted to reflect their estimated fair value. Thus, the consolidated balance sheet as of December 31, 2003 gives effect to allocations to the carrying value of assets or amounts and classifications of liabilities that were necessary when adopting fresh-start reporting. During 2004, we adjusted the carrying value of certain assets and liabilities from the previously estimated values as appraisals and valuations were completed. As these adjustments were recorded in each quarter, associated year-to-date depreciation and amortization expense amounts were also adjusted for the effects of the changes in carrying values. As of September 30, 2004, we completed our assessment of the fair value of our assets and liabilities, and as such, no further adjustments will be recorded, except for any adjustments that may be related to deferred tax assets and contingencies as discussed below.

During the second quarter of 2004, we determined that approximately $132 million of property tax liabilities and $110 million of other liabilities that should not have been adjusted in fresh-start accounting were reduced by approximately $152 million in our application of fresh-start accounting at December 31, 2003. Due to the application of fresh-start reporting, these errors were offset by fresh-start adjustments and therefore had no impact on our 2003 net income. However, these errors caused both accounts payable and long-lived assets to be understated by approximately $152 million, representing 0.5% of our total assets of $27.5 billion and approximately 0.8% of our $19.0 billion total liabilities as of December 31, 2003, which it determined to be immaterial to our 2003 consolidated balance sheet. Our September 30, 2004 consolidated balance sheet reflects the correction of these immaterial errors.

As of December 31, 2003, we had various net deferred tax assets and tax contingencies which remain unresolved. In accordance with SFAS No. 109, *"Accounting for Income Taxes,"* any future changes in these balances that existed as of the fresh-start date will be adjusted to intangible assets, until exhausted, then to additional paid-in-capital and not through income.

The estimates and assumptions used in the valuations are inherently subject to uncertainties and contingencies beyond our control. Accordingly, there can be no assurance that the estimates, assumptions, and values reflected in the valuations will be realized, and actual results could vary materially.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations is based upon our condensed consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP"). The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. We evaluate our assumptions and estimates on an ongoing basis and may employ outside experts to assist in our evaluations. We believe that the estimates we use are reasonable; however, actual results could differ from those estimates. For a complete discussion regarding our critical accounting policies, refer to our Annual Report on Form 10–K for the year ended December 31, 2003.

Adjustment to Previously Issued Financial Statements

As reported in the second quarter, we determined that we had recorded in error a restatement entry which had the effect of reducing accounts receivable by $301 million through a charge to expense in the year ended December 31, 2000. The reported 2000 net loss of $48.9 billion should have been $48.6 billion, or 0.5% lower, and our assets of $44.2 billion should have been $44.5 billion, or 0.6% higher. In 2001, $35 million of the amount reversed and left a remaining $266 million understatement of accounts receivable as of December 31, 2001. This situation remained unchanged until, as a result of the application of fresh–start accounting as of December 31, 2003, the previously expensed $266 million was reversed in our statement of operations as a component of the $22.3 billion reorganization gain. Without this expense reversal, our 2003 net income of $22.2 billion would have been $21.9 billion, or 1.2% lower. As a result of the reversal of the expense in 2003, the cumulative impact to our December 31, 2003 consolidated retained earnings was zero. We have assessed the impact on the 2000, 2001 and 2003 statements of operations as well as the consolidated balance sheets as of December 31, 2000, 2001, 2002 and 2003 and determined that the impact was not material to any period.

The impact of this reduction of accounts receivable in the consolidated balance sheet as of December 31, 2003 resulted in a misclassification of $266 million between accounts receivable and long–lived assets in our allocation of reorganization value under fresh–start accounting. To properly reflect the allocation of reorganization value as of December 31, 2003, we have reflected a reclassification entry in our consolidated balance sheet as of December 31, 2003, as presented herein, to reflect an increase of $266 million to our accounts receivable balance and reductions in our property, plant and equipment and intangible assets. Our September 30, 2004 consolidated balance sheet reflects the impact of this reclassification.

The adjustment of this item also resulted in a decrease of $6 million to our long–term deferred tax liability which has been reflected in the consolidated balance sheet as of December 31, 2003 and September 30, 2004, as presented herein.

Consolidated Results of Operations

Our industry continues to go through a state of rapid transition with excess capacity and technological change placing pricing pressures on traditional business lines. At the same time, advanced networking capabilities primarily focused on IP platforms are creating new services around network design, monitoring and comprehensive security solutions. Prior to 2002, our business was significantly expanded through numerous acquisitions and large capital expenditure programs which contributed to a sharp increase in our outstanding debt. In 2002, we filed for reorganization under the U.S. bankruptcy laws. As a result, we undertook various initiatives to lower our operating costs, including the reduction of headcount, the elimination of excess facilities,

investment in automation, and billing platform integrations. In addition, we undertook various initiatives with the near-term objective of minimizing further decreases in our revenues, including focusing on the acquisition and retention of customers and continuing to invest in new products and services. We believe that the cumulative effects of our cost reduction efforts and the successful execution of our business strategy should enable us to improve our operating results.

Through July, 2004, we also owned approximately a 19% economic interest and a 52% voting interest in Embratel Participações S.A. and subsidiaries ("Embratel"), which is a Brazilian voice and data communications company that is operated by its own management and employees. On July 23, 2004, we completed the divestiture of our 19% equity interest in Embratel and received $350 million, the remaining portion of the $400 million sales price beyond the $50 million deposit previously received, and recognized a gain on the sale of approximately $9 million in our condensed consolidated statement of operations for the third quarter of 2004. For the three and nine-month periods ended September 30, 2004 and 2003, all of Embratel's operations, as well as other Latin American operations included as part of the sale, that were previously included in our consolidated results from continuing operations were reclassified to discontinued operations.

Our condensed consolidated statements of operations for the three and nine-month periods ended September 30, 2003 were prepared in accordance with SOP 90-7, which requires an entity's statement of operations to portray the results of operations of the reporting entity during Chapter 11 proceedings. As a result, any income, expenses, realized gains and losses, and provisions resulting from our reorganization are reported separately as reorganization items, except those required to be reported as discontinued operations in conformity with SFAS No. 144.

In March 2004, we realigned our operations into three new business segments and began operating under these segments in the second quarter of 2004. The following is a discussion of our consolidated and new business segment results of operations for the three and nine-month periods ended September 30, 2004 and 2003.

The following table sets forth, for the periods indicated, our unaudited condensed consolidated statements of operations (in millions):

	Successor Company	Predecessor Company	Successor Company	Predecessor Company
	Three-Month Period Ended September 30,		Nine-Month Period Ended September 30,	
	2004	2003	2004	2003
Revenues	$ 5,076	$ 5,969	$15,716	$ 18,720
Operating expenses:				
Access costs	2,580	2,989	8,156	9,067
Costs of services and products	629	646	1,915	2,084
Selling, general and administrative	1,246	1,647	4,174	4,843
Depreciation and amortization	493	602	1,583	1,720
Loss on property dispositions	7	8	—	14
Impairment charges related to property, plant and equipment	2,775	—	2,775	—
Impairment charges related to intangible assets	738	—	738	—
Total operating expenses	8,468	5,892	19,341	17,728
Operating (loss) income	(3,392)	77	(3,625)	992
Other (expense) income, net:				
Interest expense (contractual interest of $601 and $1,824 for the three and nine-month periods ended September 30, 2003, respectively)	(104)	(19)	(299)	(80)
Miscellaneous income, net	35	87	60	28
Reorganization items, net	—	(110)	—	(470)
(Loss) income from continuing operations before income taxes, minority interests and cumulative effect of a change in accounting principle	(3,461)	35	(3,864)	470
Income tax (benefit) expense	(61)	80	(8)	252
Minority interests, net of tax	—	—	—	(6)
(Loss) income from continuing operations before cumulative effect of a change in accounting principle	(3,400)	(45)	(3,856)	224
Net income (loss) from discontinued operations	2	(10)	(1)	(4)
(Loss) income before cumulative effect of a change in accounting principle	(3,398)	(55)	(3,857)	220
Cumulative effect of a change in accounting principle	—	—	—	(215)
Net (loss) income	$(3,398)	$ (55)	$ (3,857)	$ 5

Revenues. For the third quarter and first nine months of 2004, revenue decreased by $893 million, or 15% and by $3.0 billion, or 16% as compared to the same prior year periods, respectively.

Long distance voice services revenue for the third quarter and first nine months of 2004 decreased by $584 million, or 19%, to $2.5 billion from $3.1 billion, and by $1.7 billion, or 18%, to $7.9 billion from $9.6 billion as compared to the same prior year periods, respectively. The declines were driven primarily by lower rates and volumes.

Revenue from local voice services for the third quarter and first nine months of 2004 increased by $51 million, or 9%, to $604 million from $553 million, and by $129 million, or 8%, to $1.8 billion from $1.7 billion as compared to the same prior year periods, respectively. The increases were primarily due to the high acceptance of dedicated access products in the commercial markets.

Data services revenue, which includes messaging and other revenue, for the third quarter and first nine months of 2004 decreased by $256 million, or 16%, to $1.3 billion from $1.6 billion, and decreased by $972 million, or 19%, to $4 billion from $5 billion as compared to the same prior year periods, respectively. The decrease was driven primarily by continued rate pressure partially offset by increases in data volumes.

Internet services revenue for the third quarter and first nine months of 2004 decreased by $104 million, or 14%, to $653 million from $757 million, and decreased by $433 million, or 18%, to $2 billion from $2.4 billion as compared to the same prior year periods, respectively. The Internet service revenues decrease resulted from the general migration of customers from dial-up services to broadband services.

Operating expenses.

Access costs. Access costs include costs incurred for the transmission of voice and data traffic over domestic and international networks that we do not own. Access costs also include contributions to the Universal Service Fund ("USF") which are paid to a government-established agency, passed on to our customers and included in our revenue. Access costs as a percentage of total revenue were 51% for the three-month period ended September 30, 2004 as compared to 50% for the same prior year period, and 52% for the nine-month period ended September 30, 2004 as compared to 48% for the same prior year period. Although flat in the third quarter of 2004 as compared to the same prior year period, access costs as a percentage of revenue increased in the nine-month period of 2004 compared to the same prior year period because the decline in revenues, primarily caused by lower rates, was greater than the decline in access costs. We continue to focus on an array of access cost reduction programs including increased numbers of grooms, movement of more traffic on-net and circuit optimization to offset negative pricing trends.

The decreases in access costs of $409 million and $911 million during the three and nine-month periods ended September 30, 2004 were primarily due to the declines in long distance volumes, partially offset by growth in data and dedicated Internet in the third quarter of 2004.

Lower revenues resulted in reduced USF contributions of $75 million and $142 million for the third quarter and first nine months of 2004, respectively, as compared to the same prior year periods. Additionally, in the second quarter of 2004, we recognized a $95 million benefit regarding contributions to the USF for 2003 and the first three-month period of 2004.

We expect our access costs will continue to decline due to our continued cost containment initiatives. These reductions will be partially offset by increased access costs for our local voice service, as the decision of the D.C. Circuit Court on the Triennial Review Order combined with recent Public Utility Commission mandated rate increases will impact access costs in future quarters.

Costs of services and products. Costs of services and products ("COSP") includes the expenses associated with operating and maintaining our telecommunications networks, expenditures to support our outsourcing contracts, technical facilities expenses and other service related costs.

For the three and nine-month periods ended September 30, 2004, COSP was 12% of our consolidated revenue, as compared to 11% for the same prior year periods. Actual expenses decreased by $17 million and $169 million for the three and nine-month periods ended September 30, 2004, respectively, as compared to the same prior year periods. The decreases were primarily attributable to our continued cost-cutting initiatives including force reductions, reductions to third party customer affinity programs and lower repairs and maintenance expenses. Salary expense declined by $25 million and $63 million, respectively, during the three and nine-month periods ended September 30, 2004 as compared to the same prior year periods, primarily due to headcount reductions. These decreases were offset by increases in severance expenses of $9 million and $41 million for the third quarter and nine months of 2004, respectively, from our workforce reductions.

Selling, general and administrative expenses. Selling, general and administrative ("SG&A") expenses include sales, customer service and marketing expenses, information services costs, bad debt expense, and corporate administrative costs, such as finance, legal and human resources.

We continued to incur reorganization costs during the three and nine-month periods ended September 30, 2004 and will continue to experience reorganization expenses for professional fees and other bankruptcy costs. As we adopted the provisions of fresh-start reporting on December 31, 2003, for accounting purposes, reorganization expenses and changes in estimates of reorganization items previously accrued have been included in SG&A expenses. For the three and nine-month periods ended September 30, 2004, the amounts of such expenses were $11 million and $37 million, respectively, and were for professional services related to our bankruptcy proceedings.

The decreases in SG&A expenses of $401 million and $669 million for the third quarter and first nine months of 2004, respectively, as compared to the same prior year periods, were primarily related to changes in our business strategy, as well as continued cost-cutting and process improvement initiatives. In the third quarter and first nine months of 2004, we experienced declines in advertising costs of $136 million and $349 million, respectively, as compared to the same prior year periods as we continue to adjust our marketing strategy in response to unfavorable regulatory developments. Also, we have seen an improvement to historical levels of receivable collections which has provided the basis for us to reduce our estimate for bad debt expense which, in combination with lower revenues, resulted in lower bad debt expense of $36 million and $165 million during the third quarter and first nine months of 2004, respectively, as compared to the same prior year periods.

Additionally, we experienced a decrease of $88 million and $29 million in outside services in the third quarter and nine months of 2004, respectively, as compared to the same prior year periods. The decrease was mainly due to the significant accounting fees that were incurred during the third quarter of 2003 to assist with our restatement efforts, and decreased legal and professional fees in 2004.

Compensation expense declined $123 million and $190 million for the third quarter and for the first nine months of 2004, respectively, reflecting the force reductions and lower commission expenses. These reductions in expense were partially offset by increased severance expenses during the third quarter and first nine months of 2004 of $3 million and $115 million, respectively, from our workforce reductions.

We also were able to realize benefits in our SG&A expenses due to certain adjustments recorded in the second quarter of 2004 including $44 million from certain provisions of our outsourcing agreement with EDS, a $20 million reduction in bad debt expense from our equity investment in Avantel, and an $11 million benefit from the settlement of creditor claims during our on-going settlement process. In the third quarter of 2004, we increased the bad debt expense from our equity investment in Avantel by $8 million and we recorded $14 million of settlement losses related to bankruptcy claims.

Depreciation and amortization. Depreciation and amortization expense decreased by $109 million and $137 million for the three and nine-month periods ended September 30, 2004 as compared to the same prior year periods. The changes in the three and nine-month periods were primarily due to decreases in our asset carrying values related to recognition of impairment charges during the third quarter of 2004 and changes in our asset carrying values resulting from the implementation of fresh-start reporting as of December 31, 2003 (which reduced depreciation and amortization expense by $39 million in the third quarter and is expected to reduce the expense by approximately $190 million in the fourth quarter).

Impairment charges. During the three-month period ended September 30, 2004, we recorded impairment charges of approximately $3.5 billion to adjust the carrying values of our long-lived assets and indefinite-lived intangible assets. Refer to "*Management's Discussion and Analysis of Financial Condition and Results of Operations—Impairment Charges*" for additional details of the impairment charges.

Interest expense. Interest expense increased by $85 million and $219 million during the three and nine-month periods ended September 30, 2004, respectively, as compared to the same prior year periods. This increase

primarily reflected the recognition of interest expense on our Senior Notes that were issued on the Emergence Date as well as the $114 million in non-cash interest expense related to the accretion of the discount on these Senior Notes recognized from January 1, 2004 through the Emergence Date. No interest expense was paid or recognized in 2003 on our outstanding long-term debt during our bankruptcy. We expect interest expense in 2004 to be significantly higher than interest expense recorded in 2003 as a result of the issuance of the Senior Notes in 2004.

Miscellaneous income, net. Miscellaneous income decreased by $52 million and increased by $32 million during the three and nine-month periods ended September 30, 2004, respectively, as compared to the same prior year periods. Included in the third quarter and nine month periods of 2004 was income from the fluctuation in foreign exchange rates of $17 million and $24 million, respectively, compared to income of $69 million and expense of $42 million, respectively, in the same prior year periods. Additionally, we recognized a gain of $8 million from the sale of an equity investment for $9 million in the third quarter of 2004.

Reorganization items. From the Petition Date to our adoption of fresh-start reporting as of December 31, 2003, we classified certain expenses as reorganization items in accordance with SOP 90-7. Reorganization items do not include any revenues or expenses that must be reported as related to discontinued operations. In the three and nine-month periods ended September 30, 2003, we recorded reorganization items which were net expenses of $110 million and $470 million, respectively. The following table sets forth the components of these items (in millions):

	Predecessor Company	
	Three-Month Period Ended September 30, 2003	Nine-Month Period Ended September 30, 2003
Contract rejections	$ (33)	$ (186)
Employee retention, severance and benefits	(33)	(104)
Loss on disposal of assets	(4)	(22)
Lease terminations	(33)	(165)
Professional fees	(26)	(66)
Gains on settlements with creditors	9	45
Interest income earned by the debtor entities during reorganization	10	28
Expense from reorganization items, net	$(110)	$ (470)

Contract rejection and lease termination expenses resulted from the rejection of executory contracts and leases as part of our financial reorganization under the bankruptcy laws. Employee retention and severance costs were incurred in connection with either retaining certain employees in order to complete our financial reorganization or reducing personnel levels as part of the restructuring of our business operations. These expenses were partially offset by interest income earned on our accumulated cash balances.

Reorganization items included both cash and non-cash expenses. The cash expenditures for reorganization items for the three and nine-month periods ended September 30, 2003 were $38 million and $158 million, respectively.

We continued to incur reorganization costs during the three and nine-month periods ended September 30, 2004 and will continue to experience reorganization expenses for professional fees and other bankruptcy costs. As we adopted the provisions of fresh-start reporting on December 31, 2003, for accounting purposes, reorganization expenses and changes in estimates related to reorganization items previously accrued have been included in selling, general and administrative expenses in the consolidated statement of operations. The amounts of such expenses were approximately $11 million and $37 million for the three and nine-month periods ended September 30, 2004, respectively, and were for professional services related to our bankruptcy proceedings.

Income tax (benefit) expense. Income tax benefit was $61 million and $8 million in the three and nine-month periods ended September 30, 2004, respectively, and income tax expense was $80 million and $252 million, respectively, in the three and nine-month periods ended September 30, 2003. In the three-month period ended September 30, 2004, we recognized a $99 million income tax benefit as a result of an impairment charge to reduce the carrying value of our indefinite-lived assets. Offsetting this benefit in the three and nine-month periods of 2004 and for all of 2003, we recorded income tax expense which was primarily attributable to state income taxes, taxes on the income of our international subsidiaries and the establishment of reserves for tax contingencies. Included in the tax provision are changes to foreign tax reserves from the effects of changes in foreign currency exchange rates.

Cumulative effect of a change in accounting principle. We recorded a $215 million charge as the cumulative effect of a change in accounting principle in the nine-month period ended September 30, 2003 as a result of our adoption of SFAS No. 143, *"Accounting for Asset Retirement Obligations."* This charge represented the after-tax difference between the obligation recorded for estimated future retirement costs related to certain long-lived assets and additions to assets to be depreciated.

Net (loss) income. For the three-month period ended September 30, 2004, our net loss was approximately $3.4 billion as compared to net loss of $55 million in the same prior year period. The primary factors causing this decrease were impairment charges of approximately $3.5 billion, an increase in interest expense of $85 million, and a reduction of $893 million in revenues, partially offset by decreases of $937 million in operating expenses and $110 million in reorganization items.

For the nine-month period ended September 30, 2004, our net loss was approximately $3.9 billion as compared to net income of $5 million in the same prior year period. The primary factors causing this decrease were impairment charges of approximately $3.5 billion recorded in 2004, an increase in interest expense recorded in 2004 of $219 million, and a reduction of approximately $3.0 billion in revenues, partially offset by an approximate $1.9 billion decrease in operating expenses, a $470 million decrease in reorganization items, and a $215 million decrease in cumulative effect of a change in accounting principle. In addition, the results of operations for the nine-month period ended September 30, 2004 included benefits from creditor settlements, as recorded and reported in the second quarter of 2004, of $51 million ($32 million in revenue and $19 million in access costs).

Segment Results of Operations

In March 2004, we changed our segment reporting by realigning our previous business segments into three new business segments: Enterprise Markets, U.S. Sales & Service, and International & Wholesale Markets. Enterprise Markets serves the following customers which had been served by Business Markets in the past: global accounts, government accounts, MCI Solutions and Conferencing. U.S. Sales & Service serves the previous Mass Markets accounts and certain commercial accounts. International & Wholesale Markets serves customers internationally, as well as our wholesale accounts that were previously included in Business Markets. We began operating under these new segments since the second quarter of 2004.

In addition, we developed methodologies to fully allocate indirect costs that were previously reported in Corporate and Other to the new business segments. These costs include expenses associated with the operation of our network, access costs and cost of services and products, indirect selling, general and administrative expenses, depreciation and amortization, impairment charges, and corporate functions. The allocation methodologies are based on statistical and operational data that is generated from our continuing operations. These amounts can fluctuate based upon the performance of the individual segments.

We have changed the way we manage our business to utilize operating income (loss) information to evaluate the performance of our business segments and to allocate resources to them. Accordingly, we have restated our results of segment operations data for the three and nine-month periods of 2003 into the new business segments for comparability with the current presentation.

All revenues are generated through external customers from three main product and service categories: Voice, Data, and Internet.

Our impairment charges recorded in the third quarter of 2004 were allocated to the each of our business segments based on the same methodology used to allocate depreciation and amortization expense. Refer to "*Management's Discussion and Analysis of Financial Condition and Results of Operations—Impairment Charges*" for additional details of the impairment charges.

Financial information for each of our reportable business segments and revenue product lines is as follows:

Enterprise Markets

This segment includes Global and Government Accounts, as well as our Conferencing and MCI Solutions businesses. Global Accounts provides telecommunications services to large global customers requiring international and complex network services. Government Accounts provides similar services to various government agencies. In both cases, these services include local-to-global business data, Internet, voice services and managed network services.

During the three and nine-month periods ended September 30, 2004 and 2003, the operating income (loss) of our Enterprise Markets segment was as follows (in millions):

	Successor Company	Predecessor Company	Successor Company	Predecessor Company
	Three-Month Period Ended September 30,		Nine-Month Period Ended September 30,	
	2004	2003	2004	2003
Revenues:				
Voice	$ 454	$ 465	$1,375	$ 1,460
Data	577	622	1,723	1,960
Internet	161	206	506	668
Total revenues	1,192	1,293	3,604	4,088
Costs of sales and services	719	779	2,215	2,412
Selling, general and administrative	238	287	814	824
Depreciation and amortization	127	167	404	480
Loss on property dispositions	3	4	1	8
Impairment charges	870	—	870	—
Operating (loss) income	$ (765)	$ 56	$ (700)	$ 364

Revenues. For the three and nine-month periods ended September 30, 2004, Enterprise Markets revenue was 23% of our consolidated revenue versus 22% for the same prior year periods.

Voice services revenues decreased by $11 million and $85 million for the three and nine-month periods ended September 30, 2004, respectively, as compared to the same prior year periods. Rate decreases accounted for all of these declines. Revenues for Global voice services were flat during the third quarter of 2004 as compared to the same prior year period and decreased by $61 million in the nine-month period of 2004 as compared to the same prior year period, reflecting lower price levels across this business.

Data services revenues decreased by $45 million and $237 million, respectively, for the three and nine-month periods ended September 30, 2004 as compared to the same prior year periods. These decreases were primarily due to price declines resulting from excess capacity in the marketplace, changes in product mix and customers' efforts to reconfigure their networks.

Internet services revenues decreased by $45 million and $162 million, respectively, for the three and nine-month periods ended September 30, 2004, as compared to the same prior year periods reflecting the general migration of customers from dial-up to broadband services.

The Enterprise Market segment continues to focus on its solutions lines of business with emphasis on local and wide area network management, integrating contact centers, hosting and comprehensive security services supporting our overall movement to IP–based platforms.

Costs of sales and services. Costs of sales and services were 60% and 61% of segment revenues for the three and nine–month periods ended September 30, 2004, respectively, as compared to 60% and 59% for the same prior year periods. Actual expenses decreased by $60 million and $197 million for the three and nine–month periods, respectively, as compared to the same prior year periods. Costs decreased primarily due to both reduced repairs and maintenance and due to our continued reductions in workforce. As reported in the second quarter of 2004, the segment recognized a $26 million benefit regarding contributions to USF related to 2003 and the first three–month period of 2004.

Selling, general and administrative expenses. SG&A expenses decreased by $49 million and $10 million for the three and nine–month periods ended September 30, 2004, respectively, as compared to the same prior year periods. Expenses have declined over the three–month period ended September 30, 2004 as compared to the same period in 2003 due to workforce reductions that occurred earlier in the year.

Operating (loss) income. Operating losses were $765 million and $700 million for the three and nine–month periods ended September 30, 2004, respectively, as compared to operating income of $56 million and $364 million, respectively, in the same prior year periods. The operating losses for the 2004 periods were primarily attributable to $870 million of impairment charges recorded in the third quarter. Additionally, decreases in operating income were driven by lower revenues resulting from product mix and rate compression, which were not fully offset by decreases in costs of sales and services and SG&A expenses.

U.S. Sales & Service

This segment serves Mass Markets accounts which include subscription–based residential and very small business accounts, and transactional products including 10–10–987, 10–10–220, 1–800–COLLECT, MCI Prepaid card, as well as Commercial Accounts which serves small to medium–size business accounts. Commercial Accounts also includes our Skytel business, which provides wireless email, interactive two–way messaging, wireless telemetry services and traditional text and numeric paging to customers throughout the United States.

For the three and nine–month periods ended September 30, 2004 and 2003, the operating (loss) income of our U.S. Sales & Service segment was as follows (in millions):

	Successor Company	Predecessor Company	Successor Company	Predecessor Company
	Three–Month Period Ended September 30,		Nine–Month Period Ended September 30,	
	2004	2003	2004	2003
Revenues:				
Mass Markets	$ 1,278	$ 1,558	$ 3,925	$ 4,908
Commercial Accounts	960	1,133	3,031	3,714
Total U.S. Sales & Service revenues	2,238	2,691	6,956	8,622
Costs of sales and services	1,184	1,394	3,770	4,375
Selling, general and administrative	726	980	2,400	2,939
Depreciation and amortization	227	218	660	626
Loss (gain) on property dispositions	2	1	(1)	4
Impairment charges	1,627	—	1,627	—
Operating (loss) income	$(1,528)	$ 98	$(1,500)	$ 678

Revenues. For the three and nine–month periods ended September 30, 2004, U.S. Sales & Service revenues were 44% of consolidated revenues. For the three and nine–month periods ended September 30, 2003, U.S. Sales & Service revenues were 45% and 46% of consolidated revenues, respectively.

Mass Markets. For the three and nine–month periods ended September 30, 2004 and 2003, the amounts of, and changes in, the product line revenues of our Mass Markets business were as follows (in millions):

	Successor Company	Predecessor Company			Successor Company	Predecessor Company		
	Three–Month Period Ended September 30,		Increase (decrease)		Nine–Month Period Ended September 30,		Increase (decrease)	
	2004	2003	$	%	2004	2003	$	%
Subscription services								
Long–distance voice services	$ 613	$ 856	$(243)	(28)%	$1,931	$ 2,876	$(945)	(33)%
Local voice services	480	427	53	12%	1,406	1,179	227	19%
Other services	8	5	3	60%	23	17	6	35%
Total subscription services	1,101	1,288	(187)	(15)%	3,360	4,072	(712)	(17)%
Transaction services	177	270	(93)	(34)%	565	836	(271)	(32)%
Total Mass Markets Revenues	$1,278	$ 1,558	$(280)	(18)%	$3,925	$ 4,908	$(983)	(20)%

The decreases in subscription service revenues for the three and nine–month periods ended September 30, 2004 were principally the result of continuing long–distance volume declines (reflecting a lower number of customers and lower usage per customer) of $176 million and $638 million, respectively, as compared to the same prior year periods. These decreases in long–distance were due to "Do–Not–Call" regulations, reduced advertising spending, increased competition and the decline in the wireline long–distance market. Rate declines also contributed to the decrease in long–distance revenue in the amounts of $67 million and $306 million for the three and nine–month periods ended September 30, 2004, respectively, as compared to the same prior year periods. Rate declines were driven by a continual migration of customers to lower–priced calling plans and increased competition. Partially offsetting these decreases were increases in revenues from our local service offering of $53 million and $227 million in the three and nine–month periods of 2004, respectively, as compared to the same prior year periods.

Consumers of our Mass Markets subscription services are primarily long distance customers; however, local subscription customers may also purchase long distance services. The number of our long distance customers declined by approximately 26% and 27% for the three and nine–month periods ended September 30, 2004, respectively, as compared to the same prior year periods. These decreases were mainly driven by a decrease in sales as a result of the "Do Not Call" regulations, lower advertising and RBOC competition. The number of local subscription customers increased by approximately 3% and 13% for the three and nine–month periods ended September 30, 2004, respectively, as compared to the same prior year periods. These percentage changes exclude small business customers of Mass Markets.

The decrease in Mass Markets revenues also reflected a decline in revenues from transaction services. This decrease was driven by reduced advertising spending for transaction services, product mix and the decline in the wireline long–distance market.

We are continuing to evaluate how the anticipated rise in UNE–P access costs will impact our ability to profitably provide Mass Markets subscription services, and the cost increase may force us to withdraw from certain markets. As a result, new local service account installs and revenue may decrease from current levels in future periods. In addition, we expect continuing negative impact on Mass Markets subscription revenue from "Do Not Call" regulations, product substitution, competition, and customer migration to lower–priced calling plans and products. Transaction services revenues are expected to continue to decline due to our reduction of advertising and the decline in the wireline long–distance market.

Commercial Accounts. For the three and nine–month periods ended September 30, 2004 and 2003, the amounts of, and changes in, the product line revenues of our Commercial Accounts business were as follows (in millions):

	Successor Company	Predecessor Company			Successor Company	Predecessor Company		
	Three–Month Period Ended September 30,		Increase (decrease)		Nine–Month Period Ended September 30,		Increase (decrease)	
	2004	2003	$	%	2004	2003	$	%
Voice	$402	$ 481	$ (79)	(16)%	$1,278	$ 1,590	$(312)	(20)%
Data	379	478	(99)	(21)%	1,216	1,551	(335)	(22)%
Internet	179	174	5	3%	537	573	(36)	(6)%
Total Commercial Accounts Revenues	$960	$ 1,133	$(173)	(15)%	$3,031	$ 3,714	$(683)	(18)%

The product mix during the third quarter 2004 included a greater percentage of Internet service revenue as compared to the same prior year period. This improved product mix resulted from a growing trend towards IP based services, which, as a percentage of our segment revenue, increased by 3% and 2% in the three and nine–month periods ended September 30, 2004, respectively, as compared to the same prior year periods.

Voice revenue decreases during the third quarter and first nine months of 2004 were driven by rate declines and lower voice volumes reflecting competitive market conditions and technology substitution. Voice volumes were impacted by churn among small and medium business customers, and by product and technology substitution.

Data service revenues decreased by $99 million and $335 million, respectively, for the three and nine–month periods ended September 30, 2004, as compared to the same prior year periods. The decline in revenue was primarily driven by lower rates associated with changes in product mix.

Internet revenues increased by $5 million, or 3%, during the third quarter of 2004, but decreased by $36 million, or 6%, for the first nine months of 2004 as compared to the same prior year periods. In the third quarter of 2004, continued growth in our existing customer base as well as the introduction of new products to both new and existing customers slightly reversed the nine–month period trend towards declining revenues that was a result of both rate compression and the migration from dial–up to broadband. We are also beginning to see a growing trend for business customers converting their traditional frame and ATM networks to IP Centric service—and the result has been revenue growth of our IP VPN and Private IP solutions.

The Commercial Accounts segment is expected to benefit from a growing focus on delivering solutions to customers in the areas of IP communications, hosting, managed network services, security and contact center services.

Costs of sales and services. Costs of sales and services were 53% and 54% of segment revenues for the three and nine–month periods ended September 30, 2004, respectively, as compared to 52% and 51% for the same prior year periods. Actual expenses decreased by $210 million and $605 million for the three and nine–month periods, respectively, as compared to the same prior year periods. The increases as a percentage of revenue over the nine–month period ended September 30, 2004 were partially offset by a $65 million benefit recorded in the second quarter regarding contributions to the USF related to 2003 and the first three–month period of 2004. In addition, over the nine–month period of 2004, we reduced repairs and maintenance expenses, and have continued to reduce our workforce, which has reduced our compensation expenses. These reduced compensation expenses were offset by increased severance expenses related to our workforce reductions.

Selling, general and administrative expenses. For the three and nine–month periods ended September 30, 2004, SG&A expenses decreased by $254 million and $539 million, respectively, as compared to the same prior

year periods. Our SG&A costs have decreased due to lower advertising costs, headcount reductions in our call centers and support functions, and lower billing costs due to the increasing mix of direct-billed customers. During the three and nine-month period of 2004, SG&A was additionally impacted by lower bad debt expense from lower revenues. The decreases in SG&A expenses for the nine-month period in 2004 as compared to the same prior year period were partially offset by severance expenses.

Operating (loss) income. For the three-month period ended September 30, 2004, U.S. Sales & Service had an operating loss of approximately $1.5 billion as compared to operating income of $98 million for the same prior year period. For the nine-month period ended September 30, 2004, U.S. Sales & Service had an operating loss of $1.5 billion as compared to operating income of $678 million for the same prior year period. The operating loss for the three and nine-month period was primarily attributable to an approximate $1.6 billion impairment charge recorded in the third quarter of 2004. During the three-month period ended September 30, 2004, as compared to the same prior year period, U.S. Sales and Service experienced lower revenues due to changes in product mix and rate compression, but these lower revenues were directly offset by decreases in costs of sales and services and selling, general, and administrative expenses. During the nine-month period ended September 30, 2004, as compared to the same prior year period, the lower revenues were not fully offset by decreases in costs of sales and services and selling, general and administrative expenses.

International & Wholesale Markets

This segment provides telecommunications services to business customers and telecommunications carriers in Europe, the Middle East and Africa (collectively "EMEA"), the Asia Pacific region, Latin America and Canada. These services include voice telecommunications, data services, Internet and managed network services. This segment also serves our domestic and international wholesale accounts.

During the three and nine-month periods ended September 30, 2004 and 2003, the operating loss of our International & Wholesale Markets segment was as follows (in millions):

	Successor Company	Predecessor Company	Successor Company	Predecessor Company
	Three-Month Period Ended September 30,		Nine-Month Period Ended September 30,	
	2004	2003	2004	2003
Revenues:				
Voice	$ 990	$ 1,150	$ 3,119	$ 3,332
Data	347	459	1,090	1,483
Internet	309	376	947	1,195
Total International and Wholesale Markets revenues	1,646	1,985	5,156	6,010
Costs of sales and services	1,306	1,462	4,086	4,364
Selling, general and administrative	282	380	960	1,080
Depreciation and amortization	139	217	519	614
Loss on property dispositions	2	3	—	2
Impairment charges	1,016	—	1,016	—
Operating loss	$(1,099)	$ (77)	$(1,425)	$ (50)

Revenues. For the three and nine–month periods ended September 30, 2004, International & Wholesale Markets revenues were 32% and 33%, respectively, of our consolidated revenues as compared to 33% and 32%, respectively, for the same prior year periods.

	Successor Company	Predecessor Company	Successor Company	Predecessor Company
	Three–Month Period Ended September 30,		Nine–Month Period Ended September 30,	
	2004	2003	2004	2003
International	$ 918	$ 937	$2,725	$ 2,847
Wholesale	728	1,048	2,431	3,163
Total International & Wholesale Markets Revenues	$1,646	$ 1,985	$5,156	$ 6,010

International Markets Revenues. During the three and nine–month periods ended September 30, 2004 and 2003, the amounts of, and changes in, the product line revenues of International were as shown in the table below (in millions):

	Successor Company	Predecessor Company			Successor Company	Predecessor Company		
	Three–Month Period Ended September 30,		Increase (decrease)		Nine–Month Period Ended September 30,		Increase (decrease)	
	2004	2003	$	%	2004	2003	$	%
Voice	$627	$ 612	$ 15	2%	$1,853	$ 1,841	$ 12	1%
Data	78	98	(20)	(20)%	231	291	(60)	(21)%
Internet	213	227	(14)	(6)%	641	715	(74)	(10)%
Total International Revenues	$918	$ 937	$(19)	(2)%	$2,725	$ 2,847	$(122)	(4)%

For the three and nine–month periods ended September 30, 2004, International revenues were 56% and 53% of segment revenues versus 47% as compared to the same periods in 2003. International revenue decreased by $19 million and $122 million for the three and nine–month periods ended September 30, 2004, respectively, as compared to the same prior year periods. The revenues decrease was primarily due to continued rate declines which were partially offset by favorable foreign currency exchange rate movements.

International voice services revenue increased by $15 million and $12 million for the three and nine–month periods ended September 30, 2004, respectively, as compared to the same prior year periods. Increases were due to volume increases of 7% and 9% during the three and nine–month periods ended September 30, 2004, respectively, as compared to the same prior year periods in 2003. In addition, the first nine months of 2004 voice revenues were also positively impacted, primarily in the first quarter of 2004, by an increase of higher rate mobile traffic and voice terminations to higher rate countries. These increases were more than offset by rate declines in the International channel.

International data revenues decreased by $20 million and $60 million for the three and nine–month periods ended September 30, 2004, respectively, as compared to the same prior year periods, while international internet revenues decreased by $14 million and $74 million, respectively, as compared to the same prior year periods. Data and internet services revenues decreased as a result of rate compression and the general migration of customers from dedicated–access services to DSL–access services. Competition and pricing pressures have negatively impacted data and internet revenues during the third quarter and the first nine months of 2004. The first nine months of 2004 were also impacted by a decline in Internet services revenues in selected Asian markets, such as the Japan dial business, where we chose to exit from several low margin small customer accounts, commencing in the third quarter of 2003.

International revenues were positively affected by changes in foreign currency exchange rates that contributed approximately $61 million and $218 million to revenues for the three and nine–month periods ended September 30, 2004, respectively, as compared to the same prior year periods.

We expect pricing and margin pressure to continue notably in the small, medium business segments where competition from the local PTT's is the most intense. To react to these conditions, we are focusing our emphasis on large retail customers with global communications needs.

Wholesale Revenues. Wholesale revenues relate to domestic wholesale, which includes all wholesale traffic sold in the United States, as well as traffic that originates in the United States and terminates in a different country. During the three and nine–month periods ended September 30, 2004 and 2003, the amounts of, and changes in, the product line revenues of Wholesale were as shown in the table below (in millions):

	Successor Company	Predecessor Company			Successor Company	Predecessor Company		
	Three–Month Period Ended September 30,		Increase (decrease)		Nine–Month Period Ended September 30,		Increase (decrease)	
	2004	2003	$	%	2004	2003	$	%
Voice	$363	$ 539	$(176)	(33)%	$1,266	$ 1,490	$(224)	(15)%
Data	269	361	(92)	(25)%	859	1,193	(334)	(28)%
Internet	96	148	(52)	(35)%	306	480	(174)	(36)%
Total Wholesale Revenues	$728	$ 1,048	$(320)	(31)%	$2,431	$ 3,163	$(732)	(23)%

For the three and nine–month periods ended September 30, 2004, Wholesale revenues were 44% and 47% of segment revenues versus 53% for the same prior year periods.

Wholesale revenues were $728 million and $2.4 billion, respectively, for the three and nine–month periods ended September 30, 2004, down 31% and 23%, respectively, compared to the same prior year periods, reflecting a recent change in strategy to exit our relationships with certain UNE–P suppliers. In addition, we have eliminated certain incentive discounts for wholesale clients and tightened credit controls.

Voice revenues decreased by $176 million and $224 million for the three and nine–month periods ended September 30, 2004, respectively, as compared to the same prior year periods, primarily from pricing pressure and lower volumes.

Data revenues decreased by $92 million and $334 million for the three and nine–month periods ended September 30, 2004, respectively, as compared to the same prior year periods. These decreases were primarily due to continued price compression which is a result of over–capacity in the marketplace and the continuing financial difficulties of some of our wholesale customers.

Internet revenues decreased by $52 million and $174 million for the three and nine–month periods ended September 30, 2004, respectively, as compared to the same prior year periods. These decreases were due to both lower rates from renegotiations of certain customer contracts and to decreased volumes of 14% for the three–month period and 20% for the nine–month period, as the industry shifts from dial–up to broadband services.

Costs of sales and services. Costs of sales and services were 79% of segment revenues for the three and nine–month periods ended September 30, 2004, respectively, as compared to 74% and 73% in the same prior year periods. Costs decreased by $156 million and $278 million for the three and nine–month periods ended September 30, 2004, respectively, as compared to the same prior year periods. International costs decreased as a result of workforce reductions and lower repairs and maintenance expense, partially offset by higher severance costs. International costs were also affected by changes in foreign currency exchange rates that increased costs by approximately $43 million and $154 million for the three and nine–month periods ended September 30, 2004, respectively, as compared to the same prior year periods.

Selling, general and administrative expenses. For the three and nine-month periods ended September 30, 2004, SG&A expenses decreased by $98 million and $120 million, respectively, as compared to the same prior year periods. These decreases were a result of lower headcount and reduced bad debt expense from lower revenues and successful collection efforts. The international business also received a benefit of approximately $38 million from favorable consumption tax settlements during the second quarter of 2004. Increases in the SG&A line item were mostly due to severance expenses incurred as a result of our reductions in force. In addition, selling, general and administrative expenses were also affected by changes in foreign currency exchange rates that increased costs by approximately $9 million and $37 million for the three and nine-month periods ended September 30, 2004, respectively, as compared to the same prior year periods.

Operating (loss) income. Operating losses were approximately $1.1 billion and $1.4 billion for the three and nine-month periods ended September 30, 2004, respectively, as compared to operating losses of $77 million and $50 million, respectively, in the same prior year periods. The operating losses for the three and nine-month periods of 2004 were primarily attributable to an approximate $1.0 billion impairment charge recorded in the third quarter of 2004. Additionally, decreases in operating income were driven by lower revenues that were not fully offset by reductions in costs of sales and services and SG&A expenses.

Financial Condition

As a result of our business activities through 2004, including our emergence from bankruptcy and significant payments to settle bankruptcy claims, divestiture of non-core assets, and the recording of impairment charges, our consolidated balance sheet has significantly changed since year-end 2003. The following table, and associated discussion, sets forth the condensed consolidated balance sheet as of the dates indicated (in millions):

	Successor Company	
	As of September 30, 2004	As of December 31, 2003
ASSETS		
Cash and cash equivalents	$ 5,588	$ 6,178
Other current assets	4,687	6,350
Long-term assets	7,617	14,942
	$17,892	$ 27,470
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities	$ 5,830	$ 8,810
Long-term debt, excluding current portion	5,903	7,117
Other long-term liabilities	1,657	3,071
Shareholders' equity	4,502	8,472
	$17,892	$ 27,470

Cash and cash equivalents. Cash and cash equivalents decreased by $590 million from December 31, 2003, primarily due to the removal of Embratel's cash balance ($595 million at December 31, 2003) and payments of bankruptcy claims since our Emergence Date in the amount of $1.1 billion, capital expenditures of $650 million, partially offset by the collection of $629 million from the sale of assets and cash flows from operations during the period. We completed the sale of Embratel in the third quarter of 2004. Refer to "*Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources*" for further details.

Other current assets. Other current assets decreased by approximately $1.7 billion from December 31, 2003, primarily due to a decrease in net accounts receivable of approximately $1.4 billion from better collections and lower revenues, the elimination of Embratel's accounts receivable balance ($556 million at December 31, 2003), and a decrease of $176 million from sales of non-core assets included as assets held for sale as of December 31, 2003.

Long–term assets. Long–term assets, primarily property, plant, and equipment and intangibles, decreased by approximately $7.3 billion from December 31, 2003 due to the elimination of Embratel's fixed asset balance (approximately $2.0 billion at December 31, 2003), impairment charges of approximately $3.5 billion, depreciation expense net of capital additions of approximately $760 million, and the elimination of Embratel's deferred tax balance ($607 million at December 31, 2003).

Current liabilities. Current liabilities decreased by approximately $3.0 billion from December 31, 2003, primarily due to the elimination of Embratel's liabilities (approximately $1.2 billion at December 31, 2003) and a decrease of approximately $1.5 billion in other current liabilities primarily from the settlement of amounts due to creditors leaving approximately $900 million yet to be paid.

Long–term debt. Long–term debt decreased by approximately $1.2 billion from December 31, 2003, primarily due to the removal of Embratel's debt obligations from our consolidated balance sheet.

Other long–term liabilities. Other long–term liabilities decreased by approximately $1.4 billion from December 31, 2003, primarily due to the elimination of Embratel's minority interest (approximately $1.2 billion at December 31, 2003).

Liquidity and Capital Resources

Current Liquidity

The table below is a summary of our cash and cash equivalents as of September 30, 2004 and December 31, 2003 (in millions):

	Successor Company	
	As of September 30, 2004	As of December 31, 2003
Without Embratel	$ 5,588	$ 5,583
Embratel cash and cash equivalents balance	—	595
Total cash and cash equivalents	$ 5,588	$ 6,178

The table above shows Embratel's cash and cash equivalents at December 31, 2003. Throughout the period of our ownership of an equity interest in Embratel, it was not a wholly–owned subsidiary and was operated by its own management and employees. Consequently, our ability to access Embratel's cash and cash equivalents for our corporate purposes was significantly limited. On July 23, 2004, we completed the sale of our 19% economic interest and 52% voting interest in Embratel, and realized proceeds of approximately $400 million.

Our principal cash needs consist of capital expenditures, debt service, dividends, and payments made pursuant to the Plan of Reorganization. The Plan includes the payment of approximately $2.6 billion in cash to settle certain creditor claims. Some payments were made prior to our emergence from bankruptcy and some expected payments will not be made as a result of some claims being reduced since the Plan was confirmed. As of September 30, 2004, our estimated remaining cash payments to settle pre–petition creditor claims were approximately $900 million.

The Plan also requires pursuant to Section 5.07 that the Board of Directors conduct a reasonable review of our cash needs, including amounts that may be necessary to satisfy all claims to be paid in cash pursuant to the Plan. Accordingly, the Board of Directors commenced a comprehensive review and sought information and guidance from management and financial advisors to determine the amount of excess cash greater than $1 billion. Section 5.07 of the Plan further requires that any excess cash be utilized in accordance with our best business judgment to maximize shareholder value. On August 5, 2004, the Board of Directors completed its review and declared the amount of excess cash to be $2.2 billion. The Board of Directors decided to distribute a portion of the excess cash through a return of capital and declared a cash dividend of $0.40 per share payable on

September 15, 2004 to shareholders of record on September 1, 2004, resulting in payment of $127 million of dividends on our common stock. On October 15, 2004, the Board of Directors, pursuant to Section 5.07 of the Plan and continuing its distribution of the Company's excess cash as a return of capital to shareholders, declared a cash dividend of $0.40 per share payable on December 15, 2004 to shareholders of record on December 1, 2004. We currently expect to continue to distribute a quarterly cash dividend until the excess cash is fully utilized. However, the amount and timing for future dividends is subject to the approval of our Board of Directors. In addition, if the excess cash is fully paid out to shareholders, any further dividends may be limited by the covenants in the indentures for the Senior Notes and, consequently, further dividends may not be possible as long as the Senior Notes or other debt instruments with similar covenants remain outstanding.

We expect our capital expenditures to be approximately $1 billion during 2004, of which approximately $650 million has been incurred through September 30, 2004. Our expenditures will focus on enhancements to the efficiency, functionality and reliability of our network operations, improvements in customer service and the development of additional value-added services. Included in our capital expenditures will be investments in multi-protocol label switching ("MPLS") to support the convergence of our data and voice networks as well as investments in network security products and advanced applications features.

In 2004, our debt service obligations primarily consist of interest payments on the $5.7 billion principal amount of Senior Notes that were issued upon our emergence from bankruptcy. Interest on the Senior Notes is payable semi-annually on May 1 and November 1, beginning November 1, 2004, with interest accruing contractually from April 20, 2004. On November 1, 2004, we made the first interest payment of approximately $200 million on the Senior Notes. The Senior Notes consist of three separate issues with maturities of three, five and ten years. The current weighted average interest rate on the Senior Notes is 6.73%, resulting in annual interest payments of approximately $380 million.

The interest rates on the Senior Notes are subject to adjustment depending upon the ratings assigned to the Senior Notes by Moody's Investor Service, Inc. ("Moody's") and Standard & Poor's Corporation ("S&P") as set forth in the indentures under which the Senior Notes were issued. We have been meeting with the agencies and currently expect ratings to be assigned by the end of the year.

The Senior Notes are subject to covenants that limit our ability to make certain cash distributions based on our cumulative net income or loss since the Issue Date. The impairment charges recorded during the third quarter of 2004 will not affect our ability or our current plans to continue to distribute excess cash pursuant to Section 5.07 of the Plan of Reorganization to our shareholders in the form of a quarterly dividend until such excess cash is fully utilized. The impairment charges may, however, restrict our ability to make further cash distributions to our shareholders under the Indentures.

We believe that our principal source of funds will be cash generated from our operating activities despite anticipated declines in revenues. In addition, we expect to continue the process of divesting non-core investments and other assets.

We believe that our available cash, together with cash generated from operating activities and asset sales, will be more than sufficient to meet our liquidity requirements through at least 2005.

Bank Facilities

As an additional source of liquidity during our bankruptcy, we entered into a Senior Secured Debtor-in-Possession Credit Facility (the "DIP Facility"). On the Emergence Date, there were no outstanding advances under the DIP Facility. We did have letters of credit outstanding under the DIP Facility. WorldCom had undrawn letters of credit that were issued under a $1.6 billion credit facility prior to our bankruptcy filing and Digex had letters of credit under a separate credit facility.

Upon our emergence from bankruptcy, the DIP Facility was terminated and approximately $100 million in letters of credit were rolled over to new letter of credit facilities entered into with JPMorgan Chase Bank,

Citibank, N.A. and Bank of America, N.A. (the "Letter of Credit Facilities"). The Letter of Credit Facilities provide for the issuance of letters of credit in an aggregate face amount of up to $150 million (the "Commitment"). In addition, we pay a facility fee under the Letter of Credit Facilities equal to .05% per annum of the amount of the Commitment (whether used or unused). If any fee or other amount payable under any Letter of Credit Facility is not paid when due, additional interest equal to 2% per annum plus the federal funds rate (determined in accordance with such Letter of Credit Facility) will be incurred on the overdue amount. The Letter of Credit Facilities mature in April 2005. As of September 30, 2004, under the Letter of Credit Facilities, we had $124 million in letters of credit outstanding, $12 million in availability, and $14 million reserved for issuance. During the nine-month period ended September 30, 2004, we pledged $141 million in cash as collateral for our outstanding letters of credit of which $137 million of the cash has been classified as restricted cash in other current assets and $4 million has been classified as other long-term assets in the condensed consolidated balance sheet.

On October 12, 2004, the Commitment under the Letter of Credit Facilities was increased from $150 million to $300 million. None of the additional amount has been used as of the date of this filing.

We plan to arrange a revolving credit facility of between $500 million and $750 million to support our letter of credit requirements and as an additional source of liquidity. As a result, the revolving credit facility would replace the Letter of Credit Facilities.

Historical Cash Flows

For the nine-month periods ended September 30, 2004 and 2003, our consolidated cash flows were as follows (in millions):

	Successor Company	Predecessor Company
	Nine-Month Period Ended September 30,	
	2004	2003
Cash Provided By (Used In):		
Operating activities	$ 424	$ 2,683
Investing activities	(34)	(132)
Financing activities	(365)	129
Net cash flows from discontinued operations	(615)	(9)
Net (decrease) increase in cash and cash equivalents	$(590)	$ 2,671

Net Cash Flows Provided by Operating Activities

For the nine–month periods ended September 30, 2004 and 2003, net cash provided by operating activities was $424 million and approximately $2.7 billion, respectively and was comprised of the following (in millions):

	Successor Company	Predecessor Company
	Nine–Month Period Ended September 30,	
	2004	2003
Net (loss) income	$(3,857)	$ 5
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	1,583	1,720
Charges related to impairment of property, plant and equipment and intangible assets	3,513	—
Cumulative effect of a change in accounting principle	—	215
Minority interests, net of tax	—	(6)
Net realized gain on sale of investments	(5)	—
Bad debt provision	514	679
Loss on sale of property, plant and equipment	—	14
Gain on sale of assets held for sale	(9)	—
Deferred tax provision	(98)	3
Non–cash reorganization charges	—	312
Amortization of debt discount	114	—
Stock–based compensation expense	23	—
Loss (income) from equity investments	25	(8)
Other	(60)	181
Changes in assets and liabilities:		
Accounts receivable	300	(206)
Other current assets	92	(42)
Non current assets	38	237
Accounts payable and accrued access costs	(787)	(353)
Other current liabilities	(991)	(54)
Other liabilities	29	(14)
Net cash provided by operating activities	$ 424	$ 2,683

Further, the following table identifies significant net changes in our working capital during the nine–month periods ended September 30, 2004 and 2003 (in millions):

	Successor Company	Predecessor Company
	Nine–Month Period Ended September 30,	
	2004	2003
Cash Provided By (Used In):		
Accounts receivable		
Decrease in gross accounts receivable	$ 809	$ 559
Decrease in allowance for doubtful accounts, excluding effect of bad debt provision	(509)	(765)
Decrease (increase) in accounts receivable	300	(206)
Other current assets		
Decrease (increase) in non–trade receivables	103	(38)
Increase in prepaid expenses	(18)	(57)
Other decreases	7	53
Decrease (increase) in other current assets	92	(42)
Decrease in non current assets	38	237
Total decrease (increase) in assets	$ 430	$ (11)
Accounts payable and accrued access costs		
Decrease in accounts payable	$ (866)	$ (162)
Increase (decrease) in accrued access costs	79	(201)
Other increases	—	10
Decrease in accounts payable and accrued access costs	(787)	(353)
Other current liabilities		
Payment of SEC penalty	(500)	—
Decrease in advance billings and deferred revenue	(200)	(67)
(Decrease) increase in income taxes payable	(79)	7
Other (decreases) increases	(212)	6
Decrease in other current liabilities	(991)	(54)
Increase (decrease) in other liabilities	29	(14)
Total decrease in liabilities	$(1,749)	$ (421)

For the nine–month period ended September 30, 2004, we generated $424 million in cash from operations. We had a net loss of $3.9 billion which included non–cash charges totaling approximately $5.6 billion comprised primarily of depreciation and amortization of $1.6 billion, impairment charges of approximately $3.5 billion, and bad debt provision of $514 million. The difference between our net loss and our non–cash charges was approximately $1.7 billion which was partially offset by a reduction of approximately $1.3 billion related to decreases in our assets and reductions in our liabilities.

Our liabilities decreased primarily due to the payments of approximately $1.1 billion of creditor settlements associated with our emergence. While the Plan estimated distributions of approximately $2.6 billion in cash, we have estimated that cash payments subsequent to Emergence will now approximate $2.0 billion. Therefore, we have estimated the remaining balance due to creditors to be $900 million. Additionally, our accounts payable and

other current liability balances decreased by approximately $700 million from the payment of professional fees and due to lower accruals for salary and benefit costs as a result of our headcount reductions during 2004.

Our accounts receivable decreased $300 million during the nine-month period ended September 30, 2004 primarily due to our collection efforts, reduced billings and the collection of $253 million for the settlement of disputes related to fees earned from third party companies for calls that terminated on our network.

During the nine-month period ended September 30, 2003, we generated approximately $2.7 billion from operations. The generation of cash from operations was primarily the result of our net income of $5 million which included non-cash charges for depreciation and amortization of approximately $1.7 billion and $215 million for the cumulative effect of a change in accounting principle. Cash flows from operations during this period also benefited from our cost containment and restructuring initiatives that resulted in expense savings.

Net Cash Flows Used in Investing Activities

For the nine-month period ended September 30, 2004, net cash used by investing activities was $34 million. Capital expenditures for transmission and communications equipment, software development, and desktop computers were $650 million. Investing activities also included receipts of $144 million for the sale of network equipment, licenses and leases utilized for the provision of wireless telecommunications services via Multichannel Multipoint Distribution Services, $37 million for the sale of Douglas Lake, $9 million from the sale of investments, and $400 million received from our sale of Embratel. In the nine-month period ended September 30, 2003, capital expenditures of $379 million were the primary use of cash and were partially offset by $247 million in proceeds from the sale of property, plant and equipment, resulting in net cash used of $132 million.

Net Cash Flows Used in Financing Activities

For the nine-month period ended September 30, 2004, net cash used by financing activities was $365 million and consisted primarily of $127 million for dividend payments, $141 million in cash collateral for the Letter of Credit Facilities and $38 million for repayments of capital leases. For the nine-month period ended September 30, 2003, net cash provided by financing activities was $129 million.

Net Change in Cash from Discontinued Operations

Net change in cash from discontinued operations in the nine-month period ended September 30, 2004 was $615 million and was primarily attributable to Embratel, which had a balance of $595 million as of December 31, 2003 that was removed from our consolidated balance sheet upon the consummation of the sale in July 2004.

New Accounting Standards

In December 2003, the Financial Accounting Standards Board ("FASB") issued SFAS No. 132 (revised 2003), *"Employers' Disclosures about Pensions and Other Postretirement Benefits"* ("SFAS No. 132 (R)"). SFAS No. 132 (R) revises the annual and interim disclosure requirements about pension and other postretirement benefits. This revision requires disclosures additional to those included in the original SFAS No. 132 about assets, obligations, cash flows and net periodic benefit cost of defined benefit pension plans and other defined benefit postretirement plans. The required information is provided separately for pension plans and for other postretirement benefit plans. We adopted the provisions of SFAS No. 132 (R) as of December 31, 2003 without any impact on our consolidated results of operations, financial position and cash flows.

In December 2003, the FASB issued FASB Interpretation No. 46 (Revised December 2003), *"Consolidation of Variable Interest Entities"* ("FIN 46R"). This standard replaces FIN 46, *"Consolidation of Variable Interest Entities,"* that was issued in January 2003 to address certain situations in which a company should include in its financial statements the assets, liabilities and activities of another entity. We adopted the provisions of FIN 46R as of December 31, 2003 without any impact on our consolidated results of operations, financial position and cash flows.

ITEM 3. *QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK*

Interest Rate Risk

As of December 31, 2003, we had $77 million in letters of credit outstanding under the DIP Facility. On the Emergence Date, the DIP Facility was terminated.

Prior to the Emergence Date, all of the outstanding debt and preferred securities of the Debtors were subject to compromise under our Plan and, consequently, we do not believe that these instruments subjected us to market or interest rate risk. On the Emergence Date, all of the debt and preferred securities of the Debtors were cancelled.

On the Emergence Date, we issued $5.7 billion of fixed rate Senior Notes. While changes in market interest rates affect the fair value of this debt, there is no impact to earnings or cash flows unless we redeem the Senior Notes before their maturity dates and we will do so only if market conditions, our financial structure or other conditions make such redemptions appropriate. The interest rates on the Senior Notes are subject to reset after we have applied for and received ratings for the Senior Notes from Moody's and S&P. The adjustment could result in a change in interest rates on the Senior Notes ranging from (a) a decrease of 3.0% if the Senior Notes are rated Baa3 or higher by Moody's and BBB– or higher by S&P's to (b) an increase of 3.0% if the Senior Notes are rated lower than B3 by Moody's and lower than B– by S&P's. If the Senior Notes are rated between the levels indicated, the interest rates on the Senior Notes will change to a lesser degree.

Foreign Exchange Risk

Transaction gains and losses arise from exchange rate fluctuations on transactions denominated in a currency other than an entity's functional currency. The accompanying condensed consolidated statements of operations include as a component of miscellaneous income (expense) net foreign currency translation gains of $17 million and $24 million for the three and nine–month periods ended September 30, 2004, respectively, compared to income of $69 million and a loss of $42 million, respectively, for the same prior year periods. Because differing portions of our revenues and costs are denominated in foreign currency, movements could impact our margins by, for example, increasing our foreign revenues when the dollar weakens and not correspondingly increasing our expenses.

We do not currently hedge our currency exposure. In the future, we may engage in hedging transactions to mitigate foreign exchange risk.

Market Risk for Investment Securities

Investment securities consist of shares in triple–A rated short–term money market funds that typically invest in U.S. Treasury, U.S. government agency and highly rated corporate securities. Since these funds are managed in a manner designed to maintain a $1.00 per share market value, we do not expect any material changes in market values as a result of an increase or decrease in interest rates.

ITEM 4. *CONTROLS AND PROCEDURES*

We have evaluated the effectiveness of the design of the Company's disclosure controls and procedures pursuant to Rule 13a–15 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). This evaluation has allowed us to make certain conclusions regarding the state of the Company's disclosure controls and procedures as of September 30, 2004.

As part of our compliance efforts for Section 404 of The Sarbanes Oxley Act of 2002, significant efforts have been made to establish a framework to materially improve our internal controls. We have committed considerable resources to date to redesign, document and test the key internal financial controls of the Company.

Additional efforts will be necessary to remediate and retest certain deficiencies in our control environment and to become self–sufficient in this area. While our internal financial controls are improving, such improvements were not fully implemented and had not been fully tested as of September 30, 2004. As a result, the Company concluded that the effectiveness of its internal controls during this period was not sufficiently adequate to rely solely upon them for its financial reporting. Instead, the Company relied on compensating controls and procedures. Management has no reason to believe that the consolidated financial statements included in this report are not fairly stated in all material respects.

The effectiveness of any system of disclosure controls and procedures, including our own, is subject to certain limitations, including the exercise of judgment in designing, implementing and evaluating the controls and procedures and the inability to eliminate misconduct completely.

Except for the efforts taken and continually underway as described above, there were no significant changes in our internal controls over financial reporting or other factors that have materially affected or are reasonably likely to materially affect these internal controls over financial reporting as of the end of the period covered by this report.

PART II

OTHER INFORMATION

ITEM 1. *LEGAL PROCEEDINGS*

ERISA Litigation. As disclosed in our Annual Report on Form 10–K for the year ended December 31, 2003 (the "2003 10–K"), the Company has pending a suit filed by one current and one former employee in federal court in California against the Predecessor Company and two of its former executive officers on behalf of a putative class of participants in the WorldCom 401(k) plan and its predecessor plans, claiming that defendants breached their fiduciary duties under the Employee Retirement Income Security Act ("ERISA") with respect to the administration of the plans by, among other things, misrepresenting the Predecessor Company's financial results and by allowing plan participants to continue to invest in the Predecessor Company's stock as one of their plan options. The following change with respect to this matter has occurred since the filing of the 2003 10–K.

On July 6, 2004, plaintiffs filed a Motion for Order Preliminarily Approving Settlement, Certifying a Class, and Setting a Fairness Hearing (the "Motion"). Attached to the Motion was a fully executed Settlement Agreement between the plaintiffs and the Company, the Company's fiduciary liability insurance carriers, and all of the individual defendants, with the exception of Scott Sullivan and Merrill Lynch Trust Company, F.S.B. (the "Settlement Agreement").

The Settlement Agreement provides for the creation of a Settlement Fund consisting of the following: (1) approximately $47 million in cash, and (2) another potential amount between $450,000 and $4 million in a promissory note from former WorldCom, Inc. Chief Executive Officer, Mr. Ebbers. The cash will be put into the fund by the Company, Mr. Ebbers, and the Company's fiduciary liability insurance carriers, both primary and excess. Our contribution to the settlement fund was approximately $23 million which was paid in September 2004.

The Settlement Agreement was approved by the Bankruptcy Court and an independent fiduciary for the 401(k) Plan. On October 15, 2004, Judge Cote approved the settlement.

State Tax. As disclosed in the 2003 10–K, in conjunction with the Predecessor Company's bankruptcy claims resolution proceeding, certain states have filed claims concerning the Predecessor Company's state income tax filings and its approach to related–party charges. The following change with respect to this matter has occurred since the filing of the 2003 10–K.

On June 30, 2004, the bankruptcy court denied the motion filed on March 17, 2004 by the Commonwealth of Massachusetts on behalf of itself and thirteen other states to disqualify KPMG LLP ("KPMG") from serving as the Company's accountant, auditor and tax advisor on the grounds that KPMG is not disinterested as required by Section 327(a) of the Bankruptcy Code. The states have appealed the order denying the motion. We are in discussions with the appropriate state taxing officials on these and other similar issues related to state income taxes owed by the Company and its subsidiaries.

Triennial Review Order. As disclosed in the 2003 10–K, on March 2, 2004, the U.S. Court of Appeals for the D.C. Circuit (the "D.C. Circuit") issued a decision which vacates and remands many key portions of the FCC's Triennial Review Order that had established new federal rules governing local telephony competition. In particular, pursuant to challenges by the incumbent local exchange carriers ("ILECs"), the D.C. Circuit vacated the unbundling of local switching, which is a critical component of the unbundled network element platform ("UNE–P") used to serve residential and small business customers. The D.C. Circuit's decision also affirmed the portions of the FCC's Order that had not required the ILECs to lease unbundled elements for the provision of broadband services. The following change with respect to this matter has occurred since the filing of the 2003 10–K.

Although several petitions were filed at the Supreme Court seeking review of the D.C. Circuit's decision, the Solicitor General and the FCC declined to seek such review. On October 12, 2004, the Supreme Court denied

the petitions. On remand from the D.C. Circuit, the FCC has commenced rulemaking proceedings with the goal of adopting new unbundling rules by December 2004 or early 2005. Until those new rules are in effect, the FCC has adopted interim unbundling rules (effective September 13, 2004) to maintain certain ILEC unbundling obligations under interconnection agreements as they existed prior to the D.C Circuit's mandate. ILECs are challenging the interim rules in the D.C. Circuit as a violation of the D.C. Circuit's decision and otherwise unlawful, though a ruling on their challenges is not expected in 2004.

Except as set forth above, there were no material changes in our legal proceedings as compared to those reported in the Company's Annual Report on Form 10–K for the year ended December 31, 2003 as filed with the SEC on April 29, 2004.

ITEM 2. *UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS*

On July 14, 2004 the Company began trading its stock on The NASDAQ Stock Market. MCI stock trades on The NASDAQ National Market under the new symbol "MCIP".

ITEM 3. *DEFAULTS UPON SENIOR SECURITIES*

None.

ITEM 4. *SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS*

No matters were submitted to a vote of security holders during the three–month period ended September 30, 2004, other than matters voted on by holders of the Company's debt securities in the ordinary course of its bankruptcy proceedings.

ITEM 5. *OTHER INFORMATION*

None.

ITEM 6. *EXHIBITS*

(a) Exhibits

Exhibit No.	Description
31.1	Certification of Michael D. Capellas pursuant to Rules 13a–14(a) and 15d–14(a) under the Exchange Act.
31.2	Certification of Robert T. Blakely pursuant to Rules 13a–14(a) and 15d–14(a) under the Exchange Act.
32	Certification of Principal Executive Officer and Principal Financial Officer of the registrant pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes–Oxley Act of 2002.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report on Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized to sign.

MCI, INC.

By: /s/ ROBERT T. BLAKELY

Robert T. Blakely
Executive Vice President and Chief Financial Officer

/s/ ERIC R. SLUSSER

Eric R. Slusser
Senior Vice President and Controller

Dated: November 4, 2004

EXHIBIT INDEX

Exhibit No.	Description
31.1	Certification of Michael D. Capellas pursuant to Rules 13a−14(a) and 15d−14(a) under the Exchange Act.
31.2	Certification of Robert T. Blakely pursuant to Rules 13a−14(a) and 15d−14(a) under the Exchange Act.
32	Certification of Principal Executive Officer and Principal Financial Officer of the registrant pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes−Oxley Act of 2002.

EXHIBIT 31.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Michael D. Capellas, certify that:

1. I have reviewed this Quarterly Report on Form 10–Q of MCI, Inc.;

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 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) reserved

   (c) 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

   (d) 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 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: November 4, 2004

/s/ Michael D. Capellas

Michael D. Capellas
Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Robert T. Blakely, certify that:

1. I have reviewed this Quarterly Report on Form 10–Q of MCI, Inc.;

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 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) reserved

   (c) 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

   (d) 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 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: November 4, 2004

/s/ Robert T. Blakely

Robert T. Blakely
Chief Financial Officer

EXHIBIT 32

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

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 MCI, Inc. (the "Company"), that, to his knowledge, the Quarterly Report on Form 10-Q of the Company for the period ended September 30, 2004 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 operations of the Company.

Date: November 4, 2004

/s/ Michael D. Capellas

Michael D. Capellas
Chief Executive Officer

/s/ Robert T. Blakely

Robert T. Blakely
Chief Financial Officer

Created by 10KWizard Technology www.10KWizard.com

EXHIBIT 5

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

FORM 10-K

(Mark one)

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2004

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 number 1-8606

Verizon Communications Inc.

(Exact name of registrant as specified in its charter)

Delaware	**23-2259884**
(State of incorporation)	(I.R.S. Employer Identification No.)
1095 Avenue of the Americas **New York, New York**	**10036**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (212) 395-2121

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock, $.10 par value	New York, Philadelphia, Boston, Chicago and Pacific Stock Exchanges

Securities registered pursuant to Section 12(g) of the Act:

None

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes ☑ No ☐

At June 30, 2004, the aggregate market value of the registrant's voting stock held by nonaffiliates was approximately $100,197,581,000.

At January 31, 2005, 2,769,964,950 shares of the registrant's Common Stock were outstanding, after deducting 4,900,431 shares held in treasury.

Documents incorporated by reference:

Portions of the registrant's Annual Report to Shareowners for the year ended December 31, 2004 (Parts I and II).

Portions of the registrant's Proxy Statement prepared in connection with the 2005 Annual Meeting of Shareowners (Part III).

Table of Contents

TABLE OF CONTENTS

Item No.		Page
PART I		
Item 1.	Business	1
Item 2.	Properties	17
Item 3.	Legal Proceedings	18
Item 4.	Submission of Matters to a Vote of Security Holders	18
Executive Officers of the Registrant		18
PART II		
Item 5.	Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	18
Item 6.	Selected Financial Data	19
Item 7.	Management's Discussion and Analysis of Results of Operations and Financial Condition	19
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	19
Item 8.	Financial Statements and Supplementary Data	19
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	19
Item 9A.	Controls and Procedures	19
Item 9B.	Other Information	19
PART III		
Item 10.	Directors and Executive Officers of the Registrant	19
Item 11.	Executive Compensation	20
Item 12.	Security Ownership of Certain Beneficial Owners and Management	20
Item 13.	Certain Relationships and Related Transactions	20
Item 14.	Principal Accounting Fees and Services	20
PART IV		
Item 15.	Exhibits, Financial Statement Schedules	20
Signatures		25
Certifications		

Unless otherwise indicated, all information is as of March 10, 2005

Table of Contents

PART I

Item 1. Business

General

Verizon Communications Inc. is one of the world's leading providers of communications services. Verizon's domestic wireline telecommunications business provides local telephone services, including broadband, in 29 states and Washington, D.C. and nationwide long-distance and other communications products and services. The domestic wireline consumer business generally provides local, broadband and long distance services to customers. Our domestic wireline business also provides a variety of services to other telecommunications carriers as well as large and small businesses. Verizon's domestic wireless business provides wireless voice and data products and services across the United States using one of the most extensive wireless networks. Information Services operates directory publishing businesses and provides electronic commerce services. Verizon's international presence includes wireline and wireless communications operations and investments, primarily in the Americas and Europe. Stressing diversity and commitment to the communities in which we operate, Verizon has a highly diverse workforce of 210,000 employees.

Verizon was formerly known as Bell Atlantic Corporation, which was incorporated in 1983 under the laws of the State of Delaware. We began doing business as Verizon Communications on June 30, 2000, when Bell Atlantic Corporation merged with GTE Corporation.

Our principal executive offices are located at 1095 Avenue of the Americas, New York, New York 10036 (telephone number 212-395-2121).

We have four reportable segments, which we operate and manage as strategic business units and organize by products and services. Our segments and their principal activities consist of the following:

Domestic Telecom	Domestic wireline communications services, principally representing our telephone operations that provide local telephone services in 29 states and Washington, D.C. These services include voice and data transport, enhanced and custom calling features, network access, directory assistance, private lines and public telephones. This segment also provides long distance services, customer premises equipment distribution, data solutions and systems integration, billing and collections, Internet access services and inventory management services.
Domestic Wireless	Domestic wireless products and services include wireless voice and data services and equipment sales across the United States.
Information Services	Directory publishing businesses, including print directories and SuperPages.com online search services, as well as website creation and other electronic commerce services. This segment has operations principally in the United States.
International	International wireline and wireless communications operations and investments primarily in the Americas, as well as investments in Europe.

You can find additional business information under the heading "Overview" on pages 13 through 14 and segment financial information under the heading "Segment Results of Operations" on pages 19 through 25 and in Note 18 on pages 63 through 65 of the 2004 Verizon Annual Report to Shareowners, which is incorporated herein by reference.

Domestic Telecom

Operations

Our Domestic Telecom segment, principally representing our wireline telephone operations, provided approximately 54% of 2004 total operating revenues. Our telephone operations presently serve a territory consisting of 144.7 million access line equivalents in 29 states and Washington, D.C. This segment also provides long distance and other telecommunication services. Domestic Telecom provides mainly two types of telecommunications services:

- Exchange telecommunications service is the transmission of telecommunications among customers located within a local calling area within a local access and transport area (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) and toll services outside a LATA (interLATA 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.

We have organized our Domestic Telecom segment into four marketing units operating across our telephone subsidiaries. The units focus on specific markets. We are not dependent on any single customer. Our telephone operations remain responsible within their respective service areas for the provision of telephone services, financial performance and regulatory matters.

The *Enterprise* unit markets communications and information technology and services to large businesses and to departments, agencies and offices of the executive, judicial and legislative branches of the federal, state and local governments. These services include voice switching/processing services (e.g., dedicated private lines, custom Centrex, call management and voice messaging), end-user networking (e.g.,

credit and debit card transactions and personal computer-based conferencing, including data and video), internetworking (establishing links between the geographically disparate networks of two or more companies or within the same company), network optimization (disaster avoidance and 911 service) and other communications services. The Enterprise unit also provides data transmission, Internet and network integration services, interLATA long distance services, network monitoring services and telecommunications equipment sales to medium and large businesses. Revenues in 2004 were approximately $6.4 billion, representing approximately 17% of Domestic Telecom's aggregate revenues.

The *Retail* unit markets communications and information services to residential customers and to small and medium-sized businesses within our territory, including our long distance services and Internet access services. Our long distance subsidiary provides national and international long distance services in all 50 states to residential and business customers, including calling cards, 800/888 services and operator services. This unit also provides operator and pay telephone services and sells customer premises equipment. Revenues in 2004 were approximately $22.3 billion, representing approximately 58% of Domestic Telecom's aggregate revenues. These revenues were derived primarily from the provision of telephone services to residential users.

The *Wholesale* unit markets our network operations, which principally includes our carrier access and telecom industry services. Revenues in 2004 were approximately $8.7 billion, representing approximately 22% of Domestic Telecom's aggregate revenues. Approximately 66% of total wholesale revenues were derived from interexchange carriers (switched and special access). The remaining revenues come from our telecom industry services, principally from other local exchange carriers which resell network connections to their own customers.

The *Network* unit is principally responsible for the construction and maintenance of our telephone operations' networks. This unit is also responsible for the procurement and management of inventory and supplies for our subsidiaries and sells materials and logistic services to third-party carriers. Revenues in 2004 (after eliminations and combined with all other Domestic Telecom revenues) were approximately $1.2 billion, representing approximately 3% of Domestic Telecom's aggregate revenues.

Telecommunications Act of 1996

The Telecommunications Act of 1996 (the 1996 Act), regulatory and judicial actions and the development of new technologies, products and services have created opportunities for alternative telecommunication service providers, many of which are subject to fewer regulatory constraints. We are unable to predict definitively the impact that the ongoing changes in the telecommunications industry will ultimately have on our business, results of operations or financial condition. The financial impact will depend on several factors, including the timing, extent and success of competition in our markets, the timing and outcome of various regulatory proceedings and any appeals, and the timing, extent and success of our pursuit of new opportunities resulting from the 1996 Act and technological advances.

FCC Regulation and Interstate Rates

Our telephone operations are subject to the jurisdiction of the Federal Communications Commission (FCC) with respect to interstate services and related matters.

Access Charges and Universal Service

On May 31, 2000, the FCC adopted the Coalition for Affordable Local and Long Distance Services (CALLS) plan as a comprehensive five-year plan for regulation of interstate access charges. The CALLS plan has three main components. First, it establishes a portable interstate access universal service support of $650 million for the industry. This explicit support replaces implicit support embedded in interstate access charges. Second, the plan simplifies the patchwork of common line charges into one subscriber line charge (SLC) and provides for de-averaging of the SLC by zones and class of customers in a manner that will not undermine comparable and affordable universal service. Third, the plan sets into place a mechanism to transition to a set target of $.0055 per minute for switched access services. Once that target rate is reached, local exchange carriers are no longer required to make further annual price cap reductions to their switched access prices. The annual reductions leading to the target rate, as well as annual reductions for the subset of special access services that remain subject to price cap regulation was set at 6.5% per year.

As a result of tariff adjustments which became effective in July 2003, virtually all of our switched access lines reached the $.0055 benchmark. On June 29, 2004, the U.S. Court of Appeals for the D.C. Circuit upheld the FCC's prior approval of an increase in the SLC cap. The current cap is $6.50.

The FCC previously initiated investigations of the interstate access rates charged by Verizon's local telephone companies during the 1993 to 1996 tariff years under the price cap rules that were in place prior to the adoption of the CALLS plan. On July 30, 2004, the FCC released an order resolving one of the issues in those pending investigations, and concluded that some of Verizon's local telephone companies had incorrectly calculated the impact of their obligation to "share" a portion of their earnings above certain prescribed levels with their access customers. The amount of any refund as a result of that finding will be determined in a further phase of the proceeding. Other issues remain under investigation.

The FCC has adopted rules for special access services that provide for pricing flexibility and ultimately the removal of services from price regulation when prescribed competitive thresholds are met. Approximately 55% of special access revenues are now removed from price regulation.

Table of Contents

In November 1999, the FCC adopted a new mechanism for providing universal service support to high-cost areas served by large local telephone companies. This funding mechanism provides additional support for local telephone services in several states served by our telephone operations. This system has been supplemented by the new FCC access charge plan described above. On October 16, 2003, in response to a previous court decision, the FCC announced a decision providing additional justification for its non-rural high-cost universal support mechanism and modifying it in part. That decision also has been appealed. The FCC also has proceedings underway to evaluate possible changes to its current rules for assessing contributions to the universal service fund. Any change in the current assessment mechanism could result in a change in the contribution that local telephone companies must make and that would have to be collected from customers.

Unbundling of Network Elements

On February 20, 2003, the FCC announced a decision adopting new rules defining the obligations of incumbent local exchange carriers to provide competing carriers with access to unbundled network elements (UNEs). The decision was the culmination of an FCC rulemaking referred to as its triennial review of its UNE rules, and also was in response to a decision by the U.S. Court of Appeals for the D.C. Circuit that had overturned the FCC's previous unbundling rules.

The text of the order and accompanying rules were released on August 21, 2003. With respect to broadband facilities, such as mass market fiber to the premises loops and packet switching, that order generally removed unbundling obligations under Section 251 of the 1996 Act. With respect to narrowband services, the order generally left unbundling obligations in place, with certain limited exceptions, and delegated to state regulatory proceedings a further review. The order also provided a new set of criteria relating to when carriers may purchase a combination of unbundled loops and transport elements known as enhanced extended loops (EELs) that increased arbitrage opportunities by making it easier for carriers to use EELs purchased at artificially low regulated UNE rates rather than competitive special access prices.

Multiple parties, including Verizon, appealed various aspects of the decision. On March 2, 2004, the U.S. Court of Appeals for the D.C. Circuit issued an order upholding the FCC in part, and overturning its order in part. The court upheld the FCC with respect to broadband facilities. On the narrowband unbundling requirements, the court reversed and vacated key aspects of the FCC decision that had required unbundled access to mass market switching and high capacity transmission facilities. The court's order vacating those aspects of the FCC's rules went into effect on June 16, 2004, and petitions by various parties to obtain a stay or U.S. Supreme Court review were denied.

On August 20, 2004, the FCC issued interim narrowband unbundling rules and a Notice of Proposed Rulemaking to establish new unbundling rules. In the interim rules order, the FCC required incumbent carriers to continue providing, for six months from the effective date of its order, unbundled mass market switching and high capacity transmission facilities on the same terms that they were available under interconnection agreements as of June 15, 2004. Verizon and other parties petitioned the U.S. Court of Appeals for the D.C. Circuit for a writ of mandamus to overturn the interim rules. At the request of the FCC, the court held the petition in abeyance while the FCC rulemaking proceeded and directed the parties to report on the status of the FCC proceedings no later than January 4, 2005. On January 4, 2005, Verizon and other parties asked the U.S. Court of Appeals for the D.C. Circuit to retain jurisdiction on the pending mandamus petition and to provide further briefing upon the release of the FCC order.

On February 4, 2005, the FCC released a decision on new unbundling rules. The FCC eliminated the requirement to unbundle mass market local switching on a nationwide basis, with the obligation to accept new orders ending as of the effective date of the order (March 11, 2005). The FCC also established a one year transition for existing UNE switching arrangements. For high capacity transmission facilities, the FCC established criteria for determining whether high capacity loops, transport or dark fiber transport must be unbundled in individual wire centers, and stated that these standards were only expected to affect a small number of wire centers. The FCC also eliminated the obligation to provide dark fiber loops and found that there is no obligation to provide UNEs exclusively for wireless or long distance service. In any instance where a particular high capacity facility no longer has to be made available as a UNE, the FCC established a similar one year transition for any existing high capacity loop or transport UNEs, and an 18 month transition for any existing dark fiber UNEs.

Separately, the FCC has taken steps to clarify its rules for broadband facilities in response to requests of various parties. Verizon petitioned the FCC to make clear that any broadband facilities that do not have to be unbundled under Section 251 of the 1996 Act also do not have to be unbundled under another provision of the 1996 Act, specifically Section 271. On October 22, 2004, the FCC granted that petition, and the FCC's decision has been appealed by various parties. In addition, the FCC has clarified that mass market fiber to the curb loops qualify for the same regulatory treatment as mass market fiber to the premises loops, that fiber loops to serve customers in multiple unit buildings also qualify for that same regulatory treatment as long as the building is predominantly residential, and that carriers that deploy new broadband network facilities are not required to equip those facilities with legacy capabilities that could render them subject to unbundling.

Intercarrier Compensation

The FCC has an ongoing rulemaking that could fundamentally restructure the regulatory regime for intercarrier compensation, including, but not limited to, access charges, compensation for Internet traffic, and reciprocal compensation for local traffic. To date, several parties and coalitions have submitted alternative proposals to the FCC for restructuring the intercarrier compensation rules, and the FCC has stated that it intends to conduct further proceedings to evaluate various alternatives.

The FCC also has pending before it issues relating to intercarrier compensation for dial-up Internet-bound traffic. The FCC previously found this traffic is not subject to reciprocal compensation under Section 251(b)(5) of the 1996 Act. Instead, the FCC established federal rates per minute for this traffic that declined from $.0015 to $.0007 over a three-year period, established caps on the total minutes of this traffic subject to compensation in a state, and required incumbent local exchange carriers to offer to both bill and pay reciprocal compensation for local traffic

the same rate as they are required to pay on Internet-bound traffic. On May 3, 2002, the U.S. Court of Appeals for the D.C. Circuit rejected part of the FCC's rationale, but declined to vacate the order while it is on remand. As a result, pending further action by the FCC, the FCC's underlying order remains in effect. On October 8, 2004, the FCC announced that it had denied a petition to discontinue the $.0007 rate cap on this traffic, but had decided to remove the caps on the total minutes of Internet-bound traffic subject to compensation. That decision is the subject of an appeal by several parties. Disputes also remain pending in a number of forums relating to the appropriate compensation for Internet-bound traffic during previous periods under the terms of our interconnection agreements with other carriers.

The FCC also is considering multiple petitions asking it to declare whether, and under what circumstances, services that employ Internet protocol are subject to access charges under current law, or asking it to forbear from any requirement to pay access charges on some such services. On March 10, 2004, the FCC initiated a rulemaking proceeding to address the regulation of services that use Internet protocol, including voice services. The FCC also concluded in response to one such petition that one provider's peer-to-peer Internet protocol service that does not use the public switched network is an interstate information service and is not subject to access charges. During April 2004, the FCC issued an order in connection with another such petition that stated that the petitioning company's service that utilizes Internet protocol for only one intermediate part of a call's transmission is a telecommunications service subject to access charges. The FCC also has a statutory deadline of March 22, 2005 to address a third petition asking it to forbear from applying access charges to voice over Internet protocol services that are terminated on switched local exchange networks.

Broadband Services

The FCC has several ongoing rulemakings considering the regulatory treatment of broadband services. Among the questions at issue are whether to require local telephone companies like Verizon to offer such services as a common carrier or whether such services may be offered under a less regulated private carriage arrangement, under what circumstances high speed Internet access services should be classified as largely deregulated information services, and whether to declare broadband services offered by local telephone companies as non-dominant and what the effect should be of any such classification.

State Regulation of Rates and Services

State public utility commissions regulate our telephone operations with respect to intrastate rates and services and other matters. In many jurisdictions the telephone operations have been able to replace rate of return regulation with price regulation plans.

Verizon California Inc.

Arizona

Verizon California's operations in Arizona are subject to rate of return regulation.

California

Verizon California's operations in California have operated under the New Regulatory Framework (NRF) since 1990. The NRF allows for a gradual transition to less regulation on a service-by-service basis. The NRF is reviewed every three years and currently has the following features:

- Earnings Ceiling: The ceiling is suspended.
- Price Cap Index: By setting inflation equal to productivity, the California Public Utilities Commission (CPUC) has suspended the price cap index. Limited exogenous changes are allowed. Generally, exogenous changes are changes unique to or specifically targeted to a company that are beyond its control (in this case, changes are permitted only for matters mandated by the CPUC or changes in total intrastate cost recovery resulting from changes between federal and state jurisdictions).
- Price Flexibility: Services fall into three categories.
- Category I services cannot be changed without CPUC approval.
- Category II services are partially competitive and can be adjusted within a ceiling/floor range. The current price (effectively the ceiling) cannot be increased without a formal application.
- Category III services are considered competitive and can be increased or decreased on short notice.
- New Services: New services can be classified as Category II or III. If introduced as Category III, Verizon California must demonstrate insignificant market power.

The CPUC will review NRF features during 2005 – 2006.

Nevada

Verizon California's operations in Nevada are subject to rate of return regulation.

Table of Contents

Verizon Delaware Inc.

Since 1994, Verizon Delaware has been regulated under the alternative regulation provisions of the Delaware Telecommunications Technology Investment Act of 1993 (Delaware Telecommunications Act). On September 9, 2003, the Delaware Public Service Commission approved a stipulation permitting Verizon Delaware to continue to be regulated under the Delaware Telecommunications Act through September 2006. The Delaware Telecommunications Act provides the following:

- The prices of "Basic Telephone Services" (e.g., dial-tone and local usage) will remain regulated and cannot change in any one year by more than the Gross Domestic Product – Price Index (GDP-PI) less 3%.
- The prices of "Discretionary Services" (e.g., Identa Ring(SM) and Call Waiting) cannot increase more than 15% per year per service.
- The prices of "Competitive Services" (e.g., voice messaging and message toll service) are not subject to tariff or regulation.
- Verizon Delaware will develop a technology deployment plan with a commitment to invest a minimum of $250 million in Delaware's telecommunications network during the first five years of the plan.

Verizon Florida Inc.

Florida statutes govern the price cap plan. Beginning January 1, 2001, Verizon Florida was able to raise basic local rates on 30 days notice once in any 12-month period not to exceed the GDP-PI less 1%. Verizon Florida may increase rates for non-basic services but increases for any category cannot exceed 6% in any 12-month period unless another company is providing service in a given exchange, at which time Verizon Florida can increase its price up to 20% in a 12-month period. Earnings are not regulated. Legislation was passed in 2003 that allows Verizon Florida to offset a reduction in intrastate access rates with an increase in basic local exchange revenues upon Florida Public Service Commission (FPSC) approval. The offset must be revenue neutral and take place over two to four years. In evaluating the petition, the FPSC is to consider whether granting the petition will remove current support for basic local telecommunications services preventing the creation of a more attractive competitive local exchange market for the benefit of residential consumers and enhanced market entry. When Verizon Florida's rates are reduced to parity as defined by the statute, Verizon Florida's basic services become subject to the same regulatory treatment as its non-basic services.

Verizon Hawaii Inc.

Verizon Hawaii's telephone operations are subject to rate of return regulation.

Verizon Maryland Inc.

In 1996, the Public Service Commission of Maryland approved a price cap plan for regulating the intrastate services provided by Verizon Maryland. Under the plan, services are divided into six categories: Access; Basic-Residential; Basic-Business; Discretionary; Competitive; and Miscellaneous. Rates for Access, Basic-Residential, Basic-Business and Discretionary Services can be increased or decreased annually under a formula that is based upon changes in the GDP-PI minus a productivity offset based upon changes in the rate of inflation as reflected in the Consumer Price Index. Rates for Competitive Services may be increased without regulatory limits. Regulation of profits is eliminated. The Public Service Commission of Maryland is currently reviewing the incentive regulation plan. Verizon Maryland has sought to eliminate the price cap formula and to move all business services into the competitive category.

Verizon New England Inc.

Maine

In June 2001, the Maine Public Utilities Commission (MPUC) ordered the continuation of an Alternative Form of Regulation (AFOR) for Verizon Maine for a second five-year term.

The Maine Public Advocate appealed the MPUC's 2001 AFOR decision to the Maine Supreme Judicial Court, claiming that any extension to the AFOR must be preceded by an investigation of Verizon Maine's costs and earnings utilizing traditional rate of return principles. On February 28, 2003, the court ruled that while state law requires that telephone rates under an AFOR are no higher than under rate of return regulation, the MPUC has broad discretion in making such a determination that would not necessarily require a full rate of return inquiry. However, the court vacated and remanded the decision to the MPUC for its failure to expressly make such a determination, or in the alternative that if such a showing cannot be made, that it nonetheless remains in the best interest of ratepayers to proceed with an AFOR. No change in any of Verizon Maine's rates was required by the court's decision while the remand proceeding was pending.

In March 2003, the MPUC opened a proceeding to address the Maine Supreme Judicial Court's remand of the 2001 AFOR decision. In an order issued on July 11, 2003, the MPUC ruled that it would keep in place the $1.78 increase in Verizon New England's monthly basic exchange rates pending completion of the remand and maintain certain elements (pricing flexibility, Service Quality Index) of the proposed AFOR on an interim basis until a final decision on the remand. On September 25, 2003, the PUC issued an order reinstating the AFOR and that order was appealed. On January 26, 2005, the Maine Supreme Judicial Court vacated the MPUC order and remanded the case for further investigation.

Table of Contents

The court held that the MPUC did not sufficiently comply with the statutory requirement that it ensure that local rates under an AFOR will not be higher than under traditional rate of return.

Massachusetts

In April 2001, Verizon New England filed with the Massachusetts Department of Telecommunications and Energy (DTE) a proposed alternative regulatory plan to replace the price regulation plan that was to expire in August 2001. On May 8, 2002, the DTE issued its decision in Phase I of the case in which it found that Verizon New England had demonstrated the existence of sufficient competition for most of its retail business services and granted Verizon New England pricing flexibility on the services. Price increases are not constrained. Price decreases are subject to price floor requirements. In addition, the DTE ruled that Verizon New England should reduce state switched access prices to interstate levels on a revenue neutral basis by increases in residence dial-tone rates. With respect to residence services, the DTE tentatively concluded that Verizon New England should have pricing flexibility for non-basic services but that increases in basic services should be limited. The DTE directed Verizon New England to file proposals consistent with its findings.

In May 2003, the DTE issued a final ruling approving with minor modifications Verizon New England's compliance filing implementing the DTE's alternative regulatory plan. The plan gives Verizon New England pricing flexibility for most retail business services and residence non-basic services, including second dial-tone lines. The DTE also approved rate reductions for state switched access prices to interstate levels with offsetting revenue-neutral increases in residence dial-tone rates. Those rate changes became effective on June 1, 2003.

New Hampshire

Verizon New England's operations in New Hampshire are currently subject to rate of return regulation. On January 16, 2004, the New Hampshire Public Utilities Commission (NHPUC) concluded a comprehensive proceeding examining the appropriate cost of capital for Verizon. In its order, the NHPUC set the average weighted cost of capital for Verizon at 8.2%. At present, the newly determined cost of capital has no effect on Verizon's retail revenues. The NHPUC directed Verizon to file revised UNE rates reflecting this new cost determination by March 16, 2004. Verizon's current UNE rates were approved in 2001 relying upon an average weighted cost of capital of 10.46%. Verizon filed an appeal of the NHPUC decision in federal district court in New Hampshire. The NHPUC's order to file new UNE rates was stayed by stipulation during the appeal. A decision by the court is pending. On July 9, 2004, the NHPUC issued an order finding the existing Directory Licensing Agreement between Verizon New England and its affiliated Yellow Pages company to be unreasonable as it did not include a directory revenue sharing provision. As a result, the NHPUC directed that Verizon impute $23.3 million for purposes of intrastate ratemaking in New Hampshire. On October 19, 2004, the NHPUC issued an order denying Verizon's Motion for Reconsideration of the decision. At present, the NHPUC ruling regarding imputation has no effect on Verizon's retail rates. Verizon has filed an appeal with the New Hampshire Supreme Court.

Rhode Island

Pursuant to a directive of the Rhode Island Public Utilities Commission (RIPUC), Verizon Rhode Island filed in July 2002 a proposal for a new alternative regulation plan to replace the existing price cap plan that was to expire in December 2002. Following the close of evidentiary hearings in the case, Verizon Rhode Island and the Rhode Island Division of Public Utilities and Carriers (Division) filed a stipulation on December 6, 2002 resolving all issues in the case. The principal components of the stipulated plan are:

- No index or price cap formula;
- Pricing flexibility for all business services, subject to a long-run incremental cost (LRIC)-based price floor;
- The company may increase residential basic exchange rates by $1 per year in years one and two. An additional $1 increase in year three will be subject to RIPUC and Division review;
- The company may pass through exogenous changes, subject to a $2.5 million annual cap, but must absorb the first $1 million in exogenous changes in the year in which approval is sought;
- The company will continue its voluntary funding of a discount program for Internet access for schools and libraries at up to $2 million per year until the earlier of December 31, 2004, or the implementation of an alternative funding mechanism (e.g., legislation);
- The current retail service quality plan is maintained with certain modifications; and
- The term of the plan is three years.

After further hearing and briefing, the RIPUC approved the stipulation at an open meeting on January 10, 2003, with two modifications. First, the RIPUC imposed limits on price increases for all other non-basic residential services as follows:

For services priced at $5 or less, rates may increase 15% per year

For services priced at $5.01 to $10, rates may increase 10% per year

For services priced over $10, rates may increase 5% per year

Table of Contents

Second, the company is required to file quarterly reports showing for each wire center in the state the number of access lines served by the company and the number and type of access lines served by competitors. On March 31, 2003, the RIPUC issued an order adopting the modified stipulation approved on January 10, 2003.

Vermont

In 2000, the Vermont Public Service Board approved a five-year incentive regulation plan that will provide Verizon New England with increased flexibility to introduce and price new products and services. The plan also removes most restrictions on Verizon New England's earnings from Vermont operations during the life of the plan and contains no productivity adjustment. The plan limits Verizon New England's ability to raise prices on existing products and services, and requires revenue reductions of $16.5 million at the outset of the plan, $6.5 million during the first year of the plan and approximately $6.0 million over the subsequent years of the plan. The plan also requires some service quality improvements subject to financial penalty. In May 2004, the Vermont Public Service Board opened a proceeding to consider the form of regulation for Verizon following the expiration of the current plan. The Vermont Public Service Board is expected to make a decision by July 2005.

Verizon New Jersey Inc.

The 1992 New Jersey Telecommunications Act classifies telecommunications services as "competitive" or "protected." "Protected telephone services" include basic residence, touch-tone, access services other than those otherwise deemed competitive by the New Jersey Board of Public Utilities (NJBPU), business local service for customers with four lines or less, and the ordering, installation and restoration of these services. Verizon New Jersey provides "protected telephone services" and other services, including vertical services (Rate-Regulated Services), under a Plan for Alternative Form of Regulation, which became effective on July 1, 2002, pursuant to a decision announced by the NJBPU on June 19, 2002 and issued August 19, 2003. The new plan eliminates earnings regulation, eliminates earnings sharing provisions, streamlines the process to introduce new services and strengthens commitments to service quality, lifeline service and schools and public libraries. A petition for reconsideration of the plan was filed by an opposing party. Additionally, a Verizon New Jersey petition to lower the competitive threshold for business local service to customers with less than two lines is pending before the NJBPU, with a ruling expected on or before March 31, 2005.

Verizon New York Inc.

New York

The New York State Public Service Commission (NYSPSC) adopted an incentive plan to regulate the services of Verizon New York, effective March 1, 2002. The plan expired in 2004, except that the service quality provisions of the plan will expire in 2005. The plan establishes state-wide service quality standards, with the potential for customer credits if Verizon fails to meet those standards. Verizon New York will complete its transition to generally accepted accounting principles for preparing financial statements for regulatory purposes in March 2005. Verizon New York's rates are proposed by the company based on several factors, including the competitiveness of the service and the company's underlying costs, and are subject to approval by the NYSPSC.

Connecticut

In December 2004, the Connecticut Department of Public Utility Control adopted an incentive regulation plan proposed by Verizon New York, which eliminates regulation of earnings and provides other deregulatory benefits for Verizon New York's operations in Connecticut.

Verizon North Inc.

Illinois

Verizon North's telephone operations in Illinois are subject to rate of return regulation. Optional toll plans, Integrated Services Digital Network (ISDN), frame relay, payphones, CentraNet, and other data services are considered deregulated and have total pricing flexibility.

Indiana

Verizon North's telephone operations in Indiana became subject to an alternative regulatory plan during 2004. Among other matters, earnings are not subject to regulation, tariff filings are streamlined, 3 tiers of services are subject to differing levels of pricing regulation and can be shifted between tiers, regulation of certain accounting standards and financings are eliminated and depreciation rates are not subject to approval. The plan has a three and one-half year term.

Michigan

Since the Michigan Telecommunications Act was passed in 1991, a form of regulation that focuses on services, prices and costs has replaced rate of return regulation. Earnings are not regulated. All rates for regulated services must meet a cost floor. Verizon North may increase local rates annually up to 1% less than the Consumer Price Index. Any rate increases above that amount must be approved by the Michigan Public Service Commission (MPSC) as "just and reasonable." The MPSC may only approve rate increases based upon one or more of the following 5

Table of Contents

factors: total service LRIC; comparison to other provider rates; whether a new function, feature or capability is offered; increase in costs to provide local service; and whether further investment is economically justified. The MPSC has no jurisdiction over numerous unregulated services. Other services have substantial pricing flexibility.

Ohio

Verizon North's telephone operations in Ohio are subject to rate of return regulation.

Pennsylvania

On July 26, 2001, the Pennsylvania Public Utility Commission (PPUC) rejected, in part, and accepted, in part, a proposed price cap plan filed by Verizon North. The PPUC accepted, with some modification, that part of the plan that provided for the deregulation of the pricing of competitive services; elimination of earnings sharing; adoption of a productivity factor based on inflation; a provision to adjust rates for exogenous events; and a price cap of rates of protected services. The PPUC rejected that part of Verizon North's plan that provided for improvement of Verizon North's network infrastructure. The PPUC subsequently approved a revised infrastructure plan for Verizon North that requires, inter alia, universal broadband deployment by 2015.

On November 30, 2004, a statute reauthorizing alternative regulation in Pennsylvania (Act 183) was enacted into law. Act 183:

- Authorizes Verizon North to file an amended network modernization plan requiring it to deploy a universal broadband network, defined at 1.544 megabits per second, not later than 2015, and the plan cannot be subsequently changed without Verizon North's consent;
- Permits annual price increases up to, but not exceeding, the GDP-PI minus .5% (for 100 broadband deployment by 2015) or 0% (by 2013).
- Allows nonprotected services to be declared competitive through a one-day's notice filing with the PPUC.
- Reduces PPUC reporting and other regulatory oversight requirements.
- Requires Verizon North to contribute up to 20% of the first year effect of GDP-PI price increases to funds designed to promote broadband in schools and broadband education and demand aggregation generally.

Wisconsin

Verizon North entered a price cap plan in 1995. The plan does not regulate earnings and price cap index increases can be accumulated and deferred up to three years. The maximum increase for any single basic rate element is 10% or the increase in the GDP-PI, whichever is greater. Overall basic local service increases are limited to GDP-PI less 2%. Intrastate access service mirrors interstate rates. There are no restrictions on other services as long as they cover LRICs. Rate changes are effective on one day's notice after customer notice and new services take effect after ten days. The statute requires that no earlier than six years, and no more frequently than every three years thereafter, the Public Service Commission of Wisconsin may by rule increase or decrease the GDP-PI productivity factor in any twelve-month period to reflect any statewide changes in the productivity experience of the telecommunications industry. The latest productivity factor review is complete and the factor was not changed.

Verizon Northwest Inc.

California

Verizon Northwest's California operations are subject to rate of return regulation.

Idaho

Verizon Northwest's Idaho operations are subject to rate of return regulation.

Oregon

Verizon Northwest's Oregon operations are subject to rate of return regulation. Pricing flexibility is permitted in competitive zones and Verizon Northwest currently has Digital Channel Service, ISDN, PBX trunks (telephone switching equipment on customer premises), DID trunks (trunks from the customer premises switches to the central office) and single line business service offerings in these zones. Billing and collection and CentraNet are in a competitive class and are flexibly priced.

Table of Contents

Washington

Verizon Northwest's Washington operations are subject to rate of return regulation. IntraLATA toll and billing and collection are flexibly priced.

Verizon Pennsylvania Inc.

The PPUC regulates Verizon Pennsylvania under an Alternative Regulation Plan approved in 1994. The plan provides for a pure price cap plan with no sharing of earnings with customers and replaces rate base, rate of return regulation. Competitive services, including toll, directory advertising, billing services, Centrex service, paging, speed calling, repeat calling, and HiCap (high capacity private line) and business services provided to larger customers are price deregulated. All non-competitive services are price regulated.

The plan:

- Permits annual price increases up to, but not exceeding, the GDP-PI minus 2.93%;
- Requires annual price decreases when the GDP-PI falls below 2.93%;
- Caps prices for protected services, including residential and business basic exchange services, special access and switched access, through 1999; and
- Permits revenue-neutral rate restructuring for noncompetitive services.

The PPUC's order approving the Bell Atlantic–GTE merger extended the cap on residential and business basic exchange services through 2003.

The plan also requires deployment of a universal broadband network. On September 17, 2003, the PPUC approved a revised plan that requires Verizon Pennsylvania to deploy a universal broadband network, defined at 1.544 megabits per second, in the following phases: 50% by 2004; 60% by 2006; 70% by 2008; 80% by 2010, 90% by 2012 and 100% by 2015. Verizon Pennsylvania is also required to make broadband services at 45 megabits per second available on a commercially reasonable time frame to 50% of exchanges by 2004 and 100% by 2015.

In December 2003, the statute authorizing alternative regulation in Pennsylvania expired. In January 2004, the PPUC issued a policy statement that the expiration of the statute had no effect upon current incentive regulation plans.

As described in Verizon North's Pennsylvania operations above, on November 30, 2004, a new statute reauthorizing alternative regulation in Pennsylvania, Act 183, was enacted into law. The provisions of Act 183 also apply to Verizon Pennsylvania.

Verizon South Inc.

North Carolina

Verizon South's operations in North Carolina have been under a price cap plan since 1996 that was subject to review in 2002 – 2003. Earnings are not regulated and local rates can be increased by GDP-PI less 2%. Rate increases are effective on fourteen days notice. Verizon South has complete flexibility to increase rates for billing and collection, Centrex, and enhanced digital switch service. The current price cap plan is under review.

South Carolina

Verizon South's South Carolina price cap plan started during 2000. Under the statute, existing rates are deemed just and reasonable on the date of notification. Residential and single-line business local service rates are capped for two years from the date of election. After two years, these rates may be adjusted annually pursuant to an inflation-based index. Rates for other services are flexibly priced. Price decreases are effective in seven days. Price increases and new services prices are effective in fourteen days.

Virginia

On December 21, 2000, the Virginia State Corporation Commission (VSCC) approved a price cap plan for Verizon South that was substantially similar to Verizon Virginia's plan. In January 2005, the VSCC approved modifications to the plan described below.

Verizon Southwest

The Texas Public Utilities Commission regulates Verizon Southwest under a price cap plan with no cap on earnings pursuant to the Public Utility Regulatory Act (PURA). The plan places services into four categories:

- Basic services – These include basic local residential charges such as service connection, mandatory expanded calling plans and residential call waiting. Price increases prior to September 1, 2005 are only allowed to adjust for changes in FCC separations that

affect net income by at least 10% and for rate group reclassifications due to access line growth. After September 1, 2005, price increases require approval. Full packaging (an integrated offering of some or all of our products and services) is allowed.

- Non-basic services – This category only includes switched access, which is price-capped until September 1, 2005. Decreases can be made to the LRIC. The statute contains no expiration provision.
- Price-capped non-basic services – These services include basic local business charges such as service connection and BRI-ISDN (Basic Rate Interface – Integrated Services Digital Network). These services are price-capped until September 1, 2005. Decreases can be made to the LRIC. Full packaging is allowed.
- Non-basic services without caps – This category represents all other regulated services, including intraLATA toll, custom calling features (except residential call waiting), special access, operator services, PBX and ISDN services. These services have unlimited upward pricing flexibility. Decreases can be made to the LRIC (with imputation) or the prices in effect on September 1, 1999, whichever is less. Full packaging is allowed.

Verizon Virginia Inc.

Effective in 1995, the VSCC approved an alternative regulatory plan that regulates Verizon Virginia's noncompetitive services on a price cap basis and does not regulate Verizon Virginia's competitive services. The plan does not regulate profits. In June 2001, the VSCC modified the plan and extended the moratorium on rate increases for basic local telephone service until 2004. In January 2005, the VSCC again modified the plan, permitting additional pricing flexibility for noncompetitive services and eliminating various regulatory requirements. The plan's effective date is February 1, 2005 and it has no expiration date.

Verizon Washington, DC Inc.

On September 9, 2004, the District of Columbia Public Service Commission (DCPSC) approved an amended price cap plan for local retail services provided by Verizon Washington, DC. Key provisions of the 2004 plan include:

- A three-year term;
- No earnings restrictions, service penalties or revenue sharing;
- Four service categories: basic residential, basic business, discretionary and competitive;
- A cap on residential dial-tone line rates until 2006;
- Annual pricing flexibility for all other basic residential services, with the increase in total revenues from these services limited to the annual inflation rate (as measured by the change in GDP-PI) and increases for any individual service in the category limited to 10%;
- Classification of all business services as competitive with complete pricing flexibility except for basic business dial-tone lines and message units, E911, local directory service and Connect Request;
- Pricing flexibility on discretionary services, with a 15% annual limit on any rate increase; and
- Flexibility to bundle or package existing services.

Verizon West Virginia Inc.

On October 3, 2001, the West Virginia Public Service Commission (WVPSC) approved Verizon West Virginia's new Incentive Regulation Plan (IRP). The IRP continues, until December 31, 2005, the flexible price regulation of competitive services, caps on basic rates, infrastructure commitments and unlimited earnings freedom that have been in place since 1988. In addition, long distance, wide area telephone service and national directory assistance will be rate-deregulated, and Verizon West Virginia may petition for the rate deregulation of any other service, except basic residential service, at any time.

Competition

Current and potential competitors in telecommunication services include long distance companies, other local telephone companies, cable companies, wireless service providers, foreign telecommunications providers, electric utilities, Internet service providers and other companies that offer network services. Many of these companies have a strong market presence, brand recognition and existing customer relationships, all of which contribute to intensifying competition and may affect our future revenue growth.

Table of Contents

Local Exchange Services

The ability to offer local exchange services historically has been subject to regulation by state regulatory commissions. Applications from competitors to provide and resell local exchange services have been approved in every jurisdiction in our service territory. The 1996 Act has significantly increased the level of competition in our local exchange markets.

One of the purposes of the 1996 Act was to ensure, and accelerate, the emergence of competition in local exchange markets. Toward this end, the 1996 Act requires most existing local exchange carriers (incumbent local exchange carriers, or ILECs), including our telephone operations, to permit potential competitors (CLECs) to:

- Purchase service from the ILEC for resale to CLEC customers;
- Purchase UNEs from the ILEC; and/or
- Interconnect the CLEC's network with the ILEC's network.

As a result, competition in our local exchange markets continues to increase. Our telephone operations generally have been required to sell their services to CLECs at discounts of approximately 51% from the prices our telephone operations charge their retail customers. The scope of these obligations going forward will be affected by the new unbundling rules described above, and the rates we charge local exchange competitors for access to UNEs remain under near-continual review and revision by state regulators and often result in reductions in those rates. See "State Regulation of Rates and Services."

Long Distance Services

We offer intraLATA and interLATA long distance services. IntraLATA toll calls originate and terminate within the same LATA, but generally cover a greater distance than a local call. State regulatory commissions rather than federal authorities generally regulate these services. Federal regulators have jurisdiction over interstate toll services. All of our state regulatory commissions (except in Washington, D.C., where intraLATA toll service is not provided) permit other carriers to offer intraLATA toll services within the state. InterLATA toll calls terminate outside the LATA of origination. We now offer long distance services throughout the United States, capping a seven-year effort. Our authority in Alaska is limited to interstate and international services. A number of our major competitors in the long distance business have strong brand recognition and existing customer relationships.

Alternative Access Services

A substantial portion of our telephone operations' revenues from business and government customers is derived from a relatively small number of large, multiple-line subscribers.

We face competition from alternative communications systems, constructed by large end-users, interexchange carriers and alternative access vendors, which are capable of originating and/or terminating calls without the use of our plant. The FCC's orders requiring us to offer collocated interconnection for special and switched access services have enhanced the ability of such alternative access providers to compete with us.

Other potential sources of competition include cable television systems, shared tenant services and other noncarrier systems which are capable of bypassing our telephone operations' local plant, either partially or completely, through substitution of special access for switched access or through concentration of telecommunications traffic on fewer of our telephone operations' lines, and through substitution of UNEs for special access services.

Voice over Internet Protocol Services

Our wireline telecommunications services also face increasing competition from companies which provide Voice over Internet Protocol (VoIP) services. These services use the Internet or private broadband networks to transmit voice communications. VoIP services are available from a wide range of companies including cable companies, long-distance companies, national VoIP providers and regional service providers.

Wireless Services

Wireless services also constitute a significant source of competition to our wireline telecommunications services, especially as wireless carriers (including Verizon Wireless) expand and improve their network coverage and continue to lower their prices to end-users. As a result, more end-users are substituting wireless services for basic wireline service. Wireless telephone services can also be used for data transmission.

Public Telephone Services

The growth of wireless communications has significantly decreased usage of public telephones, as more customers are substituting wireless services for public telephone services. In addition, we face competition from other providers of public telephone services.

Operator Services

Our operator services product line faces competition from alternative operator services providers and Internet service providers.

Domestic Wireless

Operations

Our Domestic Wireless segment provides wireless voice and data services and equipment sales in the United States, principally through Verizon Wireless.

Verizon Wireless is the most profitable wireless communications provider in the U.S., in terms of operating income. Verizon Wireless has the second largest customer base of any U.S. wireless provider, with 43.8 million wireless subscribers as of December 31, 2004, and provides wireless voice and data services across the United States. Approximately 269 million people reside in areas of the U.S. in which we have FCC licenses to offer our services and approximately 243 million people reside in areas covered by our service. This coverage includes approximately 90% of the population in our licensed areas and 49 of the 50 and 97 of the 100 most populated U.S. metropolitan areas.

Wireless licenses are granted by the FCC for an initial 10-year term and are renewable for successive 10-year terms. To date, all Verizon Wireless and predecessor company wireless licenses have been successfully renewed.

Background

The wireless joint venture was formed in April 2000 in connection with the combination of the U.S. wireless operations and interests of Verizon and Vodafone Group Plc (Vodafone). The wireless joint venture operates as Verizon Wireless. Verizon owns a controlling 55% interest in Verizon Wireless and Vodafone owns the remaining 45%.

Recent Acquisitions

On October 29, 2004, we acquired a 10 MHz personal communications services license from NextWave Telecom Inc. (NextWave) covering the New York metropolitan area for $930 million in cash. The license, which covers New York City and northern and central New Jersey, as well as Westchester and Rockland counties in New York, provides additional capacity for voice and data services.

In May 2003, we acquired 50 wireless licenses and related network assets from Northcoast Communications LLC for $762 million in cash. The licenses provide Verizon Wireless with additional growth capacity over large portions of the East Coast and Midwest. Total population served by the licenses is approximately 47 million.

Competition

There is substantial competition in the wireless telecommunications industry. We expect competition to intensify as a result of the higher penetration levels that currently exist in the industry, ongoing industry consolidation, local number portability, the development and deployment of new technologies, the introduction of new products and services, the availability of additional spectrum, both licensed and unlicensed, and regulatory changes. Other wireless providers, including other cellular and personal communications services operators and resellers, serve each of the markets in which we operate. We currently provide service to 49 of the top 50 markets in the U.S., and each of these 49 markets has an average of four other competing wireless providers. Competition also may increase if smaller, stand-alone wireless providers transfer licenses to larger, better capitalized and more experienced wireless providers. In addition, resellers that buy bulk wholesale service from carriers for resale, provide another category of differentiated competitors in the marketplace.

We compete primarily against four other major wireless service providers: Cingular Wireless LLC, Nextel Communications, Inc., Sprint Corporation and T-Mobile USA, Inc. In addition, in many markets we also compete with regional carriers, such as ALLTEL Corporation and US Cellular Corporation. On December 15, 2004, Sprint and Nextel announced an agreement for a merger between their companies. Based on reported information, the two entities, if fully combined as of December 31, 2004, would have been the third largest U.S. wireless service provider in terms of customers. The acquisition is subject to shareholder and regulatory approvals. Sprint and Nextel have announced that they expect the transaction to close in the second half of 2005.

Table of Contents

We believe that the following are the most important competitive factors in our industry:

Network quality, capacity and coverage: In recent years, competition in our industry has led to lower prices and to the popularity of pricing plans that do not charge for roaming which, in turn, has led to increased minutes of use per customer. As a result, the ability to keep pace with network capacity needs and offer high quality national coverage through the company's network is important. We have an extensive national network, and we continue to look for expansion opportunities through the build-out of existing licenses, acquisitions and/or spectrum leasing. We own licenses that cover much of the country but we will need to spend significant amounts to expand our capacity and extend our coverage area. Most of our competitors also have build-out needs, which they are seeking to mitigate through acquisitions or through affiliate and/or roaming agreements with other wireless providers.

Customer service: Quality customer service is essential to ensure that existing customers do not terminate service and to obtain new customers. With local number portability, customers may find it easier to switch their service to an alternate carrier, since they can take their telephone number with them to that carrier. We believe that our quality customer service will be a key to retaining our customers and to attracting customers who want to switch from other carriers. We are very focused on continually enhancing our customer service. Our competitors also recognize the importance of customer service and are also focusing on improving the customer experience.

Pricing: Service and equipment pricing is an important area in which wireless carriers compete. We seek to compete in this area by offering our customers services and equipment that they will regard as the best available value for their money.

Product Development: As wireless technologies develop and wireless broadband networks proliferate, continued customer and revenue growth will be increasingly dependent on the development of new and enhanced products and services. We are committed to continue enhancing our ability to envision, evaluate and rapidly deploy new and innovative handsets and customer solutions.

Distribution: Key to achieving sales success in the wireless industry is the reach and quality of sales channels and distribution points. We believe that the optimal mix of direct, indirect and wholesale distribution channels is an important ingredient in achieving industry-leading sales. A goal of our distribution strategy is to increase sales through our company-operated stores and our outside sales team, as well as through telemarketing and web-based sales and fulfillment capabilities. Supplementing this is an extensive indirect distribution network of full-service retail outlets and prepaid replenishment locations, as well as various resellers who buy our service on a wholesale basis.

Capital resources: In order to expand the capacity and coverage of their networks and introduce new products and services, wireless providers require significant capital resources. We generate significant cash flow from operations. Some of our competitors also have significant cash flow.

As a result of competition, we may encounter further market pressures to:

- respond to particular short-term, market-specific situations, for example, promotional service pricing or equipment discounts;
- introduce new service offerings at lower prices or restructure our service packages to offer more value;
- increase advertising spending; or
- increase our capital investment to ensure we retain our market leadership in service quality.

Such market pressures could cause us to experience lower revenues, margins and average revenue per user, as well as increased capital spending to ensure proper capacity levels.

Our success will depend on our ability to anticipate and respond to various factors affecting the industry, including the factors described above, as well as new technologies, changes in customer preferences, regulatory changes, demographic trends, economic conditions, and pricing strategies of competitors.

Information Services

Information Services is a world leader in print and online directory publishing and a content provider for electronic communications products and services. A leader in linking buyers and sellers, we produce Verizon SuperPages print yellow and white pages directories, as well as the Internet's No. 1 online directory, SuperPages.com. We pursue growth by offering customers comprehensive advertising solutions that include bundled print and electronic commerce offerings.

Information Services provides sales, publishing and other related services for approximately 1,650 directory titles in 46 states, Washington, D.C., 5 countries and a Commonwealth outside the United States. This includes almost 1,200 Verizon directory titles with a circulation of approximately 119 million copies in the US and 9 million copies internationally.

In 2003, we completed the sale of our directory businesses in Europe, which consisted of publishing operations in Austria, the Czech Republic, Gibraltar, Hungary, Poland and Slovakia.

In 2004, Verizon sold Verizon Information Services Canada Inc. directory operations to an affiliate of Bain Capital, a private investment firm, for $1.6 billion. The sale closed in the fourth quarter 2004, generating an after tax-gain of $516 million.

Our directory publishing business competes within the yellow pages industry with six major U.S.-based directory publishers (SBC Communications Inc., BellSouth Corporation, R.H. Donnelley Corporation, Yellow Book USA, Dex Media, Inc. and Trans Western Publishing) and encounters competition in nearly all of our domestic print markets. We also compete against alternative advertising media, including radio, network and cable television, newspapers, magazines, Internet, direct mail and others for a share of the total U.S. advertising media market. Our SuperPages.com competitors include national directory and local Internet search engines including Yahoo and Google.

International

Our International segment includes investments in international wireline and wireless communications operations primarily in the Americas and Europe. Our consolidated international investments as of December 31, 2004 included Verizon Dominicana, C. por A. (Verizon Dominicana) in the Dominican Republic, Telecomunicaciones de Puerto Rico, Inc. (TELPRI) in Puerto Rico and Micronesian Telecommunications Corporation in the Northern Mariana Islands. As of December 31, 2004, our International segment managed approximately 5 million access lines and provided wireless services to approximately 27 million customers.

Americas

Canada

In December 2004 we sold our 20.5% interest in TELUS Corporation. TELUS is a full-service telecommunications provider of telecommunications products and services including data, voice and wireless services across Canada.

Dominican Republic

We own 100% of Verizon Dominicana, the principal telecommunications provider in the Dominican Republic. Verizon Dominicana provides local, wireless, national and international long distance and Internet access services throughout the Dominican Republic. At December 31, 2004, Verizon Dominicana served approximately 793,000 access lines and 1.3 million wireless customers.

Puerto Rico

As of December 31, 2004, we owned a 52% interest in TELPRI, which owns Puerto Rico Telephone Company (PRTC), Puerto Rico's principal wireline company. Verizon Wireless Puerto Rico (VWPR), a division of PRTC, is Puerto Rico's second largest wireless company. At December 31, 2004, PRTC served 1.2 million access lines and VWPR provided wireless services to approximately 387,000 customers.

Venezuela

We own a 28.5% interest in Compañia Anónima Nacional Teléfonos de Venezuela (CANTV), Venezuela's largest full-service telecommunications provider. CANTV offers local services, national and international long distance, Internet access and wireless services in Venezuela as well as public telephone, private network, data transmission, directory and other value-added services. At December 31, 2004, CANTV served approximately 3.1 million access lines and 3.1 million wireless customers.

Europe and Asia

Italy

We own a 23.1% interest in Vodafone Omnitel N.V. (Vodafone Omnitel), an Italian digital cellular telecommunications company. It is the second largest wireless provider in Italy. Vodafone Omnitel served 22.2 million subscribers at December 31, 2004.

Gibraltar

Gibraltar NYNEX Communications Limited, operating as Gibtelecom, is a full-service provider of wireline, wireless, and Internet access services to the country of Gibraltar. We currently own a 50% interest in the company. Our sole partner in the company is the Government of Gibraltar.

Slovakia

In December 2004 we sold our 24.5% interest in EuroTel Bratislava, a.s. (EuroTel Bratislava). EuroTel Bratislava is a leading provider of mobile telecommunication services and managed data network services in Slovakia.

Indonesia

In January 2005, we sold our 23.1% interest in P.T. Excelcomindo Pratama, a nationwide provider of GSM services in Indonesia. In 2004, we also sold our 36.7% interest of P.T. Citra Sari Makmur, a provider of data, voice and video communications in Indonesia.

Northern Mariana Islands

We are the sole shareholder of Micronesian Telecommunications Corporation (MTC), a full-service telecommunications provider. At December 31, 2004, MTC served approximately 32,000 access lines and 23,000 wireless customers on the islands of Saipan, Tinian and Rota. In November 2001 an agreement was signed to sell MTC, which is pending due to regulatory approvals.

Other

Our International segment formerly included several Asian properties in which our investment was 20% or less. In 2004, we sold all of our investments in this category including our investments in Japan – the Tu-Ka companies and Taiwan – the Taiwan Cellular Corporation.

International Regulatory and Competitive Trends

For several years, the telecommunications industry has been experiencing dynamic changes as national and international regulatory reforms embrace competition.

In the Dominican Republic, Verizon Dominicana faces both wireline and wireless competitors, although it remains the principal service provider in all telecommunication segments. The Dominican Republic's regulatory environment is generally favorable and pricing is set at market rates.

In Puerto Rico, TELPRI operates in a highly competitive telecommunications market. All wireline services, including local, long distance, Internet access and data, face competition from various providers including a facilities-based local carrier, interexchange carriers, resellers, cable providers, and Internet service providers. PRTC remains the leading wireline service provider in Puerto Rico and continues to protect its leading position. In the wireless market, VWPR competes against five other wireless carriers and is second in wireless market share operating under the Verizon Wireless brand. With respect to regulatory matters, PRTC continues to operate in a very challenging environment. In 2001 and 2002 the Puerto Rico Telecommunications Regulatory Board (TRB) issued orders, which called for cash refunds and substantial reductions in access rates for intra-island long distance service. In November 2003, PRTC reached an agreement with the TRB to implement the reduction in access rates and replace the cash refund portion of the order with an expansion of local exchange areas, rate adjustments to reflect these changes, certain local rate credits and the elimination of touchtone charges.

In Venezuela, CANTV's wireless operations have faced competition since inception. In late 2000, the government opened the basic telephone market for local, national and international long distance service to competition and issued new guidelines governing interconnection and the use of wireless spectrum. CANTV, however, is still subject to comprehensive rate regulation, especially with respect to residential services, that limits the company's ability to raise prices to keep pace with changes in foreign exchange rates and inflation. CANTV remains Venezuela's leading provider of switched, fixed local and domestic and international long distance services and is one of the country's top providers of wireless services. In November 2004, the company announced its plan to acquire Digitel, the third largest wireless operator in Venezuela with 1.3 million subscribers for $450 million. When completed, CANTV will be the largest wireless provider with approximately 55 percent of the Venezuelan wireless market. Completion of the transaction is subject to the execution of a definitive agreement, as well as regulatory and government approvals.

In Italy, Vodafone Omnitel operates in an increasingly competitive and highly penetrated market. It responds with continued investment in loyalty programs and retail stores, coupled with a strong focus on business and high value customers. Vodafone Omnitel was awarded a license for third-generation mobile spectrum in 2000, which was subsequently extended from a 15-year life to a 20-year life in November 2001. During 2004, Vodafone Omnitel launched the commercial operations of its third-generation network.

Recent Developments

MCI Acquisition

On February 14, 2005, Verizon announced that it had agreed to acquire MCI for a combination of Verizon common shares and cash (including MCI dividends). At the closing of the acquisition, Verizon will also assume MCI's net debt (total debt less cash on hand). This consideration is subject to adjustment at closing and may be decreased based on MCI's bankruptcy claims-related experience and international tax liabilities. The boards of directors of Verizon and MCI have approved the agreement. In addition to MCI shareowner approval, the acquisition requires regulatory approvals, which the companies are targeting to obtain in about one year. At least one other company has expressed an interest in acquiring MCI.

Spectrum Purchases

On February 24, 2005, we signed an agreement with MetroPCS, Inc. to purchase 10 MHz of personal communications services spectrum covering the San Francisco area for a purchase price of $230 million. The transaction is subject to the approval of the FCC and the U.S. Department of Justice, and is expected to close in the second quarter of 2005.

On February 15, 2005, the FCC's auction of broadband personal communications services licenses ended and Verizon Wireless, together with affiliate Vista PCS, LLC, was the highest bidder for 63 licenses totaling approximately $697 million.

On November 4, 2004, we announced the signing of a definitive agreement with NextWave to purchase all of NextWave's remaining personal communications services spectrum licenses in 23 markets for $3,000 million through the purchase of stock of NextWave following the completion of its bankruptcy reorganization, when it will own no assets other than the licenses. The 10 MHz and 20 MHz licenses, in the 1.9 GHz personal communications services frequency range, cover a population of 73 million people and will be used to expand Verizon Wireless's network capacity in 22 key existing markets, including New York, Boston, Washington, D.C. and Los Angeles, as well as to expand into Tulsa, Oklahoma. The transaction has been approved by the U.S. Department of Justice, the U.S. Bankruptcy Court and the FCC. The transaction is expected to close in April 2005.

On July 1, 2004 we announced an agreement to purchase Qwest Wireless, LLC's spectrum licenses and wireless network assets for $418 million covering several existing and new markets. This transaction closed on March 4, 2005.

Sales of Businesses and Investments

Telephone Access Lines

In October 2004, Verizon announced that it had suspended discussions with potential buyers related to its upstate New York access lines, pending an evaluation of its strategic options. However, we are continuing to consider plans for a reduction in the size of our access line business, including through a spin-off mechanism or otherwise, so that we may pursue our strategy of placing greater focus on the higher growth businesses of broadband and wireless.

During the second quarter of 2004, we entered into an agreement to sell our wireline-related businesses in Hawaii, which operates 707,000 switched access lines, for $1,650 million in cash, less debt. The closing of the transaction, expected in the first half of 2005, is contingent on state regulatory approval; the FCC and the U.S. Department of Justice have provided the necessary approvals.

Environmental Matters

During 2003, under a government-approved plan, remediation of the site of a former facility in Hicksville, New York that processed nuclear fuel rods in the 1950s and 1960s commenced. Remediation beyond original expectations proved to be necessary and a reassessment of the anticipated remediation costs was conducted. In addition, a reassessment of costs related to remediation efforts at several other former facilities was undertaken. As a result, an additional environmental remediation expense of $240 million was recorded in 2003.

New York Recovery Funding

In August 2002, President Bush signed the Supplemental Appropriations bill that included $5.5 billion in New York recovery funding. Of that amount, approximately $750 million has been allocated to cover utility restoration and infrastructure rebuilding as a result of the September 11th terrorist attacks. These funds will be distributed through the Lower Manhattan Development Corporation following an application and audit process. As of September 30, 2004, we have applied for reimbursement of approximately $266 million. We received an advance of $11 million in December 2003 and an additional advance of $77 million in June 2004. We are awaiting the results of an audit relating to the total amount that we have applied for reimbursement, including funds already received. On December 22, 2004, we applied for reimbursement of an additional $136 million of "category 2" losses. Category 2 funding is for permanent restoration and infrastructure improvement. Our application is pending.

Employees

As of December 31, 2004, Verizon and its subsidiaries had approximately 210,000 employees. Unions represent approximately 48% of our employees.

Information on Our Internet Website

We make available, free of charge on our website, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC. Our website address is www.verizon.com. This information is included in "Investor Information" on our website.

Table of Contents

Cautionary Statement Concerning Forward-Looking Statements

In this Annual Report on Form 10-K we have made forward-looking statements. These statements are based on our estimates and assumptions and are subject to risks and uncertainties. Forward-looking statements include the information concerning our possible or assumed future results of operations. Forward-looking statements also include those preceded or followed by the words "anticipates," "believes," "estimates," "hopes" or similar expressions. For those statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

The following important factors, along with those discussed elsewhere in this Annual Report, could affect future results and could cause those results to differ materially from those expressed in the forward-looking statements:

- materially adverse changes in economic and industry conditions and labor matters, including workforce levels and labor negotiations, and any resulting financial and/or operational impact, in the markets served by us or by companies in which we have substantial investments;
- material changes in available technology;
- technology substitution;
- an adverse change in the ratings afforded our debt securities by nationally accredited ratings organizations;
- the final results of federal and state regulatory proceedings concerning our provision of retail and wholesale services and judicial review of those results;
- a significant change in the timing of, or the imposition of any government conditions to, the closing of our transaction with MCI, Inc., actual and contingent liabilities and the extent and timing or our ability to obtain revenue enhancements and cost savings following the transaction;
- the effects of competition in our markets;
- the timing, scope and financial impacts of our deployment of fiber-to-the-premises broadband technology;
- the ability of Verizon Wireless to continue to obtain sufficient spectrum resources; and
- changes in our accounting assumptions that regulatory agencies, including the SEC, may require or that result from changes in the accounting rules or their application, which could result in an impact on earnings.

Item 2. Properties

General

Our principal properties do not lend themselves to simple description by character and location. Our total investment in plant, property and equipment was approximately $186 billion at December 31, 2004 and $181 billion at December 31, 2003, including the effect of retirements, but before deducting accumulated depreciation. Our gross investment in plant, property and equipment consisted of the following at December 31:

	2004	2003
Network equipment	**78.7%**	78.7%
Land, buildings and building equipment	**9.1**	9.1
Furniture and other equipment	**8.7**	9.0
Other	**3.5**	3.2
	100.0%	100.0%

Our properties are divided among our operating segments at December 31, as follows:

	2004	2003
Domestic Telecom	**76.2%**	78.0%
Domestic Wireless	**19.9**	18.0
Information Services	**0.3**	0.3
International	**3.0**	2.9
Corporate and Other	**0.6**	0.8
	100.0%	100.0%

Network equipment consists primarily of aerial cable, underground cable, conduit and wiring, wireless plant, telephone poles, switching

equipment, transmission equipment and related facilities. Land, buildings and building equipment consists of land and land improvements and central office buildings. Furniture and other equipment consists of public telephone instruments and telephone equipment (including PBXs), furniture, office equipment, motor vehicles and other work equipment. Other property consists primarily of plant under construction, capital

leases, capitalized computer software costs and leasehold improvements. A portion of our property is subject to the liens of their respective mortgages securing funded debt.

The customers of our telephone operations are served by electronic switching systems that provide a wide variety of services. At December 31, 2004, substantially all of the access lines were served by digital capability.

Capital Expenditures

We continue to make significant capital expenditures to meet the demand for telecommunications services and to further improve such services. Capital spending for Domestic Telecom was $7,118 million in 2004, $6,820 million in 2003 and $8,004 million in 2002. Capital spending for Domestic Wireless was $5,633 million in 2004, $4,590 million in 2003 and $4,414 million in 2002. Capital spending for Information Services, International and Corporate and Other businesses was $508 million in 2004, $464 million in 2003 and $634 million in 2002. Capital spending for those years includes capitalized software and excludes additions under capital leases. Capital spending, including capitalized software, is expected to increase by approximately 10 percent in 2005.

Item 3. Legal Proceedings

None.

Item 4. Submission of Matters to a Vote of Security Holders

Not Applicable.

Executive Officers of the Registrant

Set forth below is information with respect to our executive officers.

Name	Age	Office	Held Since
Ivan G. Seidenberg	58	Chairman and Chief Executive Officer	2000
Lawrence T. Babbio, Jr.	60	Vice Chairman and President	2000
William P. Barr	54	Executive Vice President and General Counsel	2000
Thomas A. Bartlett	46	Senior Vice President and Treasurer	2005
David H. Benson	55	Senior Vice President and Controller	2003
John W. Diercksen	55	Executive Vice President – Strategy, Development and Planning	2003
Marc C. Reed	46	Executive Vice President – Human Resources	2004
Dennis F. Strigl	58	Executive Vice President and President and CEO – Verizon Wireless	2000
Thomas J. Tauke	54	Executive Vice President – Public Affairs, Policy and Communications	2004
Doreen A. Toben	55	Executive Vice President and Chief Financial Officer	2002

Prior to serving as an executive officer, each of the above officers have held high level managerial positions with the company or one of its subsidiaries for at least five years.

Officers are not elected for a fixed term of office but are removable at the discretion of the Board of Directors.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The principal market for trading in the common stock of Verizon is the New York Stock Exchange. The common stock is also listed in the United States on the Boston, Chicago, Pacific and Philadelphia stock exchanges. As of December 31, 2004, there were 1,000,801 shareowners of record.

High and low stock prices, as reported on the New York Stock Exchange composite tape of transactions, and dividend data are as follows:

		Market Price		Cash Dividend
		High	Low	Declared
2004	**First Quarter**	**$ 39.54**	**$ 35.08**	**$ .385**
	Second Quarter	**38.20**	**34.25**	**.385**
	Third Quarter	**41.01**	**34.13**	**.385**
	Fourth Quarter	**42.27**	**38.26**	**.385**
2003	First Quarter	$ 44.31	$ 32.06	$ .385
	Second Quarter	41.35	32.80	.385
	Third Quarter	40.25	32.05	.385
	Fourth Quarter	35.25	31.10	.385

Table of Contents

The following table provides information about Verizon's common stock repurchases during the fourth quarter of 2004.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (2)
October 2004	845,000	$ 40.68	845,000	72,368,200
November 2004	1,145,000	41.16	1,145,000	71,223,200
December 2004	763,000	41.66	763,000	70,460,200
	2,753,000	41.15	2,753,000	70,460,200

(1) On January 22, 2004, Verizon's Board of Directors authorized a common stock repurchase program.

(2) The program authorizes total repurchases of up to 80 million common shares and expires no later than the close of business on February 28, 2006. Under the plan, Verizon has the option to repurchase shares for the corporation over time, with the amount and timing of repurchases depending on market conditions and corporate needs.

Item 6. Selected Financial Data

Information required by this item is included in the 2004 Verizon Annual Report to Shareowners under the heading "Selected Financial Data" on page 13, which is incorporated herein by reference.

Item 7. Management's Discussion and Analysis of Results of Operations and Financial Condition

Information required by this item is included in the 2004 Verizon Annual Report to Shareowners under the heading "Management's Discussion and Analysis of Results of Operations and Financial Condition" on pages 13 through 35, which is incorporated herein by reference.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Information required by this item is included in the 2004 Verizon Annual Report to Shareowners under the heading "Market Risk" on pages 30 through 31, which is incorporated herein by reference.

Item 8. Financial Statements and Supplementary Data

Information required by this item is included in the 2004 Verizon Annual Report to Shareowners on pages 36 through 71, which is incorporated herein by reference.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Our chief executive officer and chief financial officer have evaluated the effectiveness of the registrant's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934), as of the end of the period covered by this annual report, that ensure that information relating to the registrant which is required to be disclosed in this report is recorded, processed, summarized and reported, within required time periods. Based on this evaluation, which disclosed no significant deficiencies or material weaknesses, they have concluded that the registrant's disclosure controls and procedures were adequate and effective to ensure that material information relating to the registrant and its consolidated subsidiaries would be made known to them by others within those entities, particularly during the period in which this annual report was being prepared. There were no significant changes in the registrant's internal control over financial reporting during the period covered by this annual report that have materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

Management's report on internal control over financial reporting and the attestation report of Verizon's independent registered accounting firm is included in the 2004 Verizon Annual Report to Shareowners on pages 36 through 37 and is incorporated herein by reference.

Item 9B. Other Information

None.

PART III

Item 10. Directors and Executive Officers of the Registrant

For information with respect to our executive officers, see "Executive Officers of the Registrant" at the end of Part I of this Report. For other information required by this item see the Proxy Statement for our 2005 Annual Meeting of Shareholders filed pursuant to Regulation 14A, which is incorporated herein by reference.

Table of Contents

Item 11. Executive Compensation

For information with respect to executive compensation, see the Proxy Statement for our 2005 Annual Meeting of Shareholders filed pursuant to Regulation 14A, which is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management

For information with respect to the security ownership of the Directors and Executive Officers and related stockholder matters, see the Proxy Statement for our 2005 Annual Meeting of Shareholders filed pursuant to Regulation 14A, which is incorporated herein by reference. In addition, see the following table for other equity compensation plan information:

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans
Equity compensation plans approved by security holders	223,617,461	$ 48.87	107,339,110
Equity compensation plans not approved by security holders	53,765,627	42.40	5,064,146*
Total	277,383,088	47.62	112,403,256

* Indicates the number of securities available for issuance under the Verizon Communications 2000 Broad-Based Incentive Plan, which provides for awards of nonqualified stock options, restricted stock, restricted stock units and other equity-based hypothetical stock units to employees of Verizon and its subsidiaries.

Item 13. Certain Relationships and Related Transactions

For information with respect to certain relationships and related transactions, see the Proxy Statement for our 2005 Annual Meeting of Shareholders filed pursuant to Regulation 14A, which is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services

For information with respect to principal accounting fees and services, see the Proxy Statement for our 2005 Annual Meeting of Shareholders filed pursuant to Regulation 14A, which is incorporated herein by reference.

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a) Documents filed as part of this report:

		Page
(1)	Report of Management on Internal Control Over Financial Reporting	*
	Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting	*
	Report of Independent Registered Public Accounting Firm on Financial Statements	*
	Financial Statements covered by Report of Independent Registered Public Accounting Firm:	
	Consolidated Statements of Income	*
	Consolidated Balance Sheets	*
	Consolidated Statements of Cash Flows	*
	Consolidated Statements of Changes in Shareowners' Investment	*
	Notes to Consolidated Financial Statements	*
	* Incorporated herein by reference to the appropriate portions of the registrant's annual report to shareowners for the fiscal year ended December 31, 2004. (See Part II.)	
(2)	Financial Statement Schedule	
	II – Valuation and Qualifying Accounts	24
(3)	Exhibits	

Table of Contents

Exhibit Number

3a	Restated Certificate of Incorporation of Verizon Communications Inc. (Verizon) (Exhibit 3a to Form 10-K for the year ended December 31, 2000).
3b	Bylaws of Verizon, as amended and restated (Exhibit 3b to Form 10-K for the year ended December 31, 2003).
4	No instrument which defines the rights of holders of long-term debt of Verizon and its consolidated subsidiaries is filed herewith pursuant to Regulation S-K, Item 601(b)(4)(iii)(A). Pursuant to this regulation, Verizon hereby agrees to furnish a copy of any such instrument to the SEC upon request.
10a	Description of Verizon Deferred Compensation Plan for Non-Employee Directors (Exhibit 10a to Form 10-K for the year ended December 31, 2000).*
	10a(i) Description of Amendment to Plan filed herewith.
10b	Bell Atlantic Deferred Compensation Plan for Outside Directors, as amended and restated (Exhibit 10a to Form 10-K for the year ended December 31, 1998).*
10c	Deferred Compensation Plan for Non-Employee Members of the Board of Directors of GTE, as amended (Exhibit 10-1 to GTE's Form 10-K for the year ended December 31, 1997 and Exhibit 10.1 to GTE's Form 10-K for the year ended December 31, 1998, File No. 1-2755).*
10d	GTE's Directors' Deferred Stock Unit Plan (Exhibit 10-8 to GTE's Form 10-K for the year ended December 31, 1997, File No. 1-2755).*
10e	Description of Plan for Non-Employee Directors' Travel Accident Insurance (Exhibit 10c to Form 10-K for the year ended December 31, 1999).*
10f	Bell Atlantic Directors' Charitable Giving Program, as amended (Exhibit 10p to Form SE dated March 29, 1990 and Exhibit 10p to Form SE dated March 29, 1993).*
10g	GTE's Charitable Awards Program (Exhibit 10-10 to GTE's Form 10-K for the year ended December 31, 1992, File No. 1-2755).*
10h	NYNEX Directors' Charitable Award Program (Exhibit 10i to Form 10-K for the year ended December 31, 2000).*
10i	Verizon Communications 2000 Broad-Based Incentive Plan (Exhibit 10h to Form 10-Q for the period ended September 30, 2000).*
10j	Verizon Communications Inc. Long-Term Incentive Plan (Appendix B to Verizon's 2001 Proxy Statement filed March 12, 2001).*
10k	GTE's Long-Term Incentive Plan, as amended (Exhibit B to GTE's 1997 Proxy Statement and Exhibit 10.5 to GTE's 1998 Form 10-K for the year ended December 31, 1998, File No. 1-2755); Description of Amendments (Exhibit 10l to Form 10-K for the year ended December 31, 2000).*
10l	NYNEX 1990 Stock Option Plan, as amended (Exhibit No. 2 to NYNEX's Proxy Statement dated March 20, 1995, File No. 1-8608); Description of Amendments (Exhibit 10m to Form 10-K for the year ended December 31, 2000).*
10m	NYNEX 1995 Stock Option Plan, as amended (Exhibit No. 1 to NYNEX's Proxy Statement dated March 20, 1995, File No. 1-8608); Description of Amendments (Exhibit 10n to Form 10-K for the year ended December 31, 2000).*
10n	Verizon Communications Inc. Short-Term Incentive Plan (Appendix C to Verizon's 2001 Proxy Statement filed March 12, 2001).*
10o	Verizon Communications Inc. Income Deferral Plan (Exhibit 10f to Form 10-Q for the period ended June 30, 2002).*
	10o(i) Description of Amendment to Plan filed herewith.
10p	Verizon Communications Inc. Excess Pension Plan filed herewith.
	10p(i) Description of Amendment to Plan filed herewith.
10q	GTE's Executive Salary Deferral Plan, as amended (Exhibit 10.10 to GTE's Form 10-K for the year ended December 31, 1998, File No. 1-2755).*

Table of Contents

10r	Bell Atlantic Senior Management Long-Term Disability and Survivor Protection Plan, as amended (Exhibit 10h to Form SE filed on March 27, 1986 and Exhibit 10b(ii) to Form 10-K for the year ended December 31, 1997).*
10s	Description of Bell Atlantic Senior Management Estate Management Plan (Exhibit 10rr to Form 10-K for year ended December 31, 1997).*
10t	GTE's Executive Retired Life Insurance Plan, as amended (Exhibits 10-6, 10-6 and 10-6 to GTE's Form 10-K for the years ended December 31, 1991, 1992 and 1993, respectively, File No. 1-2755).*
10u	NYNEX Supplemental Life Insurance Plan (Exhibit No. 10 iii 21 to NYNEX's Form 10-Q for the period ended June 30, 1996, File No. 1-8608).*
10v	Description of Verizon Executive Deferral Plan filed herewith.*
10w	Description of salary increase for Ivan G. Seidenberg filed herewith.*
10x	Employment Agreement between Verizon and Lawrence T. Babbio (Exhibit 10a to Form 10-Q for the period ended September 30, 2000).*
10y	Employment Agreement between Verizon and Marc C. Reed (Exhibit 10a to Form 10-Q for the period ended June 30, 2004).*
10z	Employment Agreement between Verizon and William P. Barr (Exhibit 10z to Form 10-Q for the period ended March 31, 2003).*
10aa	Employment Agreement between Verizon and David H. Benson (Exhibit 10b to Form 10-Q for the period ended June 30, 2002).*
10cc	Employment Agreement between Verizon and Doreen A. Toben (Exhibit 10d to Form 10-Q for the period ended June 30, 2002).*
10dd	Description of the Split-Dollar Insurance Arrangements (Exhibit 10g to Form 10-Q for the period ended June 30, 2002).*
	10dd(i) Description of Changes to Arrangements filed herewith.
10ee	Employment Agreement between Verizon Wireless and Dennis F. Strigl (Exhibit 10f to Form 10-Q for the period ended September 30, 2000).*
10ff	Employment Agreement between Verizon and Thomas J. Tauke (Exhibit 10b to Form 10-Q for the period ended June 30, 2004).*
10gg	Form of Employment Agreement between Verizon and Band 1 Senior Management Employee filed herewith.*
10hh	NYNEX Deferred Compensation Plan for Non-Employee Directors (Exhibit 10gg to NYNEX's Registration Statement No. 2-87850, File No. 1-8608).*
	10hh(i) Amendment to NYNEX Corporation Deferred Compensation Plan for Non-Employee Directors (Exhibit 10iii 5a to NYNEX's Quarterly Report on Form 10-Q for the period ended June 30, 1996, File No. 1-8608).
10ii	U.S. Wireless Agreement, dated September 21, 1999, among Bell Atlantic and Vodafone Airtouch plc, including the forms of Amended and Restated Partnership Agreement and the Investment Agreement (Exhibit 10 to Form 10-Q for the period ended September 30, 1999).
12	Computation of Ratio of Earnings to Fixed Charges filed herewith.
13	Portions of Verizon's Annual Report to Shareowners for the fiscal year ended December 31, 2004. Only the information incorporated by reference into this Form 10-K is included in the exhibit.
21	List of principal subsidiaries of Verizon filed herewith.

Table of Contents

23 Consent of Ernst & Young LLP filed herewith.

31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Indicates management contract or compensatory plan or arrangement.

Table of Contents

Schedule II – Valuation and Qualifying Accounts
Verizon Communications Inc. and Subsidiaries

For the Years Ended December 31, 2004, 2003 and 2002

(dollars in millions)

Description	Balance at Beginning of Period	Additions: Charged To Expenses	Additions: Charged to Other Accounts Note (a)	Deductions Note (b)	Balance at End of Period
Allowance for Uncollectible Accounts Receivable:					
Year 2004	**$ 2,382**	**$ 1,181**	**$ 980**	**$ 2,873**	**$ 1,670**
Year 2003	2,767	1,789	949	3,123	2,382
Year 2002	2,122	2,886	986	3,227	2,767
Valuation Allowance for Deferred Tax Assets:					
Year 2004	**$ 1,463**	**$ 6**	**$ –**	**$ 252**	**$ 1,217**
Year 2003	661	844	–	42	1,463
Year 2002	1,574	103	–	1,016	661
Discontinued Businesses:					
Year 2004	**$ 331**	**$ 39**	**$ 15**	**$ 98**	**$ 287**
Year 2003	151	240	60	120	331
Year 2002	219	(49)	–	19	151
Merger-Related Costs:					
Year 2004	**$ –**	**$ –**	**$ –**	**$ –**	**$ –**
Year 2003	–	–	–	–	–
Year 2002	531	–	–	531	–

(a) Allowance for Uncollectible Accounts Receivable includes (1) amounts previously written off which were credited directly to this account when recovered, and (2) accruals charged to accounts payable for anticipated uncollectible charges on purchases of accounts receivable from others which were billed by us. Also includes amounts transferred from other accounts.

(b) Amounts written off as uncollectible or transferred to other accounts or utilized.

Table of Contents

Signatures

Pursuant to the requirements of Section 13 or 15(d) 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.

Verizon Communications Inc.

Date: March 14, 2005

By: /s/ David H. Benson

David H. Benson
Senior Vice President and Controller

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Principal Executive Officer:

/s/ Ivan G. Seidenberg Ivan G. Seidenberg	Chairman and Chief Executive Officer	March 14, 2005

Principal Financial Officer:

/s/ Doreen A. Toben Doreen A. Toben	Executive Vice President and Chief Financial Officer	March 14, 2005

Principal Accounting Officer:

/s/ David H. Benson David H. Benson	Senior Vice President and Controller	March 14, 2005

Table of Contents

Signatures – Continued

/s/ Ivan G. Seidenberg Ivan G. Seidenberg	Director	March 14, 2005
/s/ James R. Barker James R. Barker	Director	March 14, 2005
/s/ Richard L. Carrión Richard L. Carrión	Director	March 14, 2005
/s/ Robert W. Lane Robert W. Lane	Director	March 14, 2005
/s/ Sandra O. Moose Sandra O. Moose	Director	March 14, 2005
/s/ Joseph Neubauer Joseph Neubauer	Director	March 14, 2005
/s/ Thomas H. O'Brien Thomas H. O'Brien	Director	March 14, 2005
/s/ Hugh B. Price Hugh B. Price	Director	March 14, 2005
/s/ Walter V. Shipley Walter V. Shipley	Director	March 14, 2005
/s/ John R. Stafford John R. Stafford	Director	March 14, 2005
/s/ Robert D. Storey Robert D. Storey	Director	March 14, 2005

EXHIBIT 10a(i)

Description of Amendment to Verizon Deferred Compensation Plan for Non-employee Directors

In order to comply with Section 885 of the Act and Section 409A of the Code, the Deferred Compensation Plan for Non-Employee Directors (the Directors' Plan) was amended on December 1, 2004 to freeze the accrual of benefits under the plan as of the close of business on December 31, 2004. Participants in the Directors' Plan will not accrue any additional benefits other than market-based investment earnings or losses on their individual accounts. Participants will retain the ability to invest their frozen accounts in the investment options available under the plan. However, they will not be able to defer any new compensation under the terms of the plan (unless otherwise permitted by U.S. Treasury Department guidance or regulations). Benefits that are not vested as of December 31, 2004 will be transferred to the newly adopted Verizon Executive Deferral Plan, as of January 1, 2005.

EXHIBIT 10o(i)

Description of Amendment to Verizon Communications Inc. Income Deferral Plan

In order to comply with Section 885 of the Act and Section 409A of the Code, the Income Deferral Plan (the IDP) was amended on December 1, 2004 to freeze the accrual of benefits under the plan as of the close of business on December 31, 2004. Participants in the IDP will not accrue any additional benefits other than market-based investment earnings or losses on their individual accounts. Participants will retain the ability to invest their frozen accounts in the investment options available under the plan. However, they will not be able to defer any new compensation under the terms of the plan (unless otherwise permitted by U.S. Treasury Department guidance or regulations). Participants in the IDP will no longer receive matching contribution credits or retirement credits under the plan. Benefits that are not vested as of December 31, 2004 will be transferred to the newly adopted Verizon Executive Deferral Plan, as of January 1, 2005.

EXHIBIT 10p

VERIZON EXCESS PENSION PLAN

Effective January 1, 2002

ARTICLE I. INTRODUCTION

A. This instrument states the terms and conditions of the Verizon Excess Pension Plan, effective on January 1, 2002. The Plan is a successor to the GTE Excess Pension Plan.

B. The purpose of this Plan is to provide benefits with respect to compensation which is not taken into account under the Basic Pension Plan because it exceeds qualified plan limitations, to provide benefits which would be provided under the Basic Pension Plan except that they exceed the qualified plan limitations on pensions, and, as a result thereof, to provide for the payment of certain Excess and Supplemental Pensions from the assets of a Participating Company available for general business use.

C. This Plan shall be administered in conjunction with the Basic Pension Plan with the effect that, except as otherwise provided herein or as approved by the Administrator, the terms and conditions of the Basic Pension Plan shall determine all matters related to the benefits under this Plan.

ARTICLE II. DEFINITIONS

The following terms as used herein shall, for purposes of this Plan, have the following meanings unless a different meaning is clearly required by the context:

A. "Administrator" – the most senior HR officer of Verizon Communications Inc. or any delegate of such individual.

B. "Basic Pension Plan" – the applicable provisions of the pension plan sponsored by a Participating Company that is qualified under Section 401 of the Code in which the Employee participates.

C. "Code" – the Internal Revenue Code of 1986, as amended from time to time, and applicable Treasury regulations and rulings issued thereunder.

D. "Company" – Verizon Corporate Services Group Inc.

E. "Employee" – any employee who participates in the Basic Pension Plan of a Participating Company who has been designated by the Administrator to participate in this Plan or who receives Remuneration; provided, however, anyone classified as a "senior manager" shall not be eligible to participate in this Plan while holding such classification. (See Section E under Article IV for promotions to senior manager status.)

F. "Excess Pension" – the pension which is in excess of that permitted under Section 415(b) of the Internal Revenue Code (or any successor sections thereto) and applicable Treasury regulations promulgated thereunder but which otherwise would be due and payable under the Basic Pension Plan.

G. "Participating Company" – the Company and any affiliate of the Company that participates in the Basic Pension Plan.

H. "Pension Commencement Date" – the Employee's pension commencement date within the meaning provided in the Basic Pension Plan.

I. "Plan" – this Verizon Excess Pension Plan.

J. "Remuneration" – the amount of compensation which would be taken into account with respect to an Employee who participates in the Basic Pension Plan without regard to the limitation imposed by Code Section 401(a)(17) (or any successor provision); provided, however, Remuneration shall not include any amounts included in the computation of pensions under the Basic Pension Plan.

K. "Supplemental Pension" – the difference between:

1. the pension calculated under the Basic Pension Plan (without regard to the limitations contained in Section 415 of the Code and any successor sections thereto) by including Remuneration as compensation in determining Average Annual Compensation; and

2. the pension actually payable under the Basic Pension Plan and any Excess Pension payable under this Plan.

ARTICLE III. ELIGIBILITY

A. An Employee or former Employee who was actively employed by the Company (or an entity that is aggregated with the Company under Section 414(b) or (c) of the Code) on or after January 1, 2002, shall be eligible for an Excess Pension or a Supplemental Pension under the Plan if the Employee or former Employee is eligible or has become eligible (or would be eligible if he terminated employment with the Company and its affiliates) to receive a benefit under the Basic Pension Plan. An Employee who is eligible for an Excess Pension or a Supplemental

Pension in accordance with the preceding sentence shall have a fully vested and nonforfeitable contractual right to such Excess Pension or Supplemental Pension, which shall be enforceable against Verizon Communications Inc. (and any successor to all or substantially all of the business or assets of Verizon Communications Inc.). An Employee who is not so eligible for an Excess Pension or a Supplemental Pension shall not have any right to a benefit or payment under the Plan.

B.1 Subject to the provisions of Article V regarding designation of a beneficiary, the designated beneficiary (or the surviving spouse if no beneficiary is designated) of any Employee who has a fully vested and nonforfeitable contractual right to an Excess Pension or a Supplemental Pension in accordance with Section A of this Article III and who dies either (i) while in active service of a Participating Company or an affiliate, or (ii) without having made a valid election of an optional form of benefit and after separation from service but prior to the Employee's pension commencement date shall be eligible to receive an Excess Pension and/or a Supplemental Pension in an amount, at such time and on such terms determined by applying the Basic Pension Plan provisions pertaining to a Beneficiary's Pension under the Employee's circumstances to the Employee's Excess Pension and/or Supplemental Pension, as the case may be.

B.2 Subject to the provisions of Article V regarding designation of a beneficiary, if an Employee has a fully vested and nonforfeitable contractual right to an Excess Pension or a Supplemental Pension in accordance with Section A of this Article III, in the event of:

(a) the Employee's death after the Employee's separation from service but prior to the Employee's pension commencement date with a valid election of an optional form of benefit, or

(b) the Employee's death after the Employee's pension commencement date,

a survivor benefit will be paid to the Employee's designated beneficiary in accordance with the Employee's election by applying the Basic Pension Plan provisions pertaining to the Employee's circumstances to the Employee's Excess Pension and/or Supplemental Pension, as the case may be.

ARTICLE IV. BENEFITS PAYABLE UNDER THIS PLAN

A. An Employee, surviving spouse or designated beneficiary who is entitled to an Excess Pension or a Supplemental Pension under this Plan shall be paid such benefit under this Plan as set forth or elected under Article V or at such time as may be approved by the Administrator. Notwithstanding the foregoing or any other provision of this Plan, no Excess Pension or Supplemental Pension under

this Plan shall be paid until the Employee has terminated employment with the Company and its Affiliates (as such term is defined in the Basic Pension Plan).

B. Each of the applicable formulas under the Basic Pension Plan shall apply to an Employee under this Plan to the same extent that they apply to such individual under the Basic Pension Plan. Subject to Paragraph C below in this Article, these formulas shall work in tandem under the Basic Pension Plan and this Plan. Without regard to which formula provides the highest overall pension during an Employee's career, the determination of an Employee's benefit under this Plan shall be made at the Employee's Pension Commencement Date under the Basic Pension Plan.

C. With respect to eligible Employees who elect or elected an early pension payment under the former GTE Basic Pension Plan, the Excess Pension or Supplemental Pension under this Plan shall, effective on and after January 1, 2002, be calculated as described below. An Employee shall be entitled to a benefit under this Plan based on the better of the "all service" methodology or the "A+B" methodology. Under the "all service" methodology, an Employee's benefit under this Plan will be calculated by assuming that the in-service distribution under the Basic Pension Plan had not taken place, such that the Employee would receive the same benefit under this Plan at actual retirement that he would have received if he had not taken the early pension payment; this calculation shall be based on the Code Section 401(a)(17) and 415 limitations applicable to the Basic Pension Plan at the Employee's actual retirement. Under the "A+B" methodology, the "A" benefit shall be the benefit under this Plan (or the predecessor to this Plan) as of the date of the in-service distribution under the Basic Pension Plan (using the Code limitations in effect at that time) and the "B" benefit shall be the benefit under this Plan (or the predecessor to this Plan) based only on service earned after the date that was used to calculate the in-service pension distribution under the Basic Pension Plan (using the Code limitations in effect at the time of actual retirement).

D. The Company shall not fund this Plan, but Excess Pensions and Supplemental Pensions shall be paid by the Employee's Participating Company when due from its assets available for general business use.

E. In the event an Employee is promoted to senior manager status, the lump sum value of his benefit under this Plan at the time of promotion shall be transferred to a nonqualified plan for senior managers.

ARTICLE V. FORMS AND TIMING OF PAYMENT AND BENEFICIARIES

A. An Employee shall have the right to elect to receive his benefit under this Plan in any one of the forms provided under the Basic Pension Plan.

B. If an Employee elects to receive his benefit under this Plan in a form other than a single life annuity, it shall be computed so as to be the actuarial equivalent of such benefit in the form of a single life annuity using the actuarial tables and interest rates then in effect under the Basic Pension Plan. When converting a cash balance benefit to a single life annuity, the GATT factors in the Basic Pension Plan shall be used.

C. Prior to an Employee's termination of employment, he may elect the form of distribution for his Plan benefit by completing the form required by the Administrator; provided, however, an Employee may not elect a pension commencement under the Plan that is prior to his Pension Commencement Date under the Basic Pension Plan. If an Employee does not make an election under this Plan prior to his termination of employment, his Plan benefit shall be paid in the form of a lump sum on his Pension Commencement Date under the Basic Pension Plan.

If an Employee elects to defer payment of his Plan benefit to a date later than his Pension Commencement Date under the Basic Pension Plan, the Employee's benefit under this Plan shall be determined at the time of the Pension Commencement Date under the Basic Pension Plan. The benefit under this Plan will be equal to the difference between X and Y, where

1. X equals the lump sum value of the Employee's pension using the applicable formulas in the Basic Pension Plan without regard to the limits imposed by Sections 401(a)(17) or 415 of the Code; and

2. Y equals the lump sum value of the Basic Pension Plan benefit on the Pension Commencement Date under the Basic Pension Plan.

This amount (the difference between X and Y) will then be held in a cash balance account under this Plan until the pension commencement date under this Plan. FICA taxes paid on behalf of an Employee with respect to his benefit under this Plan will reduce the amount in the cash balance account on a dollar for dollar basis. Upon the conversion of the Plan benefit to a cash balance amount, there will be no subsequent comparisons to the value of any other pension formula.

D. An Employee shall have the right to appoint any individual (a natural person or legal entity) as his beneficiary to receive any benefits payable under this Plan on the Employee's account after the Employee's death.

E. An Employee shall have the right to make an appointment of a beneficiary for any benefits payable on his account under this Plan after his death revocable or irrevocable. If an Employee's appointment of a beneficiary is revocable, such Employee may revoke the appointment of a beneficiary and appoint another beneficiary any time during the Employee's life.

F. If an Employee elects a joint and survivor annuity with a revocable beneficiary, the Administrator shall determine the life expectancy of the original beneficiary at the time of the Employee's retirement and the survivor annuity shall be payable to any other beneficiary only during the term of the original beneficiary's life expectancy as so determined.

G. The Excess Pension and the Supplemental Pension payable under Section B of Article III of this Plan shall be calculated upon the same basis as survivor pensions are calculated under the Basic Pension Plan.

H. Any appointment of a beneficiary hereunder, any revocation of such appointment, and any appointment of another beneficiary shall be made by written instrument, in a form satisfactory to the Administrator, signed by the Employee and delivered to the Company. The Employee shall accompany the appointment of his original beneficiary with proof of such beneficiary's age that is satisfactory to the Administrator. An Employee shall have no power to appoint a beneficiary, or to revoke the appointment of a beneficiary, except as provided by this Plan.

I. Anything to the contrary notwithstanding, the election and payment of benefits in the form of a lump sum distribution under Section B of this Article shall constitute a waiver of any other benefits payable under this Plan to an Employee, an Employee's surviving spouse, or any other designated beneficiary.

ARTICLE VI. ADMINISTRATION, AMENDMENT, AND TERMINATION OF THE PLAN

A. The Plan shall be administered by the Administrator. The Administrator shall have the power to interpret this Plan, to delegate such responsibilities or duties as it deems desirable, to appoint agents and advisors and otherwise govern the conduct of its business, and to make all decisions necessary or proper for the administration of this Plan. The Administrator's decisions relating to the administration of this Plan shall be final. Similar to the Basic Pension Plan, the responsibility for claims processing shall rest with the Verizon Claims Review Committee and its delegate.

B. Except as otherwise provided in this Article VI, the most senior HR officer of Verizon Communications or his direct report(s) responsible for executive compensation or benefits may:

1. amend or terminate the Plan at any time; or

2. retroactively or prospectively increase, decrease, or terminate eligibility for or the level of benefits under the Plan.

Provided, however, in the event of a "Change in Control" under the Basic Pension Plan, the benefits accrued under this Plan may not be modified or terminated retroactively; amendments to this Plan following such a change in control may only have a prospective effect.

C. If any provision of the Plan shall be held unlawful or otherwise invalid or unenforceable in whole or in part, such unlawfulness, invalidity, or unenforceability shall not affect any other provision of the Plan or part thereof, each of which shall remain in full force and effect. If the making of any payment or the provision of any other benefit required under the Plan shall be held unlawful or otherwise invalid or unenforceable, such unlawfulness, invalidity, or unenforceability shall not prevent any other payment or benefit from being made or provided under the Plan, and if the making of any payment in full or the provisions of any other benefit required under the Plan in full would be unlawful or otherwise invalid or unenforceable, then such unlawfulness, invalidity, or unenforceability shall not prevent such payment or benefit from being made or provided in part, to the extent that it would not be unlawful, invalid, or unenforceable, and the maximum payment or benefit that would not be unlawful, invalid, or unenforceable shall be made or provided under the Plan.

D.1. Except as provided in Section D.2 below, an Employee's rights and interests under the Plan may not be assigned or transferred. In the case of any former Employee's death, payment, if any, under the Plan shall be made to his or her surviving spouse or designated beneficiary in accordance with the provisions of the Plan.

D.2. Notwithstanding the foregoing, Section D.1 shall not apply with respect to an order which satisfies the requirements for a qualified domestic relations order set forth in Section 206(d)(3)(B)(i) of the Employee Retirement Income Security Act of 1974, as amended ("QDRO") which is issued with respect to an Employee's interest in the Plan, and benefits shall be payable to the alternate payee designated therein in accordance with the terms and conditions thereof.

E. The maintenance of this Plan shall not be deemed to constitute a contract of employment nor as giving any Employee any right to be retained in the employment of the Company or its affiliates.

F. This Plan is subject to the laws of the State of Delaware to the extent not preempted by federal law.

ARTICLE VII. SENIOR MANAGER PARTICIPATION EFFECTIVE JANUARY 1, 2005

A. Effective January 1, 2005, Employees who are classified as "Senior Managers" or promoted to such status will participate in this Plan as described in this article.

B. A Senior Manager will only accrue a pension under this Plan based on the basic cash balance formula that applies under the Basic Pension Plan, with respect to his eligible compensation in excess of the Code Section 401(a)(17) limit. (As of the effective date of this article, the cash balance pay credit percentages range between 4 – 7% of eligible compensation, depending on the age and eligible service of the Employee.) A Senior Manager will not be eligible to accrue a pension under this Plan based on the highest average pay (HAP) formula or any other non-cash balance pension formula in the Basic Pension Plan.

C. In the event an Employee is promoted to Senior Manager status, his opening cash balance account under this Plan will be determined as of the time of the promotion under the applicable provisions that follows:

1. If at the time of promotion, the Employee's highest pension under all formulas applicable to him under the Basic Pension Plan is based on the cash balance formula, then his opening cash balance account under this Plan will simply be the same as his then existing cash balance account value.

2. If at the time of promotion, the Employee's highest pension under all formulas applicable to him under the Basic Pension Plan is based on a formula other than the cash balance formula, then his opening cash balance account under this Plan will be equal to the lump sum value of his benefit under that pension formula, based on the actuarial tables and interest rates then in effect under the Basic Pension Plan for that Employee. After the determination of the opening cash balance account under this Plan, there will be no subsequent comparison to the value of any other pension formula.

Once an Employee is promoted to Senior Manager and his opening cash balance account is established under this Plan, he will not thereafter be permitted to "grow in" to any early retirement subsidies (Rule of 75) under this Plan based on any non-cash balance formula. At the time of promotion to Senior Manager, all rights to any non-cash balance based formula shall cease under this Plan.
[Amended 12-14-2004; Effective 01-01-2005]

ARTICLE VIII. COMPLIANCE WITH SECTION 885 OF THE AMERICAN JOBS CREATION ACT OF 2004

A. Effective January 1, 2005, the form and timing of payments to an Employee under this Plan will be governed by the provisions in this article.

B. All distributions under this Plan will be in the form of a lump sum distribution. If an Employee's pension under this Plan is based on the cash balance pension formula, the amount of the lump sum distribution will be equal to the cash balance account balance at the time of distribution. If an Employee's pension under this Plan is based on a non-cash balance pension formula, the amount of the lump sum distribution will be computed using the actuarial tables and interest rates then in effect under the Basic Pension Plan for that Employee.

C. Except for Employees who are "Key Employees" within the meaning of the American Jobs Creation Act, distributions will be made as soon as reasonably practicable following an Employee's termination of employment and based on his first available Pension Commencement Date following termination of employment. For "Key Employees" within the meaning of the American Jobs Creation Act, distributions under this Plan will be made as soon as reasonably practicable following the expiration of the six month restriction mandated by the American Jobs Creation Act. **[Amended 12-14-2004; Effective 01-01-2005]**

EXHIBIT 10p(i)

FIRST AMENDMENT TO THE

VERIZON EXCESS PENSION PLAN

This Amendment is hereby adopted this _____day of December, 2004.

WHEREAS , the Verizon Corporate Services Group Inc. maintains the Verizon Excess Pension Plan (Effective January 1, 2002) (the "Excess Plan");

WHEREAS , pursuant to Article VI, Section B of the Excess Plan, the most senior human resources officer of Verizon Communications Inc. ("Verizon") has the authority to amend the Excess Plan; and

WHEREAS , Verizon wants to amend the Excess Plan to comply with Section 885 of the American Jobs Creation Act of 2004 and to cover senior managers under the cash balance pension provisions.

NOW, THEREFORE , the Excess Plan is hereby amended, effective January 1, 2005, as set forth in the attached new Articles VII and VIII.

IN WITNESS WHEREOF , this Amendment has been executed as of the date first set forth above.

VERIZON COMMUNICATIONS INC.

By: _____
Marc C. Reed
Executive Vice President-Human Resources

ARTICLE VII. SENIOR MANAGER PARTICIPATION EFFECTIVE JANUARY 1, 2005

A. Effective January 1, 2005, Employees who are classified as "Senior Managers" or promoted to such status will participate in this Plan as described in this article.

B. A Senior Manager will only accrue a pension under this Plan based on the basic cash balance formula that applies under the Basic Pension Plan, with respect to his eligible compensation in excess of the Code Section 401(a)(17) limit. (As of the effective date of this article, the cash balance pay credit percentages range between 4 – 7% of eligible compensation, depending on the age and eligible service of the Employee.) A Senior Manager will not be eligible to accrue a pension under this Plan based on the highest average pay (HAP) formula or any other non-cash balance pension formula in the Basic Pension Plan.

C. In the event an Employee is promoted to Senior Manager status, his opening cash balance account under this Plan will be determined as of the time of the promotion under the applicable provisions that follows:

1. If at the time of promotion, the Employee's highest pension under all formulas applicable to him under the Basic Pension Plan is based on the cash balance formula, then his opening cash balance account under this Plan will simply be the same as his then existing cash balance account value.

2. If at the time of promotion, the Employee's highest pension under all formulas applicable to him under the Basic Pension Plan is based on a formula other than the cash balance formula, then his opening cash balance account under this Plan will be equal to the lump sum value of his benefit under that pension formula, based on the actuarial tables and interest rates then in effect under the Basic Pension Plan for that Employee. After the determination of the opening cash balance account under this Plan, there will be no subsequent comparison to the value of any other pension formula.

Once an Employee is promoted to Senior Manager and his opening cash balance account is established under this Plan, he will not thereafter be permitted to "grow in" to any early retirement subsidies (Rule of 75) under this Plan based on any non-cash balance formula. At the time of

promotion to Senior Manager, all rights to any non-cash balance based formula shall cease under this Plan.

ARTICLE VIII. COMPLIANCE WITH SECTION 885 OF THE AMERICAN JOBS CREATION ACT OF 2004

A. Effective January 1, 2005, the form and timing of payments to an Employee under this Plan will be governed by the provisions in this article.

B. All distributions under this Plan will be in the form of a lump sum distribution. If an Employee's pension under this Plan is based on the cash balance pension formula, the amount of the lump sum distribution will be equal to the cash balance account balance at the time of distribution. If an Employee's pension under this Plan is based on a non-cash balance pension formula, the amount of the lump sum distribution will be computed using the actuarial tables and interest rates then in effect under the Basic Pension Plan for that Employee.

C. Except for Employees who are "Key Employees" within the meaning of the American Jobs Creation Act, distributions will be made as soon as reasonably practicable following an Employee's termination of employment and based on his first available Pension Commencement Date following termination of employment. For "Key Employees" within the meaning of the American Jobs Creation Act, distributions under this Plan will be made as soon as reasonably practicable following the expiration of the six month restriction mandated by the American Jobs Creation Act.

EXHIBIT 10v

Description of Verizon Executive Deferral Plan

On December 1, 2004, the Human Resources Committee of Verizon Communications Inc.'s Board of Directors adopted the Verizon Executive Deferral Plan (the Deferral Plan) in order to comply with Section 885 of the American Jobs Creation Act of 2004 (the Act) and Section 409A of the Internal Revenue Code of 1986, as amended (the Code). Eligible employees and non-employee Directors of Verizon Communications Inc. (Verizon) may elect to participate in the Deferral Plan as of January 1, 2005.

The Deferral Plan is a nonqualified, unfunded deferred compensation and supplemental savings plan that permits participants to defer the receipt of certain compensation not otherwise eligible for deferral. For eligible employees, the Deferral Plan also provides company-matching credits on certain deferrals that are comparable to the matching contributions under the Verizon Qualified Savings Plan. Non-employee Directors do not receive matching contributions under the Deferral Plan. This plan will not provide supplemental pension credits to any participant. The terms and conditions of the Deferral Plan are outlined below.

Highlights of the New Verizon Executive Deferral Plan

Nature of Plan Benefits

The Plan benefits are expressed in terms of an unfunded account balance and will equal the value of that account balance when payments are made from the Plan. The value of an account balance will increase or decrease based upon individual investment elections. The Plan is a non-qualified benefit plan and the assets are not held in a trust.

Deferrals for Active Participants

- Eligible employees can defer up to 100% of the portion of their base salary that exceeds a limit included in the Internal Revenue Code ($210,000 in 2005) (Eligible Base Salary).
- Eligible employees can defer up to 100% of their short-term incentive award.
- Directors can defer up to 100% of their cash retainer and associated meeting fees.
- Participants may also be able to defer up to 100% of their long-term incentive award or annual equity grant to the extent otherwise permitted pursuant to the terms of the award.
- Deferral elections are submitted in accordance with applicable legal requirements under the Plan.

Company Contributions

- The Company will add a "matching contribution credit" to eligible employees' accounts equal to –
  - if they defer at least 6% of the sum of Eligible Base Salary and short-term incentive under the Plan, 5% of the sum of their Eligible Base Salary and short-term incentive; or
  - if they defer less than 6% of the sum of Eligible Base Salary and short-term incentive under the Plan, 100% of the first 4% (and

50% of the next 2%) of the sum of the Eligible Base Salary and short-term incentive that they defer.

- non-employee members of the board of directors are not eligible for any company matching contribution credits.
- deferrals of long-term incentive awards are not eligible for company matching contribution credits.

Account Investments

Generally, individuals can elect to invest their EDP account in any of the investment options available under the Plan, which generally mirror the investment options available under the Verizon Qualified Savings Plan for Management Employees.

Distributions from the Plan of Personal Deferrals

- At the time individuals elect to defer they must also elect when and how they would like to have their benefit distributed. They may elect one of the following distribution forms:
  - One single lump sum payment, or
  - Annual installments (for between 2 and 20 years)
- Distributions can generally begin at separation from service or on a specified date either before or after separation from service.
- Individuals can change their distribution elections with respect to a deferred amount provided that (1) they make the election change at least 12 months prior to the original distribution date, (2) they delay the date they would have otherwise received the distributions by at least 5 years, and (3) they will not receive the distribution sooner or over a shorter period of time. An individual may not switch from annual installments to a lump sum distribution.

Distributions from the Plan of Company Contributions

All Company contributions in an EDP account (including amounts transferred to the EDP from the IDP or Directors' Plan) will be distributed in a lump sum payment following separation from service (or six months after separation from service for certain "key" employees).

Vesting

- Personal deferrals under the Plan are vested immediately.
- Matching contribution credits vest after an eligible employee has completed at least 3 full years of employment with the Company.
- Matching contribution credits will also vest if an individual's employment is involuntarily terminated and they sign a release, if they terminate employment as a result of death or a disability, or if there is a change in control of Verizon.
- Any other Company contributions transferred to the EDP from another plan (including unvested Retirement Contribution Credits transferred from the IDP) will vest according to the vesting schedule in place under the other plan at the time of the transfer.

EXHIBIT 10w

Description of Cash Compensation

As of January 1, 2005, Mr. Seidenberg's salary increased to $2,100,000. On Janaury 20, 2005, the independent directors of the Verizon Board approved a 2004 Short-Term Incentive Award for Mr. Seidenberg of $3,375,000.

EXHIBIT 10dd(i)

Description of Changes to Arrangements

As previously disclosed, Messrs. Seidenberg, Babbio and Barr waived their rights to receive certain deferred previously earned bonus payments in exchange for Verizon's entering into split-dollar insurance arrangements for their benefit. The deferred bonus payments waived by Messrs. Seidenberg, Babbio and Barr pursuant to these arrangements were $3.8 million, $2.0 million and $500,000, respectively. These amounts were included in the summary compensation table in Verizon's proxy statements. Under these arrangements, the insurance premiums paid by Verizon would ultimately be returned to Verizon. The present value after-tax costs of these arrangements to Verizon were designed to be equivalent to the after-tax costs to Verizon of these waived deferred compensation obligations. Thus, the arrangements were cost neutral to Verizon at the time they were entered into.

As a result of provisions in the Sarbanes-Oxley Act of 2002, Verizon suspended premium payments to these split-dollar insurance policies as of July 2002. To date, the Securities and Exchange Commission has not provided any guidance as to whether the provisions in the Sarbanes-Oxley Act of 2002 apply to these types of arrangements. Accordingly, Verizon determined that it will not make any additional premium

payments to these split-dollar policies. The amounts previously waived by Messrs. Seidenberg, Babbio and Barr (plus an amount that would have accrued in a market-based investment account since the date the amounts were waived) will be returned to their respective individual deferral accounts under the Verizon Income Deferral Plan. The amounts to be restored to Messrs. Seidenberg, Babbio and Barr's deferral accounts are approximately $5.1 million, $2.4 million and $605,000, respectively. The policies will remain the property of Messrs. Seidenberg, Babbio and Barr at a reduced benefit level until such time as they are cancelled or terminated. Verizon expects to eventually recover all of the insurance premiums previously paid towards the policies.

EXHIBIT 10gg

1095 Avenue of the Americas
New York, NY 10036

[Date]

[Name and Address]

Dear :

I am pleased to offer you this employment agreement (the "Agreement") with Verizon Communications Inc. ("Verizon"). For purposes of this Agreement, the term "Company" means Verizon, all corporate subsidiaries and other companies affiliated with Verizon, all companies in which Verizon has an ownership or other proprietary interest of more than 10 percent, and their successors and assigns.

The many opportunities and challenges facing the Company are enormous and exciting. As a leader in our industry, we will be constantly challenged with sustaining our market growth and presence. We will meet these challenges by leveraging the strength of our talented and committed leaders. This Agreement demonstrates my continued confidence in you.

I value you and the leadership, vision, and commitment you bring to the Company. I am excited by the prospect of you continuing as a key member of the Company's leadership team.

The terms and conditions of this Agreement are set forth below.

1. Purpose – Verizon enters into this Agreement with you because the rapidly changing and increasingly global telecommunications market requires the Company to make critical strategic, marketing, and technical decisions. These decisions by the Company will be based, in whole or in part, on confidential analyses of the evolving telecommunications market, confidential assessments of the technical capabilities and strategic plans of the Company

and competing businesses, and confidential or proprietary information regarding the Company's technology, resources, and business opportunities or other confidential or proprietary information relating to the Company's business. Verizon seeks by this Agreement to ensure that you remain a part of the executive management team that plays a central role in this decision-making process.

In consideration for your entering into this Agreement, including the restrictions on the disclosure and use of confidential or proprietary information and the limitations on your engaging in competitive activities, the Company is providing you with the security of a written two-year agreement, short- and long-term award opportunities, and other benefits.

2. General – Under this Agreement, you shall continue as a senior executive of the Company. As a senior executive, you shall report to [_____].

3. Term – The term of employment under this Agreement ("Term of Employment") shall commence on January 1, 2005, and end on December 31, 2007; provided that, on the last day of the Term of Employment, the Term of Employment shall automatically be extended for an additional two years unless, on or before that date, the Term of Employment has terminated or the Company notifies you in writing that the Term of Employment shall not be extended. For example, on December 31, 2007, the Term of Employment shall be extended until December 31, 2009, unless, on or before December 31, 2007, the Term of Employment has terminated or the Company notifies you in writing that the Term of Employment shall not be extended. Notwithstanding the preceding provisions of this paragraph 3, the Company reserves the right to terminate your employment and the Term of Employment at any time. Your employment and the Term of Employment also may terminate for other reasons (such as your resignation, retirement, death, or disability). The consequences of the termination of your employment are specified in paragraph 11 ("Termination Of Employment").

4. Duties And Responsibilities – You shall continue to serve as a senior executive of the Company in such capacities, with such titles and authorities, as the CEO or his successor may from time to time prescribe, and you shall perform all duties incidental to such positions, shall cooperate fully with the CEO or his successor, and shall work cooperatively with the other officers of

the Company. You shall continue to devote your entire business skill, time, and effort diligently to the affairs of the Company in accordance with the duties assigned to you, and you shall perform all such duties, and otherwise conduct yourself, in a manner reasonably calculated in good faith by you to promote the best interests of the Company. During the Term of Employment, except to the extent specifically permitted in writing by the CEO or his successor, you shall not, directly or indirectly, render any services of a business, commercial, or professional nature to any other person or organization other than the Company or a person or organization in which the Company has a financial interest, whether or not the services are rendered for compensation.

5. Location – During the Term of Employment, you shall perform services for the Company at its New York City headquarters, or at any other location designated by the Company as necessary or appropriate for the discharge of your responsibilities under this Agreement. In the event of any change in your principal work location, you shall be eligible for relocation assistance under the terms of any Company relocation policy applicable to other senior executives of the Company in your salary band at the time of such relocation.

6. Base Salary – During the Term of Employment, your annual base salary shall not be less than your annual base salary on the date of this Agreement; provided that if you are granted a merit increase in your base salary, your base salary shall not thereafter be reduced below that increased level during the Term of Employment. The Human Resources Committee of Verizon's Board of Directors or its designee shall review your base salary at least annually.

7. Short-Term And Long-Term Bonus Opportunities – During the Term of Employment, the Company shall provide you with annual short-term and long-term bonus opportunities equivalent to those available to other senior executives of the Company in your salary band.

8. Benefits And Perquisites – For the immediate future, you shall–

(1) participate in the tax-qualified and nonqualified retirement plans and in the other employee benefit plans (such as the medical and dental plans), programs, and policies in which you currently participate; and

(2) be eligible for the perquisites available to senior executives in your salary band;

provided that the Company retains the right to amend or terminate any benefit plan, policy, program, or perquisite at any time.

9. Annual Physical – You are encouraged to take an annual physical examination from a physician at the Company's expense and to certify in writing to the Company's designee each year (1) that you have had the examination and (2) the nature and extent of any medical impairments that prevent you from currently performing the essential functions of your position.

10. Excise Tax Gross-Up – Under certain circumstances you may become entitled to a gross-up payment with respect to the excise tax imposed by section 4999 of the Internal Revenue Code (the "Code"). The terms governing the gross-up payment are set forth in Exhibit A, which is incorporated herein by reference.

11. Termination Of Employment – (a) Voluntary Termination By You – You may terminate your employment under this Agreement for a reason other than Retirement (as defined in subparagraph (c), below) or Good Reason (as defined in subparagraph (d), below) by giving the CEO, at least 30 calendar days' (exclusive of vacation days) in advance of such termination, written notice of your intent to so terminate. The termination shall automatically become effective upon the expiration of such notice period. Upon the effective date of such termination, your base salary and any other Company benefits and perquisites shall cease to accrue, you shall forfeit all then-outstanding stock options, and you shall forfeit all rights under this Agreement which as of the relevant date have not yet been earned. A termination of employment in accordance with this subparagraph (a) shall be deemed a "Voluntary Termination."

(b) Termination Due To Death Or Disability – If, during the Term of Employment, you terminate employment because of death or disability (as defined under the Company-sponsored long-term disability plan that applies to you at the time your employment is so terminated), the Company shall make a lump-sum cash payment to you equal to the excess of (1) one times the sum of your base salary and short-term bonus (at 50% of maximum), over (2) any amounts payable to you under Company-sponsored disability plans. For this purpose, your base salary shall be based on your base salary rate in effect

immediately before your employment terminated. You shall also be entitled to accelerated vesting of all outstanding stock options, and you shall be entitled to exercise all then-outstanding stock options until the earlier of (1) the fifth anniversary of the date your employment terminates (or any later date prescribed by the terms of the option relating to termination of employment) or (2) the expiration of the option; provided that if you terminate employment because of death, your rights under this subparagraph (b) shall pass to your estate. In addition, any unvested performance stock units and restricted stock units shall vest pursuant to the terms prescribed by the provisions of the applicable performance stock unit and restricted stock unit agreements that you have entered into with the Company.

(c) Retirement – You may terminate your employment under this Agreement by reason of Retirement (as defined below) by giving the CEO, at least 30 calendar days' (exclusive of vacation days) in advance of such termination, written notice of your intent to so terminate. The termination shall automatically become effective upon the expiration of such notice period. Upon the effective date of such termination, you shall be entitled to a pro-rated portion of any short-term bonus (when and to the extent that they are earned) and accelerated vesting of all outstanding stock options, and you shall be entitled to exercise all then-outstanding stock options until the earlier of (1) the fifth anniversary of the date your employment terminates (or any later date prescribed by the terms of the option relating to termination of employment) or (2) the expiration of the option. Any unvested performance stock units and restricted stock units shall vest pursuant to the terms prescribed by the provisions of the applicable agreement that you have entered into with the Company. For purposes of this Agreement, "Retirement" means attaining normal retirement age under the terms of the Verizon Management Pension Plan (the "Pension Plan") or satisfying the Rule of 75 under the Pension Plan. Except as provided by the preceding provisions of this subparagraph (c), upon the effective date of your Retirement, your base salary and any other Company benefits and perquisites shall cease to accrue; provided that you shall otherwise be eligible to receive any and all compensation and benefits for which a similarly situated senior executive would be eligible under the applicable provisions of the compensation and benefit plans in which he is then eligible to participate, as those plans may be amended from time to time.

(d) Termination For Good Reason – (1) You may terminate your employment under this Agreement for Good Reason by giving the CEO, at least 30 calendar days' (exclusive of vacation days) in advance of such termination

(the "Notice Period"), written notice of your intent to so terminate, setting forth in reasonable detail the facts and circumstances deemed to provide a basis for such termination. For purposes of this Agreement, "Good Reason" means a material breach by the Company of the terms and conditions of this Agreement, a material reduction in your overall compensation opportunities, or your assignment to a new principal work location that is more than 50 miles from your previous principal work location. A "Good Reason" shall not occur merely because of a change in the individual (or position) to whom (or to which) you report. In addition, a "Good Reason" shall not occur merely because the Company notifies you, in accordance with paragraph 3 ("Term"), that the Term of Employment shall not be extended for an additional two-year period.

(2) Notwithstanding the foregoing, the Company shall have 15 calendar days from its receipt of such notice to cure the action specified in the notice. In the event of a cure by the Company within the 15-day period, the action in question shall not constitute Good Reason.

(3) Except as provided in subparagraph (d)(2), above, at the end of the Notice Period, the Good Reason termination shall take effect, and your obligation to serve the Company, and the Company's obligation to employ you, under the terms of this Agreement shall terminate simultaneously, and you shall be deemed to have incurred an Involuntary Termination Without Cause, with the consequences described in subparagraph (e), below; provided that your rights under this subparagraph (d) are contingent on your execution of a release in accordance with paragraph 12 ("Release").

(4) If you do not fulfill the notice and explanation requirements imposed by this subparagraph (d), the resulting termination of employment shall be deemed a Voluntary Termination.

(e) Involuntary Termination Without Cause – The Company may terminate your employment under this Agreement at any time and for any reason. However, if the Company terminates your employment during the Term of Employment for any reason other than death, disability, or Cause (as defined in subparagraph (f), below), such termination shall be deemed an Involuntary Termination by the Company, and you shall be entitled to receive the following payments and benefits in lieu of any payment or benefit otherwise provided pursuant to paragraphs 6 ("Base Salary") through 8 ("Benefits And Perquisites"):

(1) The Company shall make a lump-sum cash severance payment to you equal to the excess of (i) two times the sum of your base salary and short-term bonus (at 50% of maximum), over (ii) the sum of any amounts paid or payable to you under any Company-sponsored severance plan, program, policy, contract, account, or arrangement;

(2) Your unvested stock options shall immediately vest, and you may exercise all of your then-outstanding stock options at any time up to the earlier of (i) the fifth anniversary of the date your employment terminates (or any later date prescribed by the terms of the option relating to termination of employment) or (ii) the expiration of the option;

(3) Your unvested performance stock units and restricted stock units shall vest pursuant to the terms prescribed by the provisions of the applicable agreements that you have entered into with the Company; and

(4) You shall be eligible for outplacement services to the extent that such services are then available to senior executives in your salary band;

provided that your rights under this subparagraph (e) are contingent on your execution of a release in accordance with paragraph 12 ("Release"). For purposes of this paragraph 11(e), the Company shall not be deemed to have terminated your employment during the Term of Employment if the Company notifies you, in accordance with paragraph 3 ("Term"), that the Term of Employment shall not be extended for an additional two-year period.

(f) Involuntary Termination For Cause – (1) Nothing in this Agreement prevents the Company from terminating your employment under this Agreement for Cause. In the event of your termination for Cause, the Company shall pay you your full accrued base salary and accrued vacation time through the date of your termination, you shall forfeit all then-outstanding stock options if you are not eligible for Retirement at the time of your termination, and the Company shall have no further obligations under this Agreement;

provided that you shall otherwise be eligible to receive any and all compensation and benefits for which a similarly situated senior executive would be eligible under the applicable provisions of the compensation and benefit plans in which he is then eligible to participate, as those plans may be amended from time to time.

(2) For purposes of this Agreement, "Cause" is defined as (i) grossly incompetent performance or substantial or continuing inattention to or neglect of the duties and responsibilities assigned to you; fraud, misappropriation or embezzlement involving the Company or a material breach of the Code of Business Conduct or any provision incorporated in paragraph 13 ("Covenants"), as determined by the CEO in his discretion, or (ii) commission of any felony of which you are finally adjudged guilty by a court of competent jurisdiction.

(3) If the Company terminates your employment for Cause, the Company shall provide you with a written statement of the grounds for such termination within 10 business days after the date of termination.

12. Release – You shall not be entitled to any benefits under paragraphs 10 ("Excise Tax Gross-Up"), 11(c) ("Retirement"), 11(d) ("Termination For Good Reason"), and 11(e) ("Involuntary Termination Without Cause") following the termination of your employment unless, at the time your employment terminates, you execute a release satisfactory to the Company releasing the Company, its affiliates, shareholders, directors, officers, employees, representatives, and agents and their successors and assigns from any and all employment-related claims you or your successors and beneficiaries might then have against them (excluding any claims you might then have under this Agreement, or any employee benefit plan that is subject to the vesting standards imposed by the Employee Retirement Income Security Act of 1974, as amended).

13. Covenants – In consideration for the benefits and agreements described above, you agree to comply with the covenants set forth in Exhibit B hereto, which are incorporated herein by reference.

14. Request For Waiver – Nothing in this Agreement bars you from requesting, at the time of your termination of employment or at any time thereafter, that the CEO, in his sole discretion, waive in writing the Company's

rights to enforce some or all of the provisions incorporated in paragraph 13 ("Covenants").

15. Other Agreements And Policies – The obligations imposed on you by paragraph 13 ("Covenants") are in addition to, and not in lieu of, any and all other policies and agreements of the Company regarding the subject matter of the foregoing obligations.

16. Nonduplication Of Benefits – No provision of this Agreement shall require the Company to provide you with any payment, benefit, or grant that duplicates any payment, benefit, or grant that you are entitled to receive under any Company compensation or benefit plan, award agreement, or other arrangement.

17. Other Company Plans – Except to the extent otherwise explicitly provided by this Agreement, any awards made to you under any Company compensation or benefit plan or program shall be governed by the terms of that plan or program and any applicable award agreement thereunder as in effect from time to time. Notwithstanding the foregoing, you shall not be entitled to participate in any Company compensation or benefit plan that is established after your employment with the Company terminates, and except as specifically provided in this Agreement, you shall not be entitled to any additional grants or awards under any Company compensation or benefit plan after your employment with the Company terminates. The amounts paid, provided, or credited under this Agreement shall not be treated as compensation for purposes of determining any benefits payable under any Company-sponsored pension, savings, life insurance, or other employee benefit plan except to the extent provided by the terms of such plan.

18. Forfeiture – (a) If you breach any of the obligations incorporated in paragraph 13 ("Covenants"), or engage in serious misconduct that is contrary to written policies of the Company and is harmful to the Company or its reputation, you shall forfeit:

(1) all credits that are added to your Retirement Contribution Sub-Account in the Verizon Income Deferral Plan (or to any successor account in that plan or a successor plan) ("Retirement Contribution Sub-Account"), on or after January 1, 2002;

(2) any interest or other earnings or gains on or after January 1, 2002, with respect to any credits in your Retirement Contribution Sub-Account (including any interest, or other earnings or gains attributable to any credit regardless of when the credit was added to your Retirement Contribution Sub-Account); and

(3) any unpaid incentive compensation (such as performance bonus awards or other awards under the Verizon Communications Inc. Long-Term Incentive Plan) that you are otherwise entitled to receive.

(b) The remedies available under this paragraph are in addition to, and not in lieu of, the remedies available under paragraph 25 ("Additional Remedies").

19. No Deemed Waiver – Failure to insist upon strict compliance with any of the terms, covenants, or conditions of this Agreement shall not be deemed a waiver of such term, covenant, or condition, nor shall any waiver or relinquishment of any right or power hereunder at any one or more times be deemed a waiver or relinquishment of such right or power at any other time or times.

20. Taxes – The Company may withhold from any benefits payable under this Agreement all taxes that the Company reasonably determines to be required pursuant to any law, regulation, or ruling. However, it is your obligation to pay all required taxes on any amounts and benefits provided under this Agreement, including the benefits and perquisites provided to you pursuant to paragraph 8 ("Benefits and Perquisites"), regardless of whether withholding is required.

21. Confidentiality – Except to the extent otherwise required by law, you shall not disclose, in whole or in part, any of the terms of this Agreement. This paragraph 21 does not prevent you from disclosing the terms of this Agreement to your spouse or to your legal, tax, or financial adviser, provided that you take all reasonable measures to assure that he or she does not disclose the terms of this Agreement to a third party except as otherwise required by law.

22. Governing Law – To the extent not preempted by federal law, the provisions of this Agreement shall be construed and enforced in accordance with the laws of the State of New York, excluding any conflicts or choice of law rule or principle that might otherwise refer construction or interpretation of this provision to the substantive law of another jurisdiction.

23. Assignment – Verizon may, without your consent, assign its rights and obligations under this Agreement to any entity that is a part of the Company, and if Verizon makes such an assignment, all references in this Agreement to Verizon (except for references to Verizon common stock) shall be deemed to refer to the assignee. However, you may not assign your rights and obligations under this Agreement.

24. Severability – The agreements contained herein and within the release prescribed by paragraph 12 ("Release") shall each constitute a separate agreement independently supported by good and adequate consideration, and shall each be severable from the other provisions of the Agreement and such release. If an arbitrator or court of competent jurisdiction determines that any term, provision, or portion of this Agreement or such release is void, illegal, or unenforceable, the other terms, provisions, and portions of this Agreement or such release shall remain in full force and effect, and the terms, provisions, and portions that are determined to be void, illegal, or unenforceable shall either be limited so that they shall remain in effect to the extent permissible by law, or such arbitrator or court shall substitute, to the extent enforceable, provisions similar thereto or other provisions, so as to provide to the Company, to the fullest extent permitted by applicable law, the benefits intended by this Agreement and such release.

25. Additional Remedies – In addition to any other rights or remedies, whether legal, equitable, or otherwise, that each of the parties to this Agreement may have, you acknowledge that

(a) The covenants incorporated in paragraph 13 ("Covenants") are essential to the continued good will and profitability of the Company;

(b) You have broad-based skills that will serve as the basis for employment opportunities that are not prohibited by the covenants incorporated in paragraph 13 ("Covenants");

(c) When your employment with the Company terminates, you shall be able to earn a livelihood without violating any of the terms of this Agreement;

(d) Irreparable damage to the Company shall result in the event that the covenants incorporated in paragraph 13 ("Covenants") are not specifically enforced and that monetary damages will not adequately protect the Company from a breach of such covenants;

(e) If any dispute arises concerning the violation by you of the covenants incorporated in paragraph 13 ("Covenants"), an injunction may be issued restraining such violation pending the determination of such controversy, and no bond or other security shall be required in connection therewith;

(f) Such covenants shall continue to apply after any expiration, termination, or cancellation of this Agreement; and

(g) Your breach of any of such covenants shall result in your immediate forfeiture of all rights under this Agreement.

26. Survival – The provisions of paragraphs 13 ("Covenants") through 28 ("Entire Agreement") shall survive the Term of Employment. In addition, if the Term of Employment is not extended in accordance with paragraph 3 ("Term") but your employment continues after the end of the Term of Employment, you shall be subject to the obligations imposed by each of such paragraphs with respect to such employment. Any obligations that the Company has incurred under this Agreement to provide benefits that have vested under the terms of this Agreement (including the Company's obligations under paragraph 11(c) ("Retirement")) shall likewise survive the Term of Employment. Except as provided by the preceding provisions of this paragraph 26, if the Term of Employment is not extended in accordance with paragraph 3 ("Term") but your employment continues after the end of the Term of Employment, the terms of such employment shall not be governed by this Agreement.

27. Arbitration – Any dispute arising out of or relating to this Agreement (except any dispute arising out of or relating to paragraph 13 ("Covenants")), and any dispute arising out of or relating to your employment,

shall be settled by final and binding arbitration, which shall be the exclusive means of resolving any such dispute, and the parties specifically waive all rights to pursue any other remedy, recourse, or relief. With respect to disputes by the Company arising out of or relating to paragraph 13 ("Covenants"), the Company has retained all its rights to legal and equitable recourse and relief, including but not limited to injunctive relief, as referred to in paragraph 25 ("Additional Remedies"). The arbitration shall be expedited and conducted in the State of New York pursuant to the Center for Public Resources ("CPR") Rules for Non-Administered Arbitration in effect at the time of notice of the dispute before one neutral arbitrator appointed by CPR from the CPR Panel of neutrals unless the parties mutually agree to the appointment of a different neutral arbitrator. The arbitration shall be governed by the Federal Arbitration Act, 9 U.S.C. sections 1-16, and judgment upon the award rendered by the arbitrator may be entered by any court having jurisdiction. The finding of the arbitrator may not change the express terms of this Agreement and shall be consistent with the arbitrator's understanding of the findings a court of proper jurisdiction would make in applying the applicable law to the facts underlying the dispute. In no event whatsoever shall such an arbitration award include any award of damages other than the amounts in controversy under this Agreement. The parties waive the right to recover, in such arbitration, punitive damages. Each party hereby agrees that New York City is the proper venue for any litigation seeking to enforce any provision of this Agreement or to enforce any arbitration award under this paragraph 27, and each party hereby waives any right it otherwise might have to defend, oppose, or object to, on the basis of jurisdiction, venue, or forum nonconveniens, a suit filed by the other party in any federal or state court in New York City to enforce any provision of this Agreement or to enforce any arbitration award under this paragraph 27. Each party also waives any right it might otherwise have to seek to transfer from a federal or state court in New York City a suit filed by the other party to enforce any provision of this Agreement or to enforce any arbitration award under this paragraph 27.

28. Entire Agreement – Except for the terms of the compensation and benefit plans in which you participate (including any award agreements issued thereunder), this Agreement, including the Exhibits hereto, sets forth the entire understanding of you and the Company, and supersedes all prior agreements and communications, whether oral or written, between the Company (or Bell Atlantic or GTE or any of their respective subsidiaries) and

you regarding the subject matter of this Agreement. This Agreement shall not be modified except by written agreement of you and Verizon.

[Name], I believe that this Agreement provides you and your family with a firm foundation of financial security as our Company faces many new challenges and opportunities. I recognize that the Company and the telecommunications industry operate in a rapidly changing and demanding environment. It is my hope that this Agreement demonstrates to you the level of confidence that I have in your abilities to meet the commitments that I expect from you. Please indicate your acceptance by signing below and returning the signed Agreement to Bob Toohey or me within fifteen business days after your receipt of this Agreement.

Sincerely yours,

Ivan Seidenberg
Chairman and Chief Executive Officer

I agree to the terms described above.

_____

[Name]

Attachments: Exhibit A – Excise Tax Gross-Up
Exhibit B – Covenants

EXHIBIT A

Excise Tax Gross-Up

1. Gross-Up Payment – If any payment or benefit received or to be received by you from the Company pursuant to the terms of the Agreement to which this Exhibit A is attached or otherwise (the "Payments") would be subject to the excise tax (the "Excise Tax") imposed by section 4999 of the Internal Revenue Code (the "Code") as determined in accordance with this Exhibit A, the Company shall pay you, at the time specified below, an additional amount (the "Gross-Up Payment") such that the net amount that you retain, after deduction of the Excise Tax on the Payments and any federal, state, and local income tax and the Excise Tax upon the Gross-Up Payment, and any interest, penalties, or additions to tax payable by you with respect thereto, shall be equal to the total present value (using the applicable federal rate (as defined in section 1274(d) of the Code) in such calculation) of the Payments at the time such Payments are to be made.

2. Calculations – For purposes of determining whether any of the Payments shall be subject to the Excise Tax and the amount of such excise tax,

(a) The total amount of the Payments shall be treated as "parachute payments" within the meaning of section 280G(b)(2) of the Code, and all "excess parachute payments" within the meaning of section 280G(b)(1) of the Code shall be treated as subject to the excise tax, except to the extent that, in the written opinion of independent counsel selected by Verizon and reasonably acceptable to you ("Independent Counsel"), a Payment (in whole or in part) does not constitute a "parachute payment" within the meaning of section 280G(b)(2) of the Code, or such "excess parachute payments" (in whole or in part) are not subject to the Excise Tax;

(b) The amount of the Payments that shall be subject to the Excise Tax shall be equal to the lesser of (i) the total amount of the Payments or (ii) the amount of "excess parachute payments " within the meaning of section 280G(b)(1) of the Code (after applying clause (a), above); and

(c) The value of any noncash benefits or any deferred payment or benefit shall be determined by Independent Counsel in accordance with the principles of section 280G(d)(3) and (4) of the Code.

3. Tax Rates – For purposes of determining the amount of the Gross-Up Payment, you shall be deemed to pay federal income taxes at the highest marginal rates of federal income taxation applicable to individuals in the calendar year in which the Gross-Up Payment is to be made and state and local income taxes at the highest marginal rates of taxation applicable to individuals as are in effect in the state and locality of your residence in the calendar year in which the Gross-Up Payment is to be made, net of the maximum reduction in federal income taxes that can be obtained from deduction of such state and local taxes, taking into account any limitations applicable to individuals subject to federal income tax at the highest marginal rates.

4. Time of Gross-Up Payments – The Gross-Up Payments provided for in this Exhibit A shall be made upon the earlier of (a) the payment to you of any Payment or (b) the imposition upon you, or any payment by you, of any Excise Tax.

5. Adjustments to Gross-Up Payments – If it is established pursuant to a final determination of a court or an Internal Revenue Service proceeding or the written opinion of Independent Counsel that the Excise Tax is less than the amount previously taken into account hereunder, you shall repay the Company, within 30 days of your receipt of notice of such final determination or opinion, the portion of the Gross-Up Payment attributable to such reduction (plus the portion of the Gross-Up Payment attributable to the Excise Tax and federal, state, and local income tax imposed on the Gross-Up Payment being repaid by you if such repayment results in a reduction in Excise Tax or a federal, state, and local income tax deduction) plus any interest received by you on the amount of such repayment, provided that if any such amount has been paid by you as an Excise Tax or other tax, you shall cooperate with the Company in seeking a refund of any tax overpayments, and you shall not be required to make repayments to the Company until the overpaid taxes and interest thereon are refunded to you.

6. Additional Gross-Up Payment – If it is established pursuant to a final determination of a court or an Internal Revenue Service proceeding or the written opinion of Independent Counsel that the Excise Tax exceeds the amount taken into account hereunder (including by reason of any payment the existence or amount of which cannot be determined at the time of the Gross-Up Payment), the Company shall make an additional Gross-Up Payment in respect of such excess within 30 days of the Company's receipt of notice of such final determination or opinion.

7. Change In Law Or Interpretation – In the event of any change in or further interpretation of section 280G or 4999 of the Code and the regulations promulgated thereunder, you shall be entitled, by written notice to Verizon, to request a written opinion of Independent Counsel regarding the application of such change or further interpretation to any of the foregoing, and Verizon shall use its best efforts to cause such opinion to be rendered as promptly as practicable.

8. Fees And Expenses – All fees and expenses of Independent Counsel incurred in connection with this Exhibit A shall be borne by Verizon.

9. Survival – The Company's obligation to make a Gross-Up Payment with respect to Payments made or accrued before the end of the Term of Employment shall survive the Term of Employment unless (a) your employment is terminated for Cause pursuant to paragraph 11(f) of the Agreement to which this Exhibit A is attached ("Involuntary Termination For Cause"), (b) you fail to execute a release in accordance with paragraph 12 of such Agreement ("Release"), or (c) you fail to comply with the covenants incorporated in paragraph 13 of such Agreement ("Covenants"), in which event the Company's obligation under this Exhibit A shall terminate immediately.

10. Defined Terms – Except where clearly provided to the contrary, all capitalized terms used in this Exhibit A shall have the definitions given to those terms in the Agreement to which this Exhibit A is attached.

EXHIBIT B

Covenants

1. Noncompetition – In consideration for the benefits and agreements described in the Agreement to which this Exhibit B is attached, you agree that:

(a) Prohibited Conduct – During the period of your employment with the Company, and for the period ending six months after your termination of employment for any reason from the Company, you shall not, without the prior written consent of the CEO(s):

(1) personally engage in Competitive Activities (as defined below); or

(2) work for, own, manage, operate, control, or participate in the ownership, management, operation, or control of, or provide consulting or advisory services to, any individual, partnership, firm, corporation, or institution engaged in Competitive Activities, or any company or person affiliated with such person or entity engaged in Competitive Activities; provided that your purchase or holding, for investment purposes, of securities of a publicly-traded company shall not constitute "ownership" or "participation in ownership" for purposes of this paragraph so long as your equity interest in any such company is less than a controlling interest;

provided that this paragraph (a) shall not prohibit you from (i) being employed by, or providing services to, a consulting firm, provided that you do not personally engage in Competitive Activities or provide consulting or advisory services to any individual, partnership, firm, corporation, or institution engaged in Competitive Activities, or any company or person affiliated with such person or entity engaged in Competitive Activities, or (ii) engaging in the private practice of law as a sole practitioner or as a partner in (or as an employee of or counsel to) a law firm in accordance with applicable legal and professional standards.

(b) Competitive Activities – For purposes of the Agreement to which this Exhibit B is attached, "Competitive Activities" means business activities relating to products or services of the same or similar type as the products or services (1) which are sold (or, pursuant to an existing business plan, will be sold) to paying customers of the Company, and (2) for which you

then have responsibility to plan, develop, manage, market, or oversee, or had any such responsibility within your most recent 24 months of employment with the Company. Notwithstanding the previous sentence, a business activity shall not be treated as a Competitive Activity if the geographic marketing area of the relevant products or services sold by you or a third party does not overlap with the geographic marketing area for the applicable products and services of the Company.

2. Interference With Business Relations – During the period of your employment with the Company, and for a period ending with the expiration of 12 months following your termination of employment for any reason from the Company, you shall not, without the written consent of the CEO(s):

(a) recruit or solicit any employee of the Company for employment or for retention as a consultant or service provider;

(b) hire or participate (with another company or third party) in the process of hiring (other than for the Company) any person who is then an employee of the Company, or provide names or other information about Company employees to any person or business (other than the Company) under circumstances that could lead to the use of that information for purposes of recruiting or hiring;

(c) interfere with the relationship of the Company with any of its employees, agents, or representatives;

(d) solicit or induce, or in any manner attempt to solicit or induce, any client, customer, or prospect of the Company (1) to cease being, or not to become, a customer of the Company or (2) to divert any business of such customer or prospect from the Company; or

(e) otherwise interfere with, disrupt, or attempt to interfere with or disrupt, the relationship, contractual or otherwise, between the Company and any of its customers, clients, prospects, suppliers, consultants, or employees.

3. Return Of Property; Intellectual Property Rights – You agree that on or before your termination of employment for any reason with the Company, you shall return to the Company all property owned by the Company or in which the Company has an interest, including files, documents, data and records (whether on paper or in tapes, disks, or other machine-readable form), office equipment, credit cards, and employee identification cards. You acknowledge that the Company is the rightful owner of any programs, ideas, inventions, discoveries, patented or copyrighted material, or trademarks that you may have originated or developed, or assisted in originating or developing, during your period of employment with the Company, where any such origination or development involved the use of Company time or resources, or the exercise of your responsibilities for or on behalf of the Company. You shall at all times, both before and after termination of employment, cooperate with the Company in executing and delivering documents requested by the Company, and taking any other actions, that are necessary or requested by the Company to assist the Company in patenting, copyrighting, or registering any programs, ideas, inventions, discoveries, patented or copyrighted material, or trademarks, and to vest title thereto in the Company.

4. Proprietary And Confidential Information – You shall at all times preserve the confidentiality of all proprietary information and trade secrets of the Company, except to the extent that disclosure of such information is legally required. "Proprietary information" means information that has not been disclosed to the public and that is treated as confidential within the business of the Company, such as strategic or tactical business plans; undisclosed financial data; ideas, processes, methods, techniques, systems, patented or copyrighted information, models, devices, programs, computer software, or related information; documents relating to regulatory matters and correspondence with governmental entities; undisclosed information concerning any past, pending, or threatened legal dispute; pricing and cost data; reports and analyses of business prospects; business transactions that are contemplated or planned; research data; personnel information and data; identities of users and purchasers of the Company's products or services; and other confidential matters pertaining to or known by the Company, including confidential information of a third party that you know or should know the Company is bound to protect.

5. Definitions – Except where clearly provided to the contrary, all capitalized terms used in this Exhibit B shall have the definitions given to those terms in the Agreement to which this Exhibit B is attached.

EXHIBIT 12

Computation of Ratio of Earnings to Fixed Charges
Verizon Communications Inc. and Subsidiaries

Years Ended December 31,	2004	2003	2002	2001	2000
				(dollars in millions)	
Income from before provision for income taxes, discontinued operations, extraordinary items, and cumulative effect of accounting change	**$ 10,112**	$ 4,673	$ 6,130	$ 2,660	$ 17,841
Minority interest	**2,409**	1,583	1,404	625	288
Equity in (earnings) loss of unconsolidated businesses	**(1,691)**	(1,278)	1,547	(446)	(3,792)
Dividends from unconsolidated businesses	**162**	198	97	178	215
Interest expense	**2,384**	2,797	3,130	3,276	3,406
Portion of rent expense representing interest	**449**	445	418	419	345
Amortization of capitalized interest	**104**	103	87	70	52
Income, as adjusted	**$ 13,929**	$ 8,521	$ 12,813	$ 6,782	$ 18,355
Fixed charges:					
Interest expense	**$ 2,384**	$ 2,797	$ 3,130	$ 3,276	$ 3,406
Portion of rent expense representing interest	**449**	445	418	419	345
Capitalized interest	**177**	144	185	368	230
Preferred stock dividend requirement	**8**	12	18	61	26
Fixed Charges	**$ 3,018**	$ 3,398	$ 3,751	$ 4,124	$ 4,007
Ratio of Earnings to Fixed Charges	**4.62**	2.51	3.42	1.64	4.58

EXHIBIT 13

Selected Financial Data Verizon Communications Inc. and Subsidiaries

(doll

EXHIBIT 6

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

FORM 10-Q

(Mark one)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2004

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 number 1-8606

Verizon Communications Inc.

(Exact name of registrant as specified in its charter)

Delaware	**23-2259884**
(State of Incorporation)	(I.R.S. Employer Identification No.)
1095 Avenue of the Americas **New York, New York** (Address of principal executive offices)	**10036** (Zip Code)

Registrant's telephone number (212) 395-2121

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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ☑ No ☐

At September 30, 2004, 2,768,958,346 shares of the registrant's Common Stock were outstanding, after deducting 5,907,035 shares held in treasury.

Table of Contents

		Page
Part I.	**Financial Information**	
Item 1.	**Financial Statements (Unaudited)**	
	Condensed Consolidated Statements of Income *For the three and nine months ended September 30, 2004 and 2003*	1
	Condensed Consolidated Balance Sheets *At September 30, 2004 and December 31, 2003*	2
	Condensed Consolidated Statements of Cash Flows *For the nine months ended September 30, 2004 and 2003*	3
	Notes to Condensed Consolidated Financial Statements	4
Item 2.	**Management's Discussion and Analysis of Results of Operations and Financial Condition**	20
Item 3.	**Quantitative and Qualitative Disclosures About Market Risk**	42
Item 4.	**Controls and Procedures**	42
Part II.	**Other Information**	
Item 2.	**Unregistered Sales of Equity Securities and Use of Proceeds**	43
Item 6.	**Exhibits**	43
Signature		44
Certifications		

Part I – Financial Information

Item 1. Financial Statements

Condensed Consolidated Statements of Income
Verizon Communications Inc. and Subsidiaries

(Dollars in Millions, Except Per Share Amounts) (Unaudited)	Three Months Ended September 30, 2004	Three Months Ended September 30, 2003	Nine Months Ended September 30, 2004	Nine Months Ended September 30, 2003
Operating Revenues	$ 18,206	$ 17,063	$ 53,020	$ 50,270
Operating Expenses				
Cost of services and sales (exclusive of items shown below)	5,994	5,706	17,104	15,849
Selling, general and administrative expense	5,132	4,891	15,807	14,823
Depreciation and amortization expense	3,483	3,416	10,345	10,162
Sales of businesses, net	–	(141)	–	(141)
Total Operating Expenses	14,609	13,872	43,256	40,693
Operating Income	3,597	3,191	9,764	9,577
Equity in earnings of unconsolidated businesses	224	358	635	673
Income from other unconsolidated businesses	2	80	74	159
Other income and (expense), net	16	10	(20)	22
Interest expense	(577)	(685)	(1,809)	(2,132)
Minority interest	(682)	(410)	(1,835)	(1,132)
Income Before Provision for Income Taxes, Discontinued Operations and Cumulative Effect of Accounting Change	2,580	2,544	6,809	7,167
Provision for income taxes	(801)	(758)	(2,065)	(2,236)
Income Before Discontinued Operations and Cumulative Effect of Accounting Change	1,779	1,786	4,744	4,931
Discontinued Operations				
Income/(loss) from operations	33	15	89	(891)
Provision for income taxes	(16)	(10)	(41)	(8)
Income/(loss) on discontinued operations, net of tax	17	5	48	(899)
Cumulative Effect of Accounting Change, Net of Tax	–	–	–	503
Net Income	$ 1,796	$ 1,791	$ 4,792	$ 4,535
Basic Earnings Per Common Share[1]				
Income before discontinued operations and cumulative effect of accounting change	$ .64	$ .65	$ 1.71	$ 1.79
Income/(loss) on discontinued operations, net of tax	.01	–	.02	(.33)
Cumulative effect of accounting change, net of tax	–	–	–	.18
Net Income	$ .65	$ .65	$ 1.73	$ 1.65
Weighted-average shares outstanding (in millions)	2,769	2,759	2,769	2,753
Diluted Earnings Per Common Share[1]				
Income before discontinued operations and cumulative effect of accounting change	$ .64	$ .64	$ 1.70	$ 1.78
Income/(loss) on discontinued operations, net of tax	.01	–	.02	(.32)
Cumulative effect of accounting change, net of tax	–	–	–	.18
Net Income	$ .64	$ .64	$ 1.72	$ 1.63

Weighted-average shares outstanding (in millions)	2,803	2,791	2,803	2,786
Dividends declared per common share	$ .385	$ .385	$ 1.155	$ 1.155

(1) Total per share amounts may not add due to rounding.

See Notes to Condensed Consolidated Financial Statements

Condensed Consolidated Balance Sheets
Verizon Communications Inc. and Subsidiaries

(Dollars in Millions, Except Per Share Amounts) (Unaudited)	At September 30, 2004	At December 31, 2003
Assets		
Current assets		
Cash and cash equivalents	$ 616	$ 669
Short-term investments	986	2,172
Accounts receivable, net of allowances of $1,772 and $2,382	9,919	9,854
Inventories	1,389	1,262
Assets of discontinued operations	719	705
Assets held for sale	950	–
Prepaid expenses and other	3,162	4,233
Total current assets	17,741	18,895
Plant, property and equipment	183,356	180,940
Less accumulated depreciation	109,870	105,638
	73,486	75,302
Investments in unconsolidated businesses	5,989	5,789
Wireless licenses	41,092	40,907
Goodwill	835	835
Other intangible assets, net	4,430	4,702
Other assets	19,324	19,538
Total assets	$ 162,897	$ 165,968
Liabilities and Shareowners' Investment		
Current liabilities		
Debt maturing within one year	$ 3,271	$ 5,967
Accounts payable and accrued liabilities	13,291	14,652
Liabilities of discontinued operations	95	76
Liabilities related to assets held for sale	500	–
Other	5,967	5,885
Total current liabilities	23,124	26,580
Long-term debt	37,252	39,413
Employee benefit obligations	17,104	16,754
Deferred income taxes	22,129	21,704
Other liabilities	3,526	3,703
Minority interest	24,588	24,348
Shareowners' investment		
Series preferred stock ($.10 par value; none issued)	–	–
Common stock ($.10 par value; 2,774,865,381 shares and 2,772,313,619 shares issued)	277	277
Contributed capital	25,420	25,363
Reinvested earnings	11,005	9,409
Accumulated other comprehensive loss	(1,372)	(1,250)
Common stock in treasury, at cost	(168)	(115)
Deferred compensation – employee stock ownership plans and other	12	(218)
Total shareowners' investment	35,174	33,466
Total liabilities and shareowners' investment	$ 162,897	$ 165,968

See Notes to Condensed Consolidated Financial Statements

Condensed Consolidated Statements of Cash Flows
Verizon Communications Inc. and Subsidiaries

(Dollars in Millions) (Unaudited)	Nine Months Ended September 30, 2004	2003
Cash Flows from Operating Activities		
Income before discontinued operations and cumulative effect of accounting change	$ 4,744	$ 4,931
Adjustments to reconcile income before discontinued operations and cumulative effect of accounting change to net cash provided by operating activities:		
Depreciation and amortization expense	10,345	10,162
Sales of businesses, net	–	(141)
Employee retirement benefits	1,679	230
Deferred income taxes	968	1,418
Provision for uncollectible accounts	876	1,282
Income from unconsolidated businesses	(709)	(832)
Changes in current assets and liabilities, net of effects from acquisition/disposition of businesses	(2,344)	(406)
Other, net	(65)	(388)
Net cash provided by operating activities	15,494	16,256
Cash Flows from Investing Activities		
Capital expenditures (including capitalized software)	(9,077)	(8,134)
Acquisitions, net of cash acquired, and investments	(300)	(1,097)
Proceeds from disposition of businesses	117	229
Net change in short-term investments	1,174	1,683
Other, net	261	409
Net cash used in investing activities	(7,825)	(6,910)
Cash Flows from Financing Activities		
Proceeds from long-term borrowings	502	2,831
Repayments of long-term borrowings and capital lease obligations	(4,867)	(8,870)
Decrease in short-term obligations, excluding current maturities	(79)	(1,274)
Dividends paid	(3,198)	(3,175)
Proceeds from sale of common stock	220	617
Purchase of common stock for treasury	(257)	–
Other, net	(43)	(168)
Net cash used in financing activities	(7,722)	(10,039)
Decrease in cash and cash equivalents	(53)	(693)
Cash and cash equivalents, beginning of period	669	1,397
Cash and cash equivalents, end of period	$ 616	$ 704

See Notes to Condensed Consolidated Financial Statements

Notes to Condensed Consolidated Financial Statements
Verizon Communications Inc. and Subsidiaries
(Unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared based upon Securities and Exchange Commission (SEC) rules that permit reduced disclosure for interim periods. These financial statements reflect all adjustments that are necessary for a fair presentation of results of operations and financial condition 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. For a more complete discussion of significant accounting policies and certain other information, you should refer to the financial statements included in the Verizon Communications Inc. (Verizon) Annual Report on Form 10-K for the year ended December 31, 2003.

We have reclassified prior year amounts to conform to the current year presentation.

2. Accounting Changes

Directory Accounting Change

During 2003, we changed our method for recognizing revenues and expenses in our directory business from the publication-date method to the amortization method. The publication-date method recognizes revenues and direct expenses when directories are published. Under the amortization method, revenues and direct expenses, primarily printing and distribution costs, are recognized over the life of the directory, which is usually 12 months. This accounting change affected the timing of the recognition of revenues and expenses. As required by generally accepted accounting principles (GAAP), the directory accounting change was recorded effective January 1, 2003. The cumulative effect of the accounting change was a one-time charge of $2,697 million ($1,647 million after-tax).

Stock-Based Compensation

Effective January 1, 2003, we adopted the fair value recognition provisions of Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation," using the prospective method (as permitted under SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure") to all new awards granted, modified or settled after January 1, 2003. The following table illustrates the effect on net income and earnings per share if the fair value method had been applied to all outstanding and unvested options in each period.

(Dollars in Millions, Except Per Share Amounts)	Three Months Ended September 30, 2004	2003	Nine Months Ended September 30, 2004	2003
Net Income, As Reported	$ 1,796	$ 1,791	$ 4,792	$ 4,535
Add: Stock option-related employee compensation expense included in reported net income, net of related tax effects	14	9	40	25
Deduct: Total stock option-related employee compensation expense determined under fair value based method for all awards, net of related tax effects	(31)	(52)	(93)	(154)
Pro Forma Net Income	$ 1,779	$ 1,748	$ 4,739	$ 4,406
Earnings Per Share				
Basic – as reported	$ .65	$ .65	$ 1.73	$ 1.65
Basic – pro forma	.64	.63	1.71	1.60
Diluted – as reported	$ .64	$ .64	$ 1.72	$ 1.63
Diluted – pro forma	.64	.63	1.70	1.59

After-tax compensation expense for other stock-based compensation included in net income as reported for the three and nine months ended September 30, 2004 was $59 million and $154 million, respectively. For the three and nine months ended September 30, 2003, after-tax compensation expense for other stock-based compensation included in net income as reported was $23 million and $55 million, respectively.

Asset Retirement Obligations

We adopted the provisions of SFAS No. 143, "Accounting for Asset Retirement Obligations" on January 1, 2003. SFAS No. 143 requires that companies recognize the fair value of a liability for asset retirement obligations in the period in which the obligations are incurred and capitalize that amount as part of the book value of the long-lived asset. We determined that Verizon does not have a material legal obligation to remove long-lived assets as described by this statement. However, prior to the adoption of SFAS No. 143, we included estimated removal costs in our group depreciation models. Consequently, in connection with the initial adoption of SFAS No. 143 we reversed accrued costs of removal in excess of salvage from our accumulated depreciation accounts for these assets. The adjustment was recorded as a cumulative effect of an accounting change, resulting in the recognition of a gain of $3,499 million ($2,150 million after-tax).

3. Strategic Actions

Severance, Pension and Benefit Charges

During the third quarter of 2004 and the nine months ended September 30, 2004, we recorded pretax pension settlement losses of $33 million ($20 million after-tax) and $792 million ($485 million after-tax), respectively. These settlement losses related to employees that received lump-sum distributions during 2004 in connection with the previously announced voluntary separation plan under which more than 21,000 employees accepted the separation offer in the fourth quarter of 2003. These charges were recorded in accordance with SFAS No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits" which requires that settlement losses be recorded once prescribed payment thresholds have been reached.

During the third quarter of 2003, we recorded pretax pension settlement losses of $131 million ($81 million after-tax) related to employees that received lump-sum distributions during the quarter in connection with previously announced employee separations.

During the second quarter of 2003 we recorded a special charge of $463 million ($286 million after-tax) in connection with enhanced pension benefits granted to employees retiring in the first half of 2003, estimated costs associated with the July 10, 2003 Verizon New York arbitration ruling and pension settlement losses related to lump-sum pay-outs in 2003. On July 10, 2003, an arbitrator ruled that Verizon New York's termination of 2,300 employees in 2002 was not permitted under a union contract; similar cases were pending impacting an additional 1,100 employees. Verizon offered to reinstate all 3,400 impacted employees, and accordingly, recorded a charge in the second quarter of 2003 representing estimated payments to employees and other related company-paid costs.

In addition, in the second quarter of 2003 we recorded a special charge of $235 million ($150 million after-tax) primarily associated with employee severance costs and severance-related activities in connection with the voluntary separation of approximately 4,000 employees.

Other Special Items

In the second quarter of 2004, we recorded an expense credit of $204 million ($123 million after-tax) resulting from the favorable resolution of pre-bankruptcy amounts due from MCI, Inc. Previously reached settlement agreements became fully effective when MCI emerged from bankruptcy proceedings in the second quarter of 2004.

Also during the second quarter of 2004, we recorded a charge of $113 million ($87 million after-tax) related to operating asset losses pertaining to our international long distance and data network. In addition, we recorded pretax charges of $12 million ($7 million after-tax) during the second quarter in connection with the early retirement of debt. During the first quarter of 2004, we also recorded pretax charges of $43 million ($27 million after-tax) resulting from the early retirement of debt.

During the second quarter of 2003, we recorded other pretax charges of $258 million ($204 million after-tax) primarily related to a pretax impairment charge of $125 million ($125 million after-tax) pertaining to our leasing operations for airplanes leased to airlines that were experiencing financial difficulties and for power generating facilities. These second quarter 2003 charges also included pretax charges of $61 million ($38 million after-tax) pertaining to the early retirement of debt and other pretax charges of $72 million ($41 million after-tax).

4. Discontinued Operations and Sales of Businesses, Net

Verizon Information Services Canada

During the third quarter of 2004, we announced our decision to sell Verizon Information Services Canada Inc. to an affiliate of Bain Capital, a global private investment firm, for $1,540 million (Cdn. $1,985 million). The sale is expected to close in the fourth quarter of 2004. In accordance with SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets," we have classified the results of operations of Verizon Information Services Canada as discontinued operations in the unaudited condensed consolidated statements of income. In addition, the assets and liabilities of Verizon Information Services Canada are summarized and disclosed as current assets and current liabilities in the unaudited condensed consolidated balance sheets. Additional detail related to the assets and liabilities of Verizon Information Services Canada is as follows:

(Dollars in Millions)	At September 30, 2004	At December 31, 2003
Current assets	$ 112	$ 103
Plant, property and equipment, net	11	14
Other non-current assets	596	588
Total assets	$ 719	$ 705
Current liabilities	$ 82	$ 66
Other non-current liabilities	13	10
Total liabilities	$ 95	$ 76

Summarized results of operations for Verizon Information Services Canada are as follows:

(Dollars in Millions)	Three Months Ended September 30, 2004	Three Months Ended September 30, 2003	Nine Months Ended September 30, 2004	Nine Months Ended September 30, 2003
Income from operations of Verizon Information Services Canada before income taxes	$ 33	$ 15	$ 89	$ 66
Income tax provision	(16)	(10)	(41)	(30)
Income on discontinued operations, net of tax	$ 17	$ 5	$ 48	$ 36

Included in income from operations of Verizon Information Services Canada before income taxes in the preceding table are operating revenues of $83 million and $92 million for the three months ended September 30, 2004 and 2003, respectively, and $243 million and $204 million for the nine months ended September 30, 2004 and 2003, respectively.

Iusacell

Also included in discontinued operations are the results of operations of Grupo Iusacell, S.A. de C.V. (Iusacell) prior to the sale of Iusacell in July 2003. In connection with the decision to sell our interest in Iusacell and a comparison of expected net sale proceeds to the net book value of our investment in Iusacell (including the foreign currency translation balance), we recorded a pretax loss of $957 million ($931 million after-tax) in the second quarter of 2003. This loss included $317 million of goodwill. Summarized results of operations for Iusacell are as follows:

(Dollars in Millions)	Three Months Ended September 30, 2003	Nine Months Ended September 30, 2003
Income from operations of Iusacell before income taxes	$ –	$ –
Investment loss	–	(957)
Income tax benefit	–	22
Loss on discontinued operations, net of tax	$ –	$ (935)

Included in income from operations of Iusacell before income taxes in the preceding table are operating revenues of $181 million for the nine months ended September 30, 2003.

Sales of Businesses, Net

During the third quarter of 2003, we recorded a net pretax gain of $141 million primarily related to the sale of our directory publication operations in Austria, the Czech Republic, Gibraltar, Hungary, Poland and Slovakia.

5. Assets Held for Sale

During the second quarter of 2004, we announced an agreement with an affiliate of The Carlyle Group to sell our wireline-related businesses in Hawaii, including Verizon Hawaii Inc. which operates 707,000 switched access lines, as well as the services and assets of Verizon Long Distance, Verizon Online and Verizon Information Services in Hawaii, for $1,650 million in cash, less debt. The closing of the transaction, expected in early 2005, is contingent on approval from the Hawaii Public Utilities Commission. The Federal Communications Commission and the U.S. Department of Justice have provided the necessary approvals. As a result of this agreement, we have separately classified the assets held for sale and related liabilities in the unaudited condensed consolidated balance sheet at September 30, 2004. Additional detail of the assets held for sale, and related liabilities, follows:

(Dollars in Millions)	At September 30, 2004
Current assets	$ 131
Plant, property and equipment, net	798
Other non-current assets	21
Total assets	$ 950
Debt maturing within one year	$ 125
Other current liabilities	50
Long-term debt	302
Other non-current liabilities	23
Total liabilities	$ 500

6. Goodwill and Other Intangible Assets

Goodwill

Changes in the carrying amount of goodwill for the nine months ended September 30, 2004 are as follows:

(Dollars in Millions)	Domestic Telecom	Domestic Wireless	Information Services	International	Corporate & Other	Total
Balance at December 31, 2003	$ 314	$ –	$ 77	$ 444	$ –	$ 835
Goodwill reclassifications and other	–	–	–	–	–	–
Balance at September 30, 2004	$ 314	$ –	$ 77	$ 444	$ –	$ 835

Other Intangible Assets

The major components and average useful lives of our other intangible assets follows:

	At September 30, 2004		At December 31, 2003	
(Dollars in Millions)	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortized intangible assets:				
Customer lists (4 to 7 years)	$ 3,441	$ 2,715	$ 3,441	$ 2,362
Non-network internal-use software (3 to 7 years)	6,452	2,790	5,777	2,196
Other (2 to 30 years)	61	19	59	17
Total	$ 9,954	$ 5,524	$ 9,277	$ 4,575
Unamortized intangible assets:				
Wireless licenses	$ 41,092		$ 40,907	

Intangible asset amortization expense was $348 million and $1,037 million for the three and nine months ended September 30, 2004, respectively. For the three and nine months ended September 30, 2003, intangible asset amortization expense was $353 million and

$1,043 million, respectively. It is estimated to be $345 million for the remainder of 2004, $1,282 million in 2005, $850 million in 2006, $552 million in 2007 and $412 million in 2008, primarily related to customer lists and non-network internal-use software.

7. Debt

Debt Issuances/Redemptions

In March 2004, Verizon Global Funding Corp. issued $500 million of 13-month floating rate exchangeable notes at par value. The notes may be exchanged periodically into similar notes until 2011.

On May 4, 2004, we redeemed Verizon California Inc. $250 million 8.07% debentures due April 15, 2024. During the first quarter of 2004, we redeemed several debt issuances: Verizon Virginia Inc. $125 million 7% debentures due July 15, 2025; Verizon New York Inc. $250 million 7% debentures due August 15, 2025; Verizon New York Inc. $450 million 7.25% debentures due February 15, 2024; and Verizon Florida Inc. $200 million 7.41% Series B debentures due December 15, 2023.

Support Agreements and Guarantees

All of Verizon Global Funding's debt has the benefit of Support Agreements between us and Verizon Global Funding, which give holders of Verizon Global Funding debt the right to proceed directly against us for payment of interest, premium (if any) and principal outstanding should Verizon Global Funding fail to pay. The holders of Verizon Global Funding debt do not have recourse to the stock or assets of most of our telephone operations; however, they do have recourse to dividends paid to us by any of our consolidated subsidiaries as well as assets not covered by the exclusion. Verizon Global Funding's long-term debt, including current portion, aggregated $13,842 million at September 30, 2004. The carrying value of the available assets reflected in our unaudited condensed consolidated balance sheets was approximately $58.3 billion at September 30, 2004.

Verizon and NYNEX Corporation are the joint and several co-obligors of the 20-Year 9.55% debentures due 2010 previously issued by NYNEX on March 26, 1990. As of September 30, 2004, $145 million principal amount of this obligation remained outstanding. In addition, Verizon Global Funding has guaranteed the debt obligations of GTE Corporation (but not the debt of its subsidiary or affiliate companies) that were issued and outstanding prior to July 1, 2003. As of September 30, 2004, $3,594 million principal amount of these obligations remained outstanding. NYNEX and GTE no longer issue public debt or file SEC reports. See Note 12 for information on guarantees of subsidiary debt listed on the New York Stock Exchange.

Exchangeable Notes

Previously, Verizon Global Funding issued two series of notes: $2,455 million of 5.75% senior exchangeable notes due on April 1, 2003 that were exchangeable into shares of Telecom Corporation of New Zealand Limited (the 5.75% Notes) and $3,180 million of 4.25% senior exchangeable notes due on September 15, 2005 that, in connection with a restructuring of Cable & Wireless Communications plc in 2000 and the bankruptcy of NTL Incorporated (NTL) in 2002, were exchangeable into shares of Cable & Wireless plc and a combination of shares and warrants in the reorganized NTL entities (the 4.25% Notes).

On April 1, 2003, all of the outstanding $2,455 million principal amount of the 5.75% Notes were redeemed at maturity. On March 15, 2003, Verizon Global Funding redeemed all of the outstanding 4.25% Notes. The cash redemption price for the 4.25% Notes was $1,048.29 for each $1,000 principal amount of the notes. The principal amount of the 4.25% Notes outstanding, before unamortized discount, at the time of redemption, was $2,839 million.

Zero-Coupon Convertible Notes

Previously, Verizon Global Funding issued approximately $5.4 billion in principal amount at maturity of zero-coupon convertible notes due 2021 which are redeemable at the option of the holders on May 15th in each of the years 2004, 2006, 2011 and 2016. On May 15, 2004, $3,292 million of principal amount of the notes ($1,984 million after unamortized discount) were redeemed by Verizon Global Funding. As of September 30, 2004, the remaining zero-coupon convertible notes were classified as long-term since they are not redeemable at the option of the holders again until May 15, 2006.

Debt Covenants

Verizon and its consolidated subsidiaries are in compliance with all of their debt covenants.

8. Comprehensive Income

Comprehensive income consists of net income and other gains and losses affecting shareowners' investment that, under GAAP, are excluded from net income.

Changes in the components of other comprehensive income (loss) are as follows:

(Dollars in Millions)	Three Months Ended September 30, 2004	2003	Nine Months Ended September 30, 2004	2003
Net Income	$ 1,796	$ 1,791	$ 4,792	$ 4,535
Other Comprehensive Income (Loss), Net of Taxes				
Foreign currency translation adjustments	322	(38)	(67)	342
Unrealized losses on net investment hedges	(39)	–	(39)	–
Unrealized derivative gains (losses) on cash flow hedges	2	11	(15)	(16)
Unrealized gains (losses) on marketable securities	12	(17)	6	(7)
Minimum pension liability adjustment	–	–	(7)	(10)
	297	(44)	(122)	309
Total Comprehensive Income	$ 2,093	$ 1,747	$ 4,670	$ 4,844

The unrealized foreign currency translation gain for the three months ended September 30, 2004 is primarily driven by the appreciation of the functional currencies on our investments in Verizon Dominicana, C. por A. (Verizon Dominicana), Vodafone Omnitel N.V. (Vodafone Omnitel) and our Canadian operations. The unrealized foreign currency translation loss in the nine months ended September 30, 2004 is primarily driven by a decline in the functional currencies on our investments in Compañia Anónima Nacional Teléfonos de Venezuela (CANTV) and Vodafone Omnitel, partially offset by the appreciation of the Canadian dollar on our Canadian operations. The foreign currency translation gain in 2003 is primarily driven by a reclassification of the foreign currency translation loss of Iusacell of $577 million in connection with the sale of Iusacell (see Note 4) and the favorable impact of the euro on our investment in Vodafone Omnitel, partially offset by unrealized foreign currency translation losses at Verizon Dominicana and CANTV.

During the third quarter of 2004, we entered into foreign currency forward contracts to hedge our net investment in two international operations. In accordance with the provisions of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" and related amendments and interpretations, changes in the fair value of these contracts due to exchange rate fluctuations are recognized in Accumulated Other Comprehensive Loss and offset the changes in the value of our net investment in the international operations being hedged.

The components of Accumulated Other Comprehensive Loss are as follows:

(Dollars in Millions)	At September 30, 2004	At December 31, 2003
Foreign currency translation adjustments	$ (727)	$ (660)
Unrealized losses on net investment hedges	(39)	–
Unrealized derivative losses on cash flow hedges	(69)	(54)
Unrealized gains on marketable securities	30	24
Minimum pension liability adjustment	(567)	(560)
Accumulated other comprehensive loss	$ (1,372)	$ (1,250)

9. Earnings Per Share

The following table is a reconciliation of the share amounts used in computing earnings per share.

(Dollars and Shares in Millions, Except Per Share Amounts)	Three Months Ended September 30, 2004	Three Months Ended September 30, 2003	Nine Months Ended September 30, 2004	Nine Months Ended September 30, 2003
Net Income Used For Basic Earnings Per Common Share				
Income before discontinued operations and cumulative effect of accounting change	$ 1,779	$ 1,786	$ 4,744	$ 4,931
Income/(loss) on discontinued operations, net of tax	17	5	48	(899)
Cumulative effect of accounting change, net of tax	–	–	–	503
Net income	$ 1,796	$ 1,791	$ 4,792	$ 4,535
Net Income Used For Diluted Earnings Per Common Share				
Income before discontinued operations and cumulative effect of accounting change	$ 1,779	$ 1,786	$ 4,744	$ 4,931
After-tax minority interest expense related to exchangeable equity interest	7	6	20	15
Income before discontinued operations and cumulative effect of accounting change – after assumed conversion of dilutive securities	1,786	1,792	4,764	4,946
Income/(loss) on discontinued operations, net of tax	17	5	48	(899)
Cumulative effect of accounting change, net of tax	–	–	–	503
Net income after assumed conversion of dilutive securities	$ 1,803	$ 1,797	$ 4,812	$ 4,550
Basic Earnings Per Common Share[1]				
Weighted-average shares outstanding – basic	2,769	2,759	2,769	2,753
Income before discontinued operations and cumulative effect of accounting change	$ .64	$ .65	$ 1.71	$ 1.79
Income/(loss) on discontinued operations, net of tax	.01	–	.02	(.33)
Cumulative effect of accounting change, net of tax	–	–	–	.18
Net income	$ .65	$ .65	$ 1.73	$ 1.65
Diluted Earnings Per Common Share[1]				
Weighted-average shares outstanding – basic	2,769	2,759	2,769	2,753
Effect of dilutive securities:				
Stock options	5	4	5	5
Exchangeable equity interest	29	28	29	28
Weighted-average shares outstanding – diluted	2,803	2,791	2,803	2,786
Income before discontinued operations and cumulative effect of accounting change	$ .64	$ .64	$ 1.70	$ 1.78
Income/(loss) on discontinued operations, net of tax	.01	–	.02	(.32)
Cumulative effect of accounting change, net of tax	–	–	–	.18
Net income	$ .64	$ .64	$ 1.72	$ 1.63

(1) Total per share amounts may not add due to rounding.

Stock options for 252 million shares for the three months ended September 30, 2004 and 253 million shares for the nine months ended September 30, 2004 were not included in the computation of diluted earnings per share because the exercise price of the stock options was greater than the average market price of the common stock. For the three and nine months ended September 30, 2003, the

number of shares not included in the computation of diluted earnings per share were 249 million and 246 million, respectively.

10. Segment Information

We have four reportable segments, which we operate and manage as strategic business units and organize by products and services. Our segments include: Domestic Telecom – principally representing our telephone operations that provide local telephone services in 29 states and the District of Columbia, including voice and data transport, enhanced and custom calling features, network access, directory assistance, private lines and public telephones as well as long distance services, customer premises equipment distribution, data solutions and systems integration, billing and collections, Internet access services and inventory management services; Domestic Wireless – domestic wireless products and services, including wireless voice and data services and equipment sales across the United States; Information Services – representing our publishing businesses and electronic commerce services; and International – which includes our foreign wireline and wireless communications operations and investments.

We measure and evaluate our reportable segments based on segment income. This segment income excludes unallocated corporate expenses and other adjustments arising during each period. The other adjustments include transactions that the chief operating decision makers exclude in assessing business unit performance due primarily to their non-recurring and/or non-operational nature. Although such transactions are excluded from the business segment results, they are included in reported consolidated earnings. Gains and losses that are not individually significant are included in all segment results, since these items are included in the chief operating decision makers' assessment of unit performance. These gains and losses are primarily contained in Information Services and International since they actively manage investment portfolios.

The following table provides operating financial information for our four reportable segments and a reconciliation of segment results to consolidated results:

(Dollars in Millions)	Three Months Ended September 30, 2004	2003	Nine Months Ended September 30, 2004	2003
External Operating Revenues				
Domestic Telecom	$ 9,423	$ 9,651	$ 28,275	$ 29,109
Domestic Wireless	7,290	5,929	20,266	16,466
Information Services	900	939	2,725	2,897
International	486	439	1,447	1,453
Total segments	18,099	16,958	52,713	49,925
Reconciling items	107	105	307	345
Total consolidated – reported	$ 18,206	$ 17,063	$ 53,020	$ 50,270
Intersegment Revenues				
Domestic Telecom	$ 224	$ 200	$ 608	$ 588
Domestic Wireless	21	13	54	39
Information Services	–	–	–	–
International	10	7	23	19
Total segments	255	220	685	646
Reconciling items	(255)	(220)	(685)	(646)
Total consolidated – reported	$ –	$ –	$ –	$ –
Total Operating Revenues				
Domestic Telecom	$ 9,647	$ 9,851	$ 28,883	$ 29,697
Domestic Wireless	7,311	5,942	20,320	16,505
Information Services	900	939	2,725	2,897
International	496	446	1,470	1,472
Total segments	18,354	17,178	53,398	50,571
Reconciling items	(148)	(115)	(378)	(301)
Total consolidated – reported	$ 18,206	$ 17,063	$ 53,020	$ 50,270
Operating Income				
Domestic Telecom	$ 1,420	$ 1,607	$ 4,338	$ 5,633
Domestic Wireless	1,646	1,124	4,463	2,979
Information Services	424	584	1,271	1,540
International	127	–	426	225
Total segments	3,617	3,315	10,498	10,377
Reconciling items	(20)	(124)	(734)	(800)
Total consolidated – reported	$ 3,597	$ 3,191	$ 9,764	$ 9,577
Segment Income				
Domestic Telecom	$ 642	$ 703	$ 2,022	$ 2,625
Domestic Wireless	478	301	1,249	776
Information Services	252	355	766	923
International	319	471	887	1,051
Total segment income	1,691	1,830	4,924	5,375
Reconciling items	105	(39)	(132)	(840)
Total consolidated net income – reported	$ 1,796	$ 1,791	$ 4,792	$ 4,535

(Dollars in Millions)	At September 30, 2004	At December 31, 2003
Assets		
Domestic Telecom	$ 77,419	$ 82,087
Domestic Wireless	66,707	65,166
Information Services	1,747	1,726
International	12,158	11,872
Total segments	158,031	160,851
Reconciling items	4,866	5,117
Total consolidated	$ 162,897	$ 165,968

Major reconciling items between the segments and the consolidated results are as follows:

(Dollars in Millions)	Three Months Ended September 30, 2004	2003	Nine Months Ended September 30, 2004	2003
Total Operating Revenues				
Corporate, eliminations and other	$ (148)	$ (115)	$ (378)	$ (301)
	$ (148)	$ (115)	$ (378)	$ (301)
Operating Income				
Severance, pension and benefit charges (see Note 3)	$ (33)	$ (131)	$ (792)	$ (828)
Lease impairment and other special items (see Note 3)	–	–	91	(197)
Corporate and other	13	7	(33)	225
	$ (20)	$ (124)	$ (734)	$ (800)
Net Income				
Severance, pension and benefit charges (see Note 3)	$ (20)	$ (81)	$ (485)	$ (517)
Sales of investments, net	–	–	43	–
Lease impairment and other special items (see Note 3)	–	–	2	(204)
Iusacell charge (see Note 4)	–	–	–	(931)
Income from discontinued operations (see Note 4)	17	5	48	33
Cumulative effect of accounting change (see Note 2)	–	–	–	503
Corporate and other	108	37	260	276
	$ 105	$ (39)	$ (132)	$ (840)

During the first quarter of 2004, we sold all of our investment in Iowa Telecom preferred stock, which resulted in a pretax gain of $43 million ($43 million after-tax) included in Income From Other Unconsolidated Businesses in the unaudited condensed consolidated statements of income. The preferred stock was received in 2000 in connection with the sale of access lines in Iowa.

Financial information for International excludes the effects of Iusacell (see Note 4). Financial information for Information Services excludes the effects of Verizon Information Services Canada (see Note 4).

Corporate, eliminations and other includes unallocated corporate expenses, intersegment eliminations recorded in consolidation, the results of other businesses such as lease financing, and asset impairments and expenses that are not allocated in assessing segment performance due to their non-recurring nature.

We generally account for intersegment sales of products and services and asset transfers at current market prices. We are not dependent on any single customer.

11. Employee Benefits

We maintain noncontributory defined benefit pension plans for substantially all employees. In addition, we maintain postretirement health care and life insurance plans for our retirees and their dependents, which are both contributory and non-contributory and include a limit on the company's share of cost for certain recent and future retirees.

Net Periodic Cost

The following tables summarize the benefit costs related to our pension and postretirement health care and life insurance plans:

	(Dollars in Millions)			
	Pension		Health Care and Life	
Three Months Ended September 30,	2004	2003	2004	2003
Service cost	$ 197	$ 191	$ 71	$ 39
Interest cost	645	601	355	266
Expected return on plan assets	(1,053)	(1,024)	(108)	(95)
Amortization of transition asset	7	(10)	9	–
Amortization of prior service cost	17	6	55	(4)
Actuarial loss (gain), net	8	(72)	31	31
Net periodic benefit (income) cost	(179)	(308)	413	237
Termination benefits	–	–	–	–
Settlement loss	33	131	–	–
Total cost	$ (146)	$ (177)	$ 413	$ 237

	(Dollars in Millions)			
	Pension		Health Care and Life	
Nine Months Ended September 30,	2004	2003	2004	2003
Service cost	$ 536	$ 574	$ 211	$ 117
Interest cost	1,716	1,800	1,108	803
Expected return on plan assets	(2,781)	(3,067)	(309)	(287)
Amortization of transition asset	5	(30)	10	2
Amortization of prior service cost	45	17	174	(12)
Actuarial loss (gain), net	35	(254)	131	93
Net periodic benefit (income) cost	(444)	(960)	1,325	716
Termination benefits	4	319	2	3
Settlement loss	792	152	–	–
Total cost	$ 352	$ (489)	$ 1,327	$ 719

Employer Contributions

In 2004, we expect to contribute $324 million to our qualified pension trusts, including $177 million for Telecomunicaciones de Puerto Rico, Inc. (TELPRI), $108 million to our other nonqualified pension plans and $1,149 million to our other postretirement benefit plans. During the three months ended September 30, 2004, we contributed $47 million to our TELPRI plans and $130 million to our other qualified pension trusts, $21 million to our nonqualified pension plans and $312 million to our other postretirement benefit plans. During the nine months ended September 30, 2004, we contributed $140 million to our TELPRI plans and $147 million to our other qualified pension trusts, $86 million to our nonqualified pension plans and $872 million to our other postretirement benefit plans. Federal legislation on pension funding relief was enacted on April 10, 2004. The legislation provides temporary funding relief for the 2004 and 2005 plan years, principally replacing the 30-year treasury rate with a higher corporate bond rate for determining current liability. The anticipated required qualified pension trust contributions disclosed in Verizon's Annual Report on Form 10-K for the year ended December 31, 2003 continue to be accurate.

Medicare Drug Act

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (Medicare Drug Act) was signed into law. The Medicare Drug Act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. We sponsor several postretirement health care plans that provide prescription drug benefits that are deemed actuarially equivalent to the Medicare Part D and elected to recognize the impact of the federal subsidy on our accumulated postretirement benefit obligation and net postretirement benefit costs in the fourth quarter of 2003. We anticipate the recognition of the Medicare Drug Act to

decrease our accumulated postretirement benefit obligation by $1,336 million and we anticipate our net postretirement benefit cost will be reduced by approximately $155 million ($155 million after-tax) in 2004. During the three and nine months ended September 30, 2004, the Medicare Drug Act has reduced our net postretirement benefit cost by $45 million and $117 million, respectively.

Severance Benefits

During the three and nine months ended September 30, 2004, we paid severance benefits of $73 million and $1,369 million, respectively. At September 30, 2004, we had a remaining severance liability of $885 million, which includes future contractual payments to employees separated as of September 30, 2004.

12. Guarantees of Operating Subsidiary Debt

Verizon has guaranteed the following two obligations of indirect wholly owned operating subsidiaries: $480 million 7% debentures series B, due 2042 issued by Verizon New England Inc. and $300 million 7% debentures series F issued by Verizon South Inc. due 2041. These guarantees are full and unconditional and would require Verizon to make scheduled payments immediately if either of the two subsidiaries failed to do so. Both of these securities were issued in denominations of $25 and were sold primarily to retail investors and are listed on the New York Stock Exchange. SEC rules permit us to include condensed consolidating financial information for these two subsidiaries in our periodic SEC reports rather than filing separate subsidiary periodic SEC reports.

Below is the condensed consolidating financial information. Verizon New England and Verizon South are presented in separate columns. The column labeled Parent represents Verizon's investments in all of its subsidiaries under the equity method and the Other column represents all other subsidiaries of Verizon on a combined basis. The Adjustments column reflects intercompany eliminations.

Condensed Consolidating Statements of Income
Three Months Ended September 30, 2004

(Dollars in Millions)	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
Operating revenues	$ –	$ 983	$ 235	$ 17,086	$ (98)	$ 18,206
Operating expenses	20	915	178	13,594	(98)	14,609
Operating income (loss)	(20)	68	57	3,492	–	3,597
Equity in earnings of unconsolidated businesses	1,713	9	–	150	(1,648)	224
Income from other unconsolidated businesses	–	–	–	2	–	2
Other income and (expense), net	68	–	–	15	(67)	16
Interest expense	(4)	(41)	(15)	(519)	2	(577)
Minority interest	–	–	–	(682)	–	(682)
Income before provision for income taxes, discontinued operations and cumulative effect of accounting change	1,757	36	42	2,458	(1,713)	2,580
Income tax benefit (provision)	39	(10)	9	(839)	–	(801)
Income before discontinued operations and cumulative effect of accounting change	1,796	26	51	1,619	(1,713)	1,779
Income on discontinued operations, net of tax	–	–	–	17	–	17
Cumulative effect of accounting change, net of tax	–	–	–	–	–	–
Net income	$ 1,796	$ 26	$ 51	$ 1,636	$ (1,713)	$ 1,796

Condensed Consolidating Statements of Income
Nine Months Ended September 30, 2004

(Dollars in Millions)	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
Operating revenues	$ –	$ 2,957	$ 700	$ 49,624	$ (261)	$ 53,020
Operating expenses	160	2,802	534	40,021	(261)	43,256
Operating income (loss)	(160)	155	166	9,603	–	9,764
Equity in earnings of unconsolidated businesses	4,667	46	–	500	(4,578)	635
Income from other unconsolidated businesses	–	–	–	74	–	74
Other income and (expense), net	97	8	2	(32)	(95)	(20)
Interest expense	(14)	(123)	(47)	(1,631)	6	(1,809)
Minority interest	–	–	–	(1,835)	–	(1,835)
Income before provision for income taxes, discontinued operations and cumulative effect of accounting change	4,590	86	121	6,679	(4,667)	6,809
Income tax benefit (provision)	202	(8)	(21)	(2,238)	–	(2,065)
Income before discontinued operations and cumulative effect of accounting change	4,792	78	100	4,441	(4,667)	4,744
Income on discontinued operations, net of tax	–	–	–	48	–	48
Cumulative effect of accounting change, net of tax	–	–	–	–	–	–
Net income	$ 4,792	$ 78	$ 100	$ 4,489	$ (4,667)	$ 4,792

Condensed Consolidating Statements of Income
Three Months Ended September 30, 2003

(Dollars in Millions)	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
Operating revenues	$ –	$ 1,021	$ 236	$ 15,876	$ (70)	$ 17,063
Operating expenses	21	914	186	12,821	(70)	13,872
Operating income (loss)	(21)	107	50	3,055	–	3,191
Equity in earnings of unconsolidated businesses	1,746	8	–	342	(1,738)	358
Income from other unconsolidated businesses	–	–	–	80	–	80
Other income and (expense), net	10	–	(2)	9	(7)	10
Interest expense	(21)	(37)	(12)	(614)	(1)	(685)
Minority interest	–	–	–	(410)	–	(410)
Income before provision for income taxes, discontinued operations and cumulative effect of accounting change	1,714	78	36	2,462	(1,746)	2,544
Income tax benefit (provision)	77	(28)	(14)	(793)	–	(758)
Income before discontinued operations and cumulative effect of accounting change	1,791	50	22	1,669	(1,746)	1,786
Income on discontinued operations, net of tax	–	–	–	5	–	5
Cumulative effect of accounting change, net of tax	–	–	–	–	–	–
Net income	$ 1,791	$ 50	$ 22	$ 1,674	$ (1,746)	$ 1,791

Condensed Consolidating Statements of Income
Nine Months Ended September 30, 2003

(Dollars in Millions)	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
Operating revenues	$ –	$ 3,100	$ 710	$ 46,669	$ (209)	$ 50,270
Operating expenses	6	2,730	561	37,605	(209)	40,693
Operating income (loss)	(6)	370	149	9,064	–	9,577
Equity in earnings (loss) of unconsolidated businesses	4,307	(32)	–	693	(4,295)	673
Income (loss) from other unconsolidated businesses	(10)	–	–	169	–	159
Other income and (expense), net	59	(3)	1	(13)	(22)	22
Interest expense	(43)	(120)	(47)	(1,932)	10	(2,132)
Minority interest	–	–	–	(1,132)	–	(1,132)
Income before provision for income taxes, discontinued operations and cumulative effect of accounting change	4,307	215	103	6,849	(4,307)	7,167
Income tax benefit (provision)	228	(98)	(40)	(2,326)	–	(2,236)
Income before discontinued operations and cumulative effect of accounting change	4,535	117	63	4,523	(4,307)	4,931
Loss on discontinued operations, net of tax	–	–	–	(899)	–	(899)
Cumulative effect of accounting change, net of tax	–	369	47	87	–	503
Net income	$ 4,535	$ 486	$ 110	$ 3,711	$ (4,307)	$ 4,535

Condensed Consolidating Balance Sheets
At September 30, 2004

(Dollars in Millions)	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
Cash	$ –	$ –	$ –	$ 616	$ –	$ 616
Short-term investments	–	46	9	931	–	986
Accounts receivable, net	1	963	153	9,765	(963)	9,919
Other current assets	7,163	207	167	5,984	(7,301)	6,220
Total current assets	7,164	1,216	329	17,296	(8,264)	17,741
Plant, property and equipment, net	1	6,480	1,217	65,788	–	73,486
Investments in unconsolidated businesses	30,246	116	–	9,124	(33,497)	5,989
Other assets	359	498	374	64,680	(230)	65,681
Total assets	$ 37,770	$ 8,310	$ 1,920	$ 156,888	$ (41,991)	$ 162,897
Debt maturing within one year	$ 31	$ 123	$ –	$ 10,397	$ (7,280)	$ 3,271
Other current liabilities	2,386	1,270	183	16,998	(984)	19,853
Total current liabilities	2,417	1,393	183	27,395	(8,264)	23,124
Long-term debt	114	2,971	900	33,497	(230)	37,252
Employee benefit obligations	63	1,788	230	15,023	–	17,104
Deferred income taxes	–	575	237	21,317	–	22,129
Other liabilities	2	238	38	3,248	–	3,526
Minority interest	–	–	–	24,588	–	24,588
Total shareowners' investment	35,174	1,345	332	31,820	(33,497)	35,174
Total liabilities and shareowners' investment	$ 37,770	$ 8,310	$ 1,920	$ 156,888	$ (41,991)	$ 162,897

Condensed Consolidating Balance Sheets
At December 31, 2003

(Dollars in Millions)	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
Cash	$ –	$ –	$ –	$ 669	$ –	$ 669
Short-term investments	–	200	40	1,932	–	2,172
Accounts receivable, net	3	1,117	162	10,373	(1,801)	9,854
Other current assets	5,201	380	192	5,756	(5,329)	6,200
Total current assets	5,204	1,697	394	18,730	(7,130)	18,895
Plant, property and equipment, net	1	6,751	1,280	67,270	–	75,302
Investments in unconsolidated businesses	30,869	117	–	6,354	(31,551)	5,789
Other assets	152	610	385	64,845	(10)	65,982
Total assets	$ 36,226	$ 9,175	$ 2,059	$ 157,199	$ (38,691)	$ 165,968
Debt maturing within one year	$ 30	$ 513	$ –	$ 11,125	$ (5,701)	$ 5,967
Other current liabilities	2,484	1,739	301	17,518	(1,429)	20,613
Total current liabilities	2,514	2,252	301	28,643	(7,130)	26,580
Long-term debt	145	2,749	900	35,629	(10)	39,413
Employee benefit obligations	99	1,787	216	14,652	–	16,754
Deferred income taxes	–	602	238	20,864	–	21,704
Other liabilities	2	235	39	3,427	–	3,703
Minority interest	–	–	–	24,348	–	24,348
Total shareowners' investment	33,466	1,550	365	29,636	(31,551)	33,466
Total liabilities and shareowners' investment	$ 36,226	$ 9,175	$ 2,059	$ 157,199	$ (38,691)	$ 165,968

Condensed Consolidating Statements of Cash Flows
Nine Months Ended September 30, 2004

(Dollars in Millions)	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
Net cash from operating activities	$ 5,071	$ 734	$ 191	$ 14,403	$ (4,905)	$ 15,494
Net cash from investing activities	–	(284)	(58)	(7,476)	(7)	(7,825)
Net cash from financing activities	(5,071)	(450)	(133)	(6,980)	4,912	(7,722)
Net decrease in cash	$ –	$ –	$ –	$ (53)	$ –	$ (53)

Condensed Consolidating Statements of Cash Flows
Nine Months Ended September 30, 2003

(Dollars in Millions)	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
Net cash from operating activities	$ 7,442	$ 995	$ 209	$ 14,383	$ (6,773)	$ 16,256
Net cash from investing activities	–	(255)	(169)	(6,648)	162	(6,910)
Net cash from financing activities	(7,442)	(740)	(40)	(8,428)	6,611	(10,039)
Net decrease in cash	$ –	$ –	$ –	$ (693)	$ –	$ (693)

13. Recent Accounting Pronouncements

Impairment Testing of Domestic Wireless Licenses

On September 29, 2004, the staff of the SEC issued a Staff Announcement, "Use of the Residual Method to Value Acquired Assets Other Than Goodwill." The Staff Announcement requires SEC registrants to adopt a direct value method of assigning value to

intangible assets acquired in a business combination under SFAS No. 141, "Business Combinations," effective for all acquisitions completed after September 29, 2004. Further, all intangible assets valued under the residual method prior to this adoption are required to be tested for impairment using a direct value method no later than the beginning of 2005. Any impairment of intangible assets recognized upon application of a

direct value method by entities previously applying the residual method should be reported as a cumulative effect of a change in accounting principle. Under this Staff Announcement, the reclassification of recorded balances between goodwill and intangible assets prior to the adoption of this Staff Announcement is prohibited. Verizon is currently evaluating the provisions of this Staff Announcement to determine the impact of adopting a direct value method, if any, on its results of operations and financial position.

Contingently Convertible Debt

In September 2004, the Emerging Issues Task Force (EITF) of the Financial Accounting Standards Board reached a conclusion in EITF Issue No. 04-8 pertaining to including contingently convertible debt in fully diluted earnings per share. Verizon's zero-coupon convertible notes, which are convertible into Verizon common stock, will be included in current and prior periods' fully diluted earnings per share calculation. Verizon anticipates the impact of adopting EITF Issue No. 04-8, effective year-end 2004, will be a reduction of earnings per diluted share of approximately 2 cents in prior years and 1 cent in 2004 and future years.

14. Commitments and Contingencies

Several state and federal regulatory proceedings may require our telephone operations to pay penalties or to refund to customers a portion of the revenues collected in the current and prior periods. There are also various legal actions 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 actions, 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, including the Hicksville matters described below, will have a material effect on our financial condition, but it could have a material effect on our results of operations.

During 2003, under a government-approved plan, remediation at the site of a former facility in Hicksville, New York that processed nuclear fuel rods in the 1950s and 1960s commenced. Remediation beyond original expectations proved to be necessary and a reassessment of the anticipated remediation costs was conducted. In addition, a reassessment of costs related to remediation efforts at several other former facilities was undertaken. As a result, an additional environmental remediation expense of $240 million was recorded in the fourth quarter of 2003. We expect overall remediation efforts, including soil and ground water remediation and property costs, to take place over the next several years, and our cost estimates may be revised as remediation continues.

There are also litigation matters associated with the Hicksville site primarily involving personal injury claims in connection with alleged emissions arising from operations in the 1950s and 1960s at the Hicksville site. These matters are pending before the court.

Under the terms of an investment agreement, Vodafone Group Plc (Vodafone) may require Verizon Wireless to purchase up to an aggregate of $20 billion worth of Vodafone's interest in Verizon Wireless at designated times at its then fair market value. In the event Vodafone exercises its put rights, we have the right, exercisable at our sole discretion, to purchase up to $12.5 billion of Vodafone's interest instead of Verizon Wireless for cash or Verizon stock at our option. Vodafone had the right to require the purchase of up to $10 billion during a 61-day period opening on June 10 and closing on August 9 in 2004, and did not exercise that right. As a result, Vodafone still has the right to require the purchase of up to $20 billion worth of its interest, not to exceed $10 billion in any one year, during a 61-day period opening on June 10 and closing on August 9 in 2005 through 2007. Vodafone also may require that Verizon Wireless pay for up to $7.5 billion of the required repurchase through the assumption or incurrence of debt.

15. Subsequent Events

On November 4, 2004, we announced the signing of a definitive agreement with NextWave Telecom Inc. (NextWave) to purchase all of NextWave's remaining personal communications services spectrum licenses in 23 markets for $3,000 million. The 10 MHz and 20 MHz licenses, in the 1.9 GHz personal communications services frequency range, cover a population of 73 million people and will be used to expand Verizon Wireless's network capacity in 22 key existing markets, including New York, Boston, Washington, D.C. and Los Angeles, as well as to expand into Tulsa, Oklahoma. The transaction is subject to approval by the U.S. Bankruptcy Court and the FCC as well as antitrust regulatory review and is expected to close by mid-2005.

We announced on July 8, 2004 that we had won an auction for a spectrum license covering the New York metropolitan area held by NextWave. The transaction closed on October 29, 2004. Under the terms of the purchase agreement, we paid $930 million for the license, $186 million of which was paid as a deposit in the third quarter of 2004.

Item 2. Management's Discussion and Analysis of Results of Operations and Financial Condition

Overview

Verizon Communications is one of the world's leading providers of communications services. Verizon companies operate in four strategic business units: Domestic Telecom, which provides wireline telecommunications services in 29 states and the District of Columbia, long distance across the United States and other communications services; Domestic Wireless, a leading nationwide wireless voice and data service provider with more than 42 million customers; Information Services, which operates directory publishing businesses and provides electronic commerce services; and International, which includes wireline and wireless communications operations and investments, primarily in the Americas and Europe. Stressing diversity and commitment to the communities in which we operate, Verizon has a highly diverse workforce of approximately 208,000 employees.

The sections that follow provide information about the important aspects of our operations and investments, both at the consolidated and segment levels, and include discussions of our results of operations, financial position and sources and uses of cash. In addition, we have highlighted key trends and uncertainties to the extent practicable. The content and organization of the financial and non-financial data presented in these sections are consistent with information used by our chief operating decision makers for, among other purposes, evaluating performance and allocating resources. We also monitor several key economic indicators as well as the state of the economy in general, primarily in the United States where the majority of our operations are located, in evaluating our operating results and analyzing and understanding business trends. While most key economic indicators, including gross domestic product, impact our operations to some degree, we have noted higher correlations to housing starts, non-farm employment, personal consumption expenditures and capital spending, as well as more general economic indicators such as inflation and unemployment rates.

Our results of operations, financial position and sources and uses of cash in the current and future periods reflect Verizon management's focus on the following four key areas:

Revenue Growth – Our emphasis is on revenue transformation, devoting more resources from traditional services, where we have been experiencing access line losses, to the higher growth markets such as wireless, digital subscriber lines (DSL), long distance and other data services as well as expanded services to enterprise markets. In the third quarter of 2004, revenues from these growth areas increased by 21% compared to the third quarter of 2003 and represent 55% of our total revenues, up from 49% of total revenues in the third quarter of 2003. Verizon reported consolidated revenue growth of 6.7% in the third quarter of 2004 compared to the third quarter of 2003, led by 23.0% higher revenue at Domestic Wireless. Verizon added 1.7 million wireless customers, 309,000 DSL lines, 525,000 long distance lines and more than 700 Enterprise Advance sales in the third quarter of 2004.

Operational Efficiency – While focusing resources on growth markets, we are continually challenging our management team to lower expenses, particularly through technology-assisted productivity improvements. The effect of these and other efforts, such as 2003's labor agreements and voluntary separation plans, has been to significantly change the company's cost structure. Verizon now has significantly lower workforce levels, which will provide ongoing expense benefits. Domestic Telecom's salary and wage expenses declined by more than $200 million in the current quarter compared to the third quarter of 2003 as a result of last year's voluntary separation plans.

Capital Allocation – Capital spending has been, and will continue to be directed toward growth markets. High-speed wireless data (EV-DO), replacement of copper lines with fiber optics to the home, as well as voice over the Internet (VoIP) and expanded services to enterprise markets are examples of areas of capital spending in support of these growth markets.

Cash Flow Generation – The financial statements reflect the emphasis of management on not only directing resources to growth markets, but also using cash provided by our operating and investing activities for the repayment of debt in addition to providing a stable dividend to our shareowners.

Supporting these key focus areas are continuing initiatives to more effectively package and add more value to our products and services. At Domestic Telecom, earlier this year we introduced VoiceWing, Verizon's nationwide VoIP service that allows customers with DSL or cable-modem broadband service to make telephone calls and utilize advanced service features through an Internet connection rather than the traditional telephone network. In addition, Verizon announced a deployment expansion of FiOS, its fiber optics to the home product, to parts of six states:

Delaware, Maryland, Massachusetts, New York, Pennsylvania and Virginia. Verizon is on target to pass one million homes and businesses in nine states with fiber optic technology by the end of this year and begin marketing video services on the FiOS network in 2005. In 2004, we have also begun expanding our bundles to include video in the retail bundle through an agreement with DIRECTV and have added iobi call management services. Innovative product bundles include local wireline services, long distance, wireless and DSL for consumer and general business retail customers. In our enterprise markets, we are expanding our presence having completed the build-out of our nationwide network and by expanding our portfolio of advanced data services. These efforts will also help counter the effects of competition and technology substitution that have resulted in access line losses that have contributed to declining Domestic Telecom revenues over the past several years.

At Domestic Wireless, we will continue to execute on the fundamentals of our network superiority and value proposition to deliver growth for the business. In addition, we have expanded the areas where we are offering BroadbandAccess, our EV-DO service, to currently include 14 major metropolitan areas and 24 airports. Among other cities, BroadbandAccess is now available in New York City, Los Angeles, Atlanta, Baltimore, Philadelphia and Miami.

Consolidated Results of Operations

In this section, we discuss our overall results of operations and highlight special and non-recurring items. In the following section, we review the performance of our four reportable segments. We exclude the effects of the special and non-recurring items from the segments' results of operations since management does not consider them in assessing segment performance, due primarily to their non-recurring and/or non-operational nature. We believe that this presentation will assist readers in better understanding our results of operations and trends from period to period. This section on consolidated results of operations carries forward the segment results, which exclude the special and non-recurring items, and highlights and describes those items separately to ensure consistency of presentation in this section and the "Segment Results of Operations" section.

Consolidated Revenues

(Dollars in Millions)	Three Months Ended September 30, 2004	2003	% Change	Nine Months Ended September 30, 2004	2003	% Change
Domestic Telecom	$ 9,647	$ 9,851	(2.1)%	$ 28,883	$ 29,697	(2.7)%
Domestic Wireless	7,311	5,942	23.0	20,320	16,505	23.1
Information Services	900	939	(4.2)	2,725	2,897	(5.9)
International	496	446	11.2	1,470	1,472	(.1)
Corporate & Other	(148)	(115)	28.7	(378)	(301)	25.6
Consolidated Revenues	$ 18,206	$ 17,063	6.7	$ 53,020	$ 50,270	5.5

Consolidated revenues in the third quarter of 2004 were higher by $1,143 million, or 6.7% and $2,750 million, or 5.5% for the nine months ended September 30, 2004 compared to the similar periods in 2003. These increases were primarily the result of significantly higher revenues at Domestic Wireless, partially offset by lower revenues at Domestic Telecom.

Domestic Wireless's revenues increased by $1,369 million, or 23.0% in the third quarter of 2004 and $3,815 million, or 23.1% for the nine months ended September 30, 2004 compared to the similar periods in 2003. These increases were primarily due to a 16.9% increase in customers as of September 30, 2004 compared to September 30, 2003 as well as an increase in average service revenue per customer (ARPU). ARPU increased by 3.1% to $51.58 in the third quarter of 2004 and by 2.7% to $50.18 for the nine months ended September 30, 2004 compared to the similar periods in 2003, primarily due to higher access price plan offerings as well as an increase in data revenues per customer, partially offset by decreased roaming revenue due to bundled pricing. Increases in handsets sold and increased equipment upgrades also drove increases in equipment and other revenue in the 2004 periods.

Revenues at Domestic Telecom declined during the third quarter of 2004 by $204 million, or 2.1% and $814 million, or 2.7% for the nine months ended September 30, 2004 compared to the similar periods in 2003 primarily due to lower revenues from local and network access services, partially offset by higher long distance revenues. The local service revenue declines of $197 million in the third quarter of 2004 and $664 million for the nine months ended September 30, 2004 compared to the similar periods in 2003 were mainly due to lower demand and usage of our basic local exchange and accompanying services, as reflected by a 4.4% decline in switched access lines in service from September 30, 2003, driven by the effects of competition, regulatory pricing rules for unbundled network

elements (UNEs) and technology substitution. Network access services revenues declined by $67 million in the third quarter of 2004 and by $475 million for the nine months ended September 30, 2004 compared to the similar periods in 2003 principally due to decreasing switched minutes of use (MOUs) and access lines, as well as mandated price reductions associated with federal and state price cap filings and other regulatory decisions, partially offset by higher customer demand for high capacity and digital data services. Long distance service revenues increased $87 million in the third quarter of 2004 and $336 million for the nine months ended September 30, 2004 compared to the similar periods in 2003, principally as a result of customer growth from our interLATA long distance services. We added 525,000 long distance lines in the third quarter of 2004 and 1,995,000 long distance lines in the nine months ended September 30, 2004, for a total of 17.3 million long distance lines nationwide, representing a 16.6% increase in long distance lines from September 30, 2003.

Consolidated Operating Expenses

(Dollars in Millions)	Three Months Ended September 30, 2004	2003	% Change	Nine Months Ended September 30, 2004	2003	% Change
Cost of services and sales	$ 5,994	$ 5,706	5.0%	$ 17,104	$ 15,849	7.9%
Selling, general and administrative expense	5,132	4,891	4.9	15,807	14,823	6.6
Depreciation and amortization expense	3,483	3,416	2.0	10,345	10,162	1.8
Sales of businesses, net	–	(141)	(100.0)	–	(141)	(100.0)
Total Operating Expenses	$ 14,609	$ 13,872	5.3	$ 43,256	$ 40,693	6.3

Cost of Services and Sales

Consolidated cost of services and sales in the third quarter of 2004 were higher by $288 million, or 5.0% and $1,255 million, or 7.9% for the nine months ended September 30, 2004 compared to the similar periods in 2003. These increases were driven by increases in pension and other postretirement benefit costs and higher costs associated with our growth businesses, including wireless, long distance and DSL.

As of December 31, 2003, we changed key employee benefit plan assumptions in response to conditions in the securities markets. In addition, as a result of extending and increasing limits (caps) on company payments toward retiree health care costs in connection with the union contracts ratified in the fourth quarter of 2003, we began recording health care costs as if there were no caps in the fourth quarter of 2003 relative to these union contracts. The impact of these assumption changes and lower than expected actual asset returns resulted in net pension and other postretirement benefit expense (primarily in cost of services and sales) of $185 million in the third quarter of 2004 and $727 million for the nine months ended September 30, 2004 compared to pension income, net of other postretirement benefit expense of $83 million and $233 million in the third quarter and nine months ended September 30, 2003, respectively.

Higher costs were also driven by our growth businesses including wireless, long distance and DSL. Increases in wireless customers and higher usage per customer increased MOUs on the wireless network and resulted in higher wireless network costs in the current year periods. Cost of wireless handsets and other equipment sales were 30.8% higher in the third quarter of 2004 and 25.3% higher for the nine months ended September 30, 2004 compared to similar periods in 2003, driven by an increase in handsets sold, due to higher gross activations and an increase in equipment upgrades. In addition, year-to-date comparisons were affected by the prior year reduction in operating expenses of $122 million for insurance recoveries related to the terrorist attacks on September 11, 2001.

These cost increases were partially offset in both 2004 periods by the effect of work force reductions of approximately 11,700 employees, or 5.3% over the past year, principally in connection with a voluntary separation plan announced in the fourth quarter of 2003, and lower Domestic Wireless roaming, local interconnection and long distance rates. In addition, both 2004 periods were impacted by lower interconnection expense and the effect of prior year contingency costs in connection with labor negotiations and other costs in 2003 at Domestic Telecom.

Selling, General and Administrative Expense

Consolidated selling, general and administrative expense in the third quarter of 2004 was $241 million, or 4.9% higher and $984 million, or 6.6% higher for the nine months ended September 30, 2004 compared to the similar periods in 2003. During the third quarter of 2004, special charges declined by $98 million, partially offset by higher costs at Domestic Wireless and Domestic Telecom compared to the third quarter of 2003. For the nine months ended September 30, 2004, higher costs at Domestic Wireless, Domestic Telecom and corporate were partially offset by a $324 million decline in special charges compared to the similar period in 2003.

Higher selling, general and administrative expense at Domestic Wireless and Domestic Telecom in the quarter and nine months ended September 30, 2004, and corporate expense in the nine months ended September 30, 2004, was driven by increases in salary and benefits expense as a result of an increase in the number of employees, principally in the customer care and sales functions, and higher sales commissions related to the increase in gross customer additions and customer renewals in the current year periods at Domestic Wireless and increases in pension and benefits expenses. Also contributing to the increases were higher advertising and promotion expenses and professional and general costs. These cost increases were partially offset in both periods by the effect of work force reductions and in the quarterly period by lower property and gross receipts taxes.

Special charges recorded during the third quarter of 2004 and the nine months ended September 30, 2004 included $33 million and $792 million, respectively, related to pension settlement losses incurred in connection with the voluntary separation of approximately 21,000 employees in the fourth quarter of 2003 who received lump-sum distributions during the current year periods. During the third quarter of 2003 and nine months ended September 30, 2003 we recorded special charges of $131 million and $828 million, respectively, in connection with enhanced pension benefits granted to employees retiring in the first half of 2003, estimated costs associated with the July 10, 2003 Verizon New York arbitration ruling, pension settlement losses related to lump-sum pay-outs in 2003 and employee severance costs and severance-related activities in connection with the voluntary separation of approximately 4,000 employees.

Special charges in the nine months ended September 30, 2004 also include an expense credit of $204 million resulting from the favorable resolution of pre-bankruptcy amounts due from MCI, Inc., partially offset by a charge of $113 million related to operating asset losses. During the nine months ended September 30, 2003, we recorded other pretax charges of $197 million related to our leasing operations and other charges.

Depreciation and Amortization Expense

Consolidated depreciation and amortization expense in the third quarter of 2004 was higher by $67 million, or 2.0% and $183 million, or 1.8% for the nine months ended September 30, 2004 compared to the similar periods in 2003. These increases were primarily due to increased depreciation expense related to the increase in depreciable assets, partially offset by lower Domestic Telecom depreciation rates.

Sales of Businesses, Net

During the third quarter of 2003, we recorded a net pretax gain of $141 million primarily related to the sale of our directory publication operations in Austria, the Czech Republic, Gibraltar, Hungary, Poland and Slovakia.

Other Consolidated Results

Equity in Earnings of Unconsolidated Businesses

Equity in earnings of unconsolidated businesses decreased by $134 million, or 37.4% in the third quarter of 2004 and $38 million, or 5.6% for the nine months ended September 30, 2004 compared to the similar periods in 2003. These decreases primarily resulted from additional Italian tax benefits in 2003 from a reorganization at our Italian investment, Vodafone Omnitel N.V. (Vodafone Omnitel), partially offset by favorable foreign currency impacts from the euro on that investment and continued operational growth.

Income From Other Unconsolidated Businesses

Income from other unconsolidated businesses decreased by $78 million, or 97.5% in the third quarter of 2004 and $85 million, or 53.5% in the nine months ended September 30, 2004 compared to the similar periods in 2003. The decrease in the third quarter of 2004 compared to the similar period of 2003 was primarily due to the sales of shares of investments, including Taiwan Cellular Corporation (TCC) and TelecomAsia Corporation Public Company Limited (TelecomAsia) in the 2003 period. The decrease for the first nine months of 2004 was primarily driven by the sales of shares of investments in the 2003 period, partially offset by a pretax gain of $43 million recorded in connection with the sale of our investment in Iowa Telecom preferred stock and TCC share sales in the first quarter of 2004.

Other Income and (Expense), Net

(Dollars in Millions)	Three Months Ended September 30, 2004	2003	% Change	Nine Months Ended September 30, 2004	2003	% Change
Interest income	$ 18	$ 11	63.6%	$ 86	$ 77	11.7%
Foreign exchange gains (losses), net	17	3	nm	(20)	(5)	nm
Other, net	(19)	(4)	nm	(86)	(50)	72.0
Total	$ 16	$ 10	60.0	$ (20)	$ 22	nm

nm – Not meaningful

The change in other income and expense, net for the third quarter of 2004 compared to the similar period in 2003 was primarily driven by favorable changes in foreign exchange rates and higher interest income. For the nine months ended September 30, 2004, we recorded increased foreign exchange losses and higher other, net expenses. Other, net in the nine months ended September 30, 2004 and 2003 includes expenses of $55 million and $61 million, respectively, related to the early retirement of debt.

Interest Expense

(Dollars in Millions)	Three Months Ended September 30, 2004	2003	% Change	Nine Months Ended September 30, 2004	2003	% Change
Interest expense	$ 577	$ 685	(15.8)%	$ 1,809	$ 2,132	(15.2)%
Capitalized interest costs	40	29	37.9	115	97	18.6
Total interest costs on debt balances	$ 617	$ 714	(13.6)	$ 1,924	$ 2,229	(13.7)
Average debt outstanding	$ 41,190	$ 47,148	(12.6)	$ 43,385	$ 50,233	(13.6)
Effective interest rate	6.0%	6.1%		5.9%	5.9%	

The decreases in interest expense costs for the third quarter of 2004 and nine months ended September 30, 2004 were primarily due to lower average debt levels by $5,958 million and $6,848 million, respectively, compared to the similar periods in 2003.

Minority Interest

(Dollars in Millions)	Three Months Ended September 30, 2004	2003	% Change	Nine Months Ended September 30, 2004	2003	% Change
Minority interest	$ 682	$ 410	66.3%	$ 1,835	$ 1,132	62.1%

The increases in minority interest expense for the third quarter of 2004 and nine months ended September 30, 2004 compared to the similar periods in 2003 were primarily due to higher earnings at Verizon Wireless, which has a significant minority interest attributable to Vodafone Group Plc (Vodafone) and higher earnings at Telecomunicaciones de Puerto Rico, Inc. (TELPRI).

Provision for Income Taxes

(Dollars in Millions)	Three Months Ended September 30, 2004	2003	% Change	Nine Months Ended September 30, 2004	2003	% Change
Provision for income taxes	$ 801	$ 758	5.7%	$ 2,065	$ 2,236	(7.6)%
Effective income tax rate	31.0%	29.8%		30.3%	31.2%	

The effective income tax rate is the provision for income taxes as a percentage of income from continuing operations before the provision for income taxes. Our effective income tax rate for the third quarter of 2004 was higher than the third quarter of 2003 due to lower foreign-related tax benefits, particularly associated with equity income from our investment in Vodafone Omnitel, and higher state taxes. Our effective income tax rate for the nine months ended September 30, 2004 was lower than the similar period in 2003 due to tax benefits related to deferred tax balance adjustments and expense credits that are not taxable. In addition, we recorded a tax benefit resulting from an Internal Revenue Service audit settlement in the nine months ended September 30, 2004. Our effective income tax rate for the nine months ended September 30, 2003 was favorably impacted by tax benefits resulting from the reversal of a valuation allowance relating to investments.

Discontinued Operations

Discontinued operations represent the results of operations of Verizon Information Services Canada Inc. for all periods presented in the unaudited condensed consolidated statements of income and Grupo Iusacell, S.A. de C.V. (Iusacell) prior to the sale of Iusacell in July 2003. During the third quarter of 2004, we announced our decision to sell Verizon Information Services Canada and, in accordance with Statement of Financial Accounting Standards (SFAS) No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets," we have classified the results of operations of Verizon Information Services Canada as discontinued operations. In connection with our decision to sell our interest in Iusacell and a comparison of expected net sale proceeds to the net book value of our investment in Iusacell (including the foreign currency translation balance), we recorded a pretax loss of $957 million ($931 million after-tax, or $.33 per diluted share) in the second quarter of 2003.

Cumulative Effect of Accounting Change

Directory Accounting Change

During 2003, we changed our method for recognizing revenues and expenses in our directory business from the publication-date method to the amortization method. The publication-date method recognizes revenues and direct expenses when directories are published. Under the amortization method, revenues and direct expenses, primarily printing and distribution costs, are recognized over the life of the directory, which is usually 12 months. This accounting change affected the timing of the recognition of revenues and expenses. As required by generally accepted accounting principles, the directory accounting change was recorded effective January 1, 2003. The cumulative effect of the accounting change was a one-time charge of $2,697 million ($1,647 million after-tax, or $.59 per diluted share).

Impact of SFAS No. 143

We adopted the provisions of SFAS No. 143, "Accounting for Asset Retirement Obligations" on January 1, 2003. SFAS No. 143 requires that companies recognize the fair value of a liability for asset retirement obligations in the period in which the obligations are incurred and capitalize that amount as part of the book value of the long-lived asset. We determined that Verizon does not have a material legal obligation to remove long-lived assets as described by this statement. However, prior to the adoption of SFAS No. 143, we included estimated removal costs in our group depreciation models. Consequently, in connection with the initial adoption of SFAS No. 143 we reversed accrued costs of removal in excess of salvage from our accumulated depreciation accounts for these assets. The adjustment was recorded as a cumulative effect of an accounting change, resulting in the recognition of a gain of $3,499 million ($2,150 million after-tax, or $.77 per diluted share).

Segment Results of Operations

We have four reportable segments, which we operate and manage as strategic business units and organize by products and services. Our segments are Domestic Telecom, Domestic Wireless, Information Services and International. Additional information about our segments can be found in Note 10 to the unaudited condensed consolidated financial statements.

We measure and evaluate our reportable segments based on segment income. This segment income excludes unallocated corporate expenses and other adjustments arising during each period. The other adjustments include transactions that the chief operating decision makers exclude in assessing business unit performance due primarily to their non-recurring and/or non-operational nature. Although such transactions are excluded from business segment results, they are included in reported consolidated earnings. We previously highlighted the more significant of these transactions in the "Consolidated Results of Operations" section. Gains and losses that are not individually significant are included in all segment results, since these items are included in the chief operating decision makers' assessment of unit performance. These gains and losses are primarily contained in Information Services and International since they actively manage investment portfolios.

Domestic Telecom

Domestic Telecom provides local telephone services, including voice and data transport, enhanced and custom calling features, network access, directory assistance, private lines and public telephones in 29 states and the District of Columbia. This segment also provides long distance services, customer premises equipment distribution, data solutions and systems integration, billing and collections, Internet access services and inventory management services.

Operating Revenues

(Dollars in Millions)	Three Months Ended September 30, 2004	2003	% Change	Nine Months Ended September 30, 2004	2003	% Change
Local services	$ 4,629	$ 4,826	(4.1)%	$ 13,965	$ 14,629	(4.5)%
Network access services	3,026	3,093	(2.2)	9,171	9,646	(4.9)
Long distance services	1,087	1,000	8.7	3,118	2,782	12.1
Other services	905	932	(2.9)	2,629	2,640	(.4)
	$ 9,647	$ 9,851	(2.1)	$ 28,883	$ 29,697	(2.7)

Local Services

Local service revenues are earned by our telephone operations from the provision of local exchange, local private line, wire maintenance, voice messaging and value-added services. Value-added services are a family of services that expand the utilization of the network, including products such as Caller ID, Call Waiting and Return Call. The provision of local exchange services not only includes retail revenues but also includes local wholesale revenues from UNEs, interconnection revenues from competitive local exchange carriers (CLECs) and wireless carriers, and some data transport revenues.

The local service revenue declines of $197 million, or 4.1% in the third quarter of 2004 and $664 million, or 4.5% for the nine months ended September 30, 2004 compared to the similar periods in 2003 were mainly due to lower demand and usage of our basic local exchange and accompanying services, as reflected by a 4.4% decline in switched access lines in service from September 30, 2003. This revenue decline was mainly driven by the effects of competition, regulatory pricing rules for UNEs and technology substitution. Regulatory pricing rules for UNEs, which mandate lower prices for other carriers that use our facilities to provide local exchange services, are putting downward pressure on our revenues by shifting the mix of access lines from retail to wholesale. We added 105,000 UNE platform lines in the third quarter of 2004 and 1,038,000 in the nine months ended September 30, 2004, bringing total UNE platform provisioned lines to 6.1 million at September 30, 2004 compared to 4.6 million at September 30, 2003. The reduced consumer marketing presence of our large competitors has resulted in less lines lost to UNE platforms, compared to prior periods. Technology substitution also affected local service revenue growth in the quarter and nine month periods, as indicated by declining demand for residential access lines of 4.8% at September 30, 2004 compared to September 30, 2003, as more customers substituted wireless services, broadband and other competitive alternatives for traditional landline services. At the same time, basic business access lines have declined 3.6% at September 30, 2004 compared to September 30, 2003, primarily reflecting competition and a shift to high-speed, high-volume special access lines.

We continue to seek opportunities to retain and win-back customers. Our Freedom service plans offer local services with various combinations of long distance, wireless and Internet access services in a discounted bundle available on one bill. Since January 2003, we have introduced our Freedom service plans in nearly all of our key markets. For small businesses, we have also introduced Verizon Freedom for Business in nine key markets, covering approximately 77% of business access lines. As of September 30, 2004, approximately 53% of Verizon's residential customers have purchased local services in combination with either Verizon long distance or Verizon DSL, or both.

Network Access Services

Network access services revenues are earned from end-user customers and long distance and other competing carriers who use our local exchange facilities to provide usage services to their customers. Switched access revenues are derived from fixed and usage-based charges paid by carriers for access to our local network. Special access revenues originate from carriers and end-users that buy dedicated local exchange capacity to support their private networks. End-user access revenues are earned from our customers and from resellers who purchase dial-tone services. Further, network access revenues include our DSL services.

Network access services revenues declined by $67 million, or 2.2% in the third quarter of 2004 and by $475 million, or 4.9% for the nine months ended September 30, 2004 compared to the similar periods in 2003. These declines were principally due to decreasing switched MOUs and access lines, as well as mandated price reductions associated with federal and state price cap filings and other regulatory decisions. Switched MOUs declined 5.8% in the third quarter of 2004 and 5.1% for the nine months ended September 30, 2004, from the prior year periods, reflecting the impact of access line loss and wireless substitution.

These factors were partially offset by higher customer demand for high capacity and digital data services that grew 11.5% in the third quarter of 2004 and 6.7% for the nine months ended September 30, 2004 compared to the prior

year periods. Special access revenue growth reflects continuing demand in the business market for high-capacity, high-speed digital services, partially offset by lessening demand for older, low-speed data products and services. Voice-grade equivalents (switched access lines and data circuits) grew 2.7% at September 30, 2004 compared to September 30, 2003, as customers chose more high-capacity digital services. We added 934,000 new DSL lines in the nine months ended September 30, 2004, including 309,000 in the third quarter, for a total of 3.3 million lines at September 30, 2004, representing a 53.7% increase from September 30, 2003.

The Federal Communications Commission (FCC) regulates the rates that we charge long distance carriers and end-user customers for interstate access services. See "Other Factors That May Affect Future Results – FCC Regulation and Interstate Rates" for additional information on FCC rulemakings concerning federal access rates, universal service and unbundling of network elements and broadband services.

Long Distance Services

Long distance service revenues include both intraLATA toll services and interLATA long distance voice services.

Long distance service revenues increased $87 million, or 8.7% in the third quarter of 2004 and $336 million, or 12.1% for the nine months ended September 30, 2004 compared to the similar periods in 2003, principally as a result of customer growth from our interLATA long distance services. We added 525,000 long distance lines in the third quarter of 2004 and 1,995,000 long distance lines in the nine months ended September 30, 2004, for a total of 17.3 million long distance lines nationwide, representing a 16.6% increase in long distance lines from September 30, 2003. The introduction of our Freedom service plans continues to stimulate growth in long distance services. In 2003, we received final FCC approval to offer long distance services in our remaining three jurisdictions and began offering long distance services throughout the United States, capping a seven-year effort. As of September 30, 2004, approximately 46% of our local wireline residential customers have chosen Verizon as their long distance carrier.

Other Services

Our other services include such services as billing and collections for long distance carriers, public (coin) telephone and customer premises equipment and supply sales. Other services revenues also include services provided by our non-regulated subsidiaries such as data solutions and systems integration businesses.

Revenue increases resulting from higher sales of voice and data customer premises equipment services were more than offset by declines in business volumes related to billing and collection services, public telephone services, and the dissolution of non-strategic businesses.

Operating Expenses

(Dollars in Millions)	Three Months Ended September 30, 2004	2003	% Change	Nine Months Ended September 30, 2004	2003	% Change
Cost of services and sales	$ 3,805	$ 3,879	(1.9)%	$ 11,165	$ 10,815	3.2%
Selling, general and administrative expense	2,207	2,069	6.7	6,699	6,322	6.0
Depreciation and amortization expense	2,215	2,296	(3.5)	6,681	6,927	(3.6)
	$ 8,227	$ 8,244	(.2)	$ 24,545	$ 24,064	2.0

Cost of Services and Sales

Cost of services and sales includes the following costs directly attributable to a service or product: salaries and wages, benefits, materials and supplies, contracted services, network access and transport costs, customer provisioning costs, computer systems support and cost of products sold. Aggregate customer care costs, which include billing and service provisioning, are allocated between cost of services and sales and selling, general and administrative expense.

Cost of services and sales declined by $74 million or 1.9% in the third quarter of 2004 and increased by $350 million, or 3.2% for the nine months ended September 30, 2004 compared to the similar periods in 2003. Both periods in 2004 were impacted by increased pension and other postretirement benefit costs. As of December 31, 2003, Verizon evaluated key employee benefit plan assumptions in response to conditions in the securities markets. The expected rate of return on pension plan assets has been maintained at 8.50%. However, the discount rate assumption has been lowered from 6.75% in 2003 to 6.25% in 2004, consistent with interest rate levels at the end of 2003. Further, as a result of extending and increasing limits (caps) on company payments toward retiree health care costs in connection with the union contracts ratified in the fourth quarter of 2003, we began recording health care costs as if there were

no caps in the fourth quarter of 2003 relative to these union contracts. The overall impact of these assumption changes, combined with the impact of lower than expected actual asset returns over the past three years, resulted in net pension and other postretirement benefit expense (primarily in cost of services and sales) of $157 million in the third quarter of 2004 and $591 million for the nine months ended September 30, 2004, compared to pension income, net of other postretirement benefit expense of $118 million and $337 million in the third quarter and nine months ended September 30, 2003, respectively. Higher costs associated with our growth businesses such as long distance and DSL and annual wage increases also contributed to the increase in cost of services and sales in both periods. Further, both the quarter and year-to-date comparisons were affected by the prior year reduction to operating expenses (primarily cost of services and sales) of approximately $11 million in the third quarter of 2003 and $122 million year-to-date 2003 for insurance recoveries related to the terrorist attacks on September 11, 2001.

These expense increases were more than offset in the third quarter of 2004 and partially offset for the nine months ended September 30, 2004 compared to the similar periods in 2003, by the effect of work force reductions of approximately 15,700 employees, or 10.1% over the past year, principally in connection with a voluntary separation plan announced in the fourth quarter of 2003. In addition, both 2004 periods were impacted by lower interconnection expense as a result of our ongoing reviews of local interconnection expense charged by CLECs and settlements with carriers, including the MCI settlement recorded in the second quarter of 2004. Expense comparisons were also impacted by prior year contingency costs in connection with labor negotiations and other costs recorded in the third quarter of 2003.

Selling, General and Administrative Expense

Selling, general and administrative expense includes salaries and wages and benefits not directly attributable to a service or product, bad debt charges, taxes other than income, advertising and sales commission costs, customer billing, call center and information technology costs, professional service fees and rent for administrative space.

Selling, general and administrative expense increased by $138 million, or 6.7% in the third quarter of 2004 and $377 million, or 6.0% for the nine months ended September 30, 2004 compared to the similar periods in 2003. In both 2004 periods, these increases include higher net pension and benefit costs as described above, additional other employee benefit costs and higher professional and general costs. These cost increases were partially offset in both periods by the effect of work force reductions and in the quarterly period by lower property and gross receipts taxes. The year-to-date 2004 period also included a gain on the sale of a small business unit earlier this year.

Depreciation and Amortization Expense

The decrease in depreciation and amortization expense of $81 million, or 3.5% in the third quarter of 2004 and $246 million, or 3.6% for the nine months ended September 30, 2004 compared to the similar periods in 2003, was mainly driven by lower rates of depreciation.

Segment Income

(Dollars in Millions)	Three Months Ended September 30, 2004	2003	% Change	Nine Months Ended September 30, 2004	2003	% Change
Segment Income	$ 642	$ 703	(8.7)%	$ 2,022	$ 2,625	(23.0)%

Segment income decreased by $61 million, or 8.7% in the third quarter of 2004 and by $603 million, or 23.0% for the nine months ended September 30, 2004 compared to the similar periods in 2003, primarily as a result of the after-tax impact of operating revenues and operating expenses described above and favorable deferred tax balance adjustments in the current year periods.

Special and non-recurring items not included in Domestic Telecom's segment income totaled $20 million and $79 million for the quarter ended September 30, 2004 and 2003, respectively. Special and non-recurring charges included in the third quarter of 2004 and 2003 related to pension settlement losses for employees that received lump-sum distributions during those quarters under 2003 voluntary separation plans. Special and non-recurring items totaling $428 million for the nine months ended September 30, 2004 also included operating asset losses pertaining to our international long distance and data network, additional pension settlement losses for employees that received lump-sum distributions during the quarter under the prior year voluntary separation plan and costs associated with the early retirement of debt, partially offset by an expense credit resulting from the favorable resolution of pre-bankruptcy amounts due from MCI as well as a gain on the sale of an investment. Special and non-recurring items totaling $(1,491) million for the nine months ended September 30, 2003 also included a net gain recorded in connection with

the adoption of SFAS No. 143, the directory accounting change and special costs associated with severance activity and other employee benefits.

Domestic Wireless

Our Domestic Wireless segment provides wireless voice and data services and equipment sales across the United States. This segment primarily represents the operations of the Verizon Wireless joint venture.

Operating Revenues

(Dollars in Millions)	Three Months Ended September 30, 2004	2003	% Change	Nine Months Ended September 30, 2004	2003	% Change
Wireless sales and services	$ 7,311	$ 5,942	23.0%	$ 20,320	$ 16,505	23.1%

Domestic Wireless segment revenues increased by $1,369 million, or 23.0% in the third quarter of 2004 and $3,815 million, or 23.1% for the nine months ended September 30, 2004 compared to the similar periods in 2003. Service revenue of $6,389 million for the third quarter of 2004 was $1,090 million, or 20.6% higher than the similar period in 2003. Service revenue of $17,933 million for the nine months ended September 30, 2004 was $2,963 million, or 19.8% higher than the similar period in 2003. These increases were primarily due to a 16.9% increase in customers as of September 30, 2004 compared to September 30, 2003 as well as an increase in ARPU. Equipment and other revenue of $922 million increased by $279 million, or 43.4% in the third quarter of 2004 compared to the similar period in 2003. Equipment and other revenue of $2,387 million increased by $852 million, or 55.5% for the nine months ended September 30, 2004 compared to the similar period in 2003. These revenue increases were primarily attributable to increases in handsets sold of 35% in the third quarter of 2004 and 31% for the nine months ended September 30, 2004 compared to similar periods in 2003, and increased equipment upgrades.

We ended the third quarter of 2004 with more than 42.1 million customers compared to 36.0 million customers at the end of the third quarter of 2003. Almost 1.7 million net customers were added during the third quarter of 2004 compared to 1.4 million during the third quarter of 2003. We added 4.6 million net customers during the nine months ended September 30, 2004 compared to 3.5 million during the similar period in 2003. Retail net additions accounted for approximately 94% of the total net adds. The overall composition of our customer base as of September 30, 2004 was 92% retail postpaid, 4% retail prepaid and 4% resellers. As of September 30, 2004, approximately 40.2 million, or 96% of our customers subscribe to digital service compared to 93% at September 30, 2003. In addition, our average monthly churn rate, the rate at which customers disconnect service, decreased to 1.5% in the third quarter of 2004 and for the nine months ended September 30, 2004 compared to 1.9% in the third quarter of 2003 and for the nine months ended September 30, 2003. Retail postpaid churn decreased to 1.3% in the third quarter of 2004 and for the nine months ended September 30, 2004 compared to 1.4% in the third quarter of 2003 and 1.5% for the nine months ended September 30, 2003.

ARPU increased by 3.1% to $51.58 in the third quarter of 2004 and by 2.7% to $50.18 for the nine months ended September 30, 2004 compared to similar periods in 2003, primarily due to higher access price plan offerings as well as an increase in data revenues per customer. Data revenues of $302 million increased by $182 million, or 152% in the third quarter of 2004 compared to the third quarter of 2003. For the nine months ended September 30, 2004, data revenues of $757 million increased by $478 million, or 171% compared to the similar period in 2003. These increases are the result of higher use of our messaging and other data services. For the third quarter of 2004, data revenue accounted for 4.7% of service revenue compared to 2.3% during the third quarter of 2003. These increases were partially offset by decreased roaming revenue due to bundled pricing.

Operating Expenses

(Dollars in Millions)	Three Months Ended September 30, 2004	2003	% Change	Nine Months Ended September 30, 2004	2003	% Change
Cost of services and sales	$ 2,107	$ 1,715	22.9%	$ 5,619	$ 4,721	19.0%
Selling, general and administrative expense	2,411	2,103	14.6	6,933	5,942	16.7
Depreciation and amortization expense	1,147	1,000	14.7	3,305	2,863	15.4
	$ 5,665	$ 4,818	17.6	$ 15,857	$ 13,526	17.2

Cost of Services and Sales

Cost of services and sales, which are costs to operate the wireless network as well as the cost of roaming, long distance and equipment sales, increased by $392 million, or 22.9% for the third quarter of 2004 and $898 million, or 19.0% for the nine months ended September 30, 2004 compared to the similar periods in 2003. These increases were primarily due to higher cost of equipment sales, which were 30.8% higher in the third quarter of 2004 and 25.3% higher for the nine months ended September 30, 2004 compared to similar periods in 2003. The cost of equipment sales increases were driven by an increase in handsets sold, due to higher gross activations and an increase in equipment upgrades for the third quarter and the nine months ended September 30, 2004 compared to the similar periods in 2003. In addition, wireless network costs increased in the current year periods as a result of increased MOUs on the wireless network, partially offset by lower roaming, local interconnection and long distance rates.

Selling, General and Administrative Expense

Selling, general and administrative expenses increased by $308 million, or 14.6% in the third quarter of 2004 and $991 million, or 16.7% for the nine months ended September 30, 2004 compared to the similar periods in 2003. These increases were primarily due to higher salary and benefits expense of $180 million for the third quarter of 2004 and $553 million for the nine months ended September 30, 2004 compared to similar periods in 2003. The salary and benefits expense increases were primarily the result of higher salary and benefits costs and an increase in the number of employees, principally in the customer care and sales functions. Also contributing to the cost increases was a $27 million aggregate increase in sales commissions in our direct and indirect channels for the third quarter of 2004 and a $109 million increase for the nine months ended September 30, 2004 compared to similar periods in 2003, primarily related to the increase in gross customer additions and customer renewals in the current year periods. Advertising and promotion expenses increased by $20 million in the third quarter of 2004 and $88 million for the nine months ended September 30, 2004 compared to similar periods in 2003.

Depreciation and Amortization Expense

Depreciation and amortization increased by $147 million, or 14.7% in the third quarter of 2004 and $442 million, or 15.4% for the nine months ended September 30, 2004 compared to similar periods in 2003. These increases were primarily due to increased depreciation expense related to the increase in depreciable assets.

Segment Income

(Dollars in Millions)	Three Months Ended September 30, 2004	2003	% Change	Nine Months Ended September 30, 2004	2003	% Change
Segment Income	$ 478	$ 301	58.8%	$ 1,249	$ 776	61.0%

Segment income increased by $177 million, or 58.8% in the third quarter of 2004 and by $473 million, or 61.0% for the nine months ended September 30, 2004 compared to the similar periods in 2003 primarily as a result of the after-tax impact of operating revenues and operating expenses described above, partially offset by an increase in minority interest. Increases in minority interest were principally due to the increased earnings of the Domestic Wireless segment, which has a significant minority interest attributable to Vodafone.

Information Services

Information Services' multi-platform business comprises yellow pages directories, online directory and search services through SuperPages.com, and directory and information services on wireless telephones through SuperPages On the Go. This segment's operations are principally in the United States and Latin America.

On September 8, 2004, we announced the signing of a definitive agreement to sell our directory operations in Canada, Verizon Information Services Canada. We reclassified Verizon Information Services Canada in the current and prior years as discontinued operations in accordance with SFAS No. 144. Discontinued operations are excluded from Information Services' segment income.

Operating Revenues

(Dollars in Millions)	Three Months Ended September 30, 2004	2003	% Change	Nine Months Ended September 30, 2004	2003	% Change
Operating Revenues	$ 900	$ 939	(4.2)%	$ 2,725	$ 2,897	(5.9)%

Information Services' operating revenues decreased $39 million, or 4.2% in the third quarter of 2004 and $172 million, or 5.9% for the nine months ended September 30, 2004 compared to the similar periods in 2003. The decreases were due primarily to reduced domestic print advertising revenue and the elimination of revenue from the sale of European operations, which was completed in July 2003. SuperPages.com continues to achieve strong growth, as demonstrated by a 25.2% increase in revenue and a 32.7% increase in searches in the third quarter of 2004 compared to the third quarter of 2003, and a 19.7% increase in revenue and a 46.9% increase in searches in the nine months ended September 30, 2004 compared to the similar period in 2003.

Operating Expenses

(Dollars in Millions)	Three Months Ended September 30, 2004	2003	% Change	Nine Months Ended September 30, 2004	2003	% Change
Cost of services and sales	$ 126	$ 147	(14.3)%	$ 397	$ 438	(9.4)%
Selling, general and administrative expense	327	330	(.9)	992	1,002	(1.0)
Depreciation and amortization expense	23	19	21.1	65	58	12.1
Sales of businesses, net	–	(141)	(100.0)	–	(141)	(100.0)
	$ 476	$ 355	34.1	$ 1,454	$ 1,357	7.1

Cost of services and sales decreased $21 million, or 14.3% in the third quarter of 2004 and $41 million, or 9.4% for the nine months ended September 30, 2004 compared to the similar periods in 2003. For the third quarter of 2004, the decrease was due primarily to cost reductions. For the nine months ended September 30, 2004, the decrease was due primarily to cost reductions and reduced expenses related to the July 2003 sale of European operations.

Selling, general and administrative expenses and depreciation and amortization expense were relatively consistent during the third quarter of 2004 and the nine months ended September 30, 2004 compared to the similar periods in 2003. For the nine months ended September 30, 2004, lower selling, general and administrative expense from cost reductions and reduced expenses related to the July 2003 sale of European operations were largely offset by higher domestic pension and benefit costs. Sales of businesses, net primarily includes the July 2003 sale of directory businesses in Europe, which consisted of publishing operations in Austria, the Czech Republic, Gibraltar, Hungary, Poland and Slovakia.

Segment Income

(Dollars in Millions)	Three Months Ended September 30, 2004	2003	% Change	Nine Months Ended September 30, 2004	2003	% Change
Segment Income	$ 252	$ 355	(29.0)%	$ 766	$ 923	(17.0)%

Segment income decreased $103 million, or 29.0% in the third quarter of 2004, and $157 million, or 17.0% for the nine months ended September 30, 2004 compared to the similar periods in 2003. The decrease was primarily the result of the after-tax impact of the operating revenues and expense issues described above. Special and non-recurring items not included in Information Services' segment income for the nine months ended September 30, 2004 and 2003 totaled $7 million and $1,584 million, respectively. The special items included in the 2004 period were primarily related to pension settlement losses for employees who received lump-sum distributions under a prior year voluntary separation plan. The special items included in the 2003 period related to a loss recorded in connection with the directory accounting change and severance charges.

International

Our International segment includes international wireline and wireless telecommunication operations and investments primarily in the Americas and Europe. Our consolidated international investments as of September 30, 2004 included Verizon Dominicana, C. por A. (Verizon Dominicana) in the Dominican Republic, TELPRI in Puerto Rico and Micronesian Telecommunications Corporation in the Northern Mariana Islands. Either the cost or the equity method is applied to those investments in which we have less than a controlling interest.

On June 13, 2003, we announced our decision to sell our 39.4% consolidated interest in Iusacell. In the second quarter of 2003, we reclassified our investment and the results of operations of Iusacell as discontinued operations. We sold our shares in Iusacell on July 29, 2003. Discontinued operations are excluded from International's segment income.

Operating Revenues

(Dollars in Millions)	Three Months Ended September 30, 2004	2003	% Change	Nine Months Ended September 30, 2004	2003	% Change
Operating Revenues	$ 496	$ 446	11.2%	$ 1,470	$ 1,472	(.1)%

Revenues generated by our international businesses increased $50 million, or 11.2% in the third quarter of 2004 and decreased $2 million, or .1% for the nine months ended September 30, 2004 compared to the similar periods in 2003. The third quarter increase is primarily due to operational growth at Verizon Dominicana and an adjustment to carrier access revenues at TELPRI in the 2003 period, partially offset by declining foreign exchange rates in the Dominican Republic. The decrease for the nine months ended September 30, 2004 is primarily due to declining foreign exchange rates in the Dominican Republic offset by operational growth at Verizon Dominicana and an adjustment to carrier access revenues at TELPRI in the 2003 period.

Operating Expenses

(Dollars in Millions)	Three Months Ended September 30, 2004	2003	% Change	Nine Months Ended September 30, 2004	2003	% Change
Cost of services and sales	$ 153	$ 144	6.3%	$ 456	$ 422	8.1%
Selling, general and administrative expense	136	222	(38.7)	351	573	(38.7)
Depreciation and amortization expense	80	80	–	237	252	(6.0)
	$ 369	$ 446	(17.3)	$ 1,044	$ 1,247	(16.3)

Cost of Services and Sales

Cost of services and sales increased $9 million, or 6.3% in the third quarter of 2004 and $34 million, or 8.1% in the nine months ended September 30, 2004 compared to the similar periods in 2003. These increases primarily reflect higher variable costs at Verizon Dominicana partially offset by the decline of the Dominican Republic's foreign exchange rates.

Selling, General and Administrative Expense

Selling, general and administrative expense decreased $86 million, or 38.7% in the third quarter of 2004 and $222 million, or 38.7% in the nine months ended September 30, 2004 compared to the similar periods in 2003. The third quarter 2004 decrease is primarily due to a third quarter 2003 TELPRI charge recorded as a result of an adverse Puerto Rico Circuit Court of Appeals ruling on intra-island long distance access rates. The decrease for the nine months ended September 30, 2004 reflects the third quarter 2003 TELPRI charge as well as the favorable resolution to the TELPRI charge in the second quarter of 2004 and declining foreign exchange rates in the Dominican Republic.

Depreciation and Amortization Expense

Depreciation and amortization expense decreased $15 million, or 6% for the nine months ended September 30, 2004 compared to the similar period in 2003 primarily due to declining foreign exchange rates in the Dominican Republic.

Segment Income

(Dollars in Millions)	Three Months Ended September 30, 2004	2003	% Change	Nine Months Ended September 30, 2004	2003	% Change
Segment Income	$ 319	$ 471	(32.3)%	$ 887	$ 1,051	(15.6)%

Segment income decreased by $152 million, or 32.3% in the third quarter of 2004 and $164 million, or 15.6% for the nine months ended September 30, 2004 compared to the similar periods in 2003. The decreases are primarily the result of the decreases in equity in earnings of unconsolidated businesses and income from other unconsolidated businesses partially offset by Verizon's share (after minority interest) of the after-tax impact of operating revenues and operating expenses described above.

Equity in earnings of unconsolidated businesses decreased by $159 million in the third quarter of 2004 and $63 million for the nine months ended September 30, 2004 compared to the similar periods in 2003. These decreases primarily resulted from additional Italian tax benefits in 2003 from a reorganization at our Italian investment, Vodafone Omnitel, partially offset by favorable foreign currency impacts from the euro on that investment and continued operational growth.

Income from other unconsolidated businesses decreased by $78 million in the third quarter of 2004 and decreased $138 million for the nine months ended September 30, 2004 compared to the similar periods in 2003. These decreases are primarily related to 2003 sales of our interest in TCC and TelecomAsia.

The special and non-recurring item not included in International's segment income of $2 million for the nine months ended September 30, 2004 related to pension settlement losses for employees that received lump-sum distributions during the first quarter of 2004 under a voluntary separation plan. Special and non-recurring items not included in International's segment income totaled $900 million for the nine months ended September 30, 2003, primarily related to a loss on our investment in Iusacell.

Special Items

Severance, Pension and Benefit Charges

During the third quarter of 2004 and the nine months ended September 30, 2004, we recorded pretax pension settlement losses of $33 million ($20 million after-tax, or $.01 per diluted share) and $792 million ($485 million after-tax, or $.17 per diluted share), respectively. These settlement losses related to employees that received lump-sum distributions during 2004 in connection with the previously announced voluntary separation plan under which more than 21,000 employees accepted the separation offer in the fourth quarter of 2003. These charges were recorded in accordance with SFAS No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits" which requires that settlement losses be recorded once prescribed payment thresholds have been reached. Verizon had previously estimated settlements related to the voluntary separation plan to total $700 million to $900 million, after taxes, mostly in the first quarter of 2004 although continuing throughout the year. Due to favorable offsets such as an improved return on pension plan assets and lower than expected lump-sum payouts, we now expect total after-tax charges associated with the voluntary separation plan will likely be less than the lower end of this range.

During the third quarter of 2003, we recorded pretax pension settlement losses of $131 million ($81 million after-tax, or $.03 per diluted share) related to employees that received lump-sum distributions during the quarter in connection with previously announced employee separations.

During the second quarter of 2003 we recorded a special charge of $463 million ($286 million after-tax, or $.10 per diluted share) in connection with enhanced pension benefits granted to employees retiring in the first half of 2003, estimated costs associated with the July 10, 2003 Verizon New York arbitration ruling and pension settlement losses related to lump-sum pay-outs in 2003. On July 10, 2003, an arbitrator ruled that Verizon New York's termination of 2,300 employees in 2002 was not permitted under a union contract; similar cases were pending impacting an additional 1,100 employees. Verizon offered to reinstate all 3,400 impacted employees, and accordingly, recorded a charge in the second quarter of 2003 representing estimated payments to employees and other related company-paid costs.

In addition, in the second quarter of 2003 we recorded a special charge of $235 million ($150 million after-tax, or $.05 per diluted share) primarily associated with employee severance costs and severance-related activities in connection with the voluntary separation of approximately 4,000 employees.

Sale of Investment

During the first quarter of 2004, we sold all of our investment in Iowa Telecom preferred stock, which resulted in a pretax gain of $43 million ($43 million after-tax, or $.02 per diluted share) included in Income From Other Unconsolidated Businesses in the unaudited condensed consolidated statements of income. The preferred stock was received in 2000 in connection with the sale of access lines in Iowa.

Discontinued Operations

During the second quarter of 2003, we announced our decision to sell our 39.4% consolidated interest in Iusacell into the tender offer launched by Movil Access, a Mexican company. Verizon tendered its shares shortly after the tender offer commenced, and the tender offer closed on July 29, 2003. In accordance with SFAS No. 144, we classified the results of operations of Iusacell as discontinued operations and in connection with a comparison of expected net sale proceeds to the net book value of our investment in Iusacell (including the foreign currency translation balance), we

recorded a pretax loss of $957 million ($931 million after-tax, or $.33 per diluted share) in the second quarter of 2003.

Other Special Items

In the second quarter of 2004, we recorded an expense credit of $204 million ($123 million after-tax, or $.04 per diluted share) resulting from the favorable resolution of pre-bankruptcy amounts due from MCI. Previously reached settlement agreements became fully effective when MCI emerged from bankruptcy proceedings in the second quarter of 2004.

Also during the second quarter of 2004, we recorded a charge of $113 million ($87 million after-tax, or $.03 per diluted share) related to operating asset losses pertaining to our international long distance and data network. In addition, we recorded pretax charges of $12 million ($7 million after-tax, or less than $.01 per diluted share) during the second quarter in connection with the early retirement of debt. During the first quarter of 2004, we also recorded pretax charges of $43 million ($27 million after-tax, or $.01 per diluted share) resulting from the early retirement of debt.

During the second quarter of 2003, we recorded other pretax charges of $258 million ($204 million after-tax, or $.07 per diluted share) primarily related to a pretax impairment charge of $125 million ($125 million after-tax, or $.04 per diluted share) pertaining to our leasing operations for airplanes leased to airlines that were experiencing financial difficulties and for power generating facilities. These second quarter 2003 charges also included pretax charges of $61 million ($38 million after-tax, or $.01 per diluted share) pertaining to the early retirement of debt and other pretax charges of $72 million ($41 million after-tax, or $.01 per diluted share).

Consolidated Financial Condition

(Dollars in Millions)	Nine Months Ended September 30, 2004	2003	$ Change
Cash Flows Provided By (Used In)			
Operating activities	$ 15,494	$ 16,256	$ (762)
Investing activities	(7,825)	(6,910)	(915)
Financing activities	(7,722)	(10,039)	2,317
Decrease in Cash and Cash Equivalents	$ (53)	$ (693)	$ 640

We use the net cash generated from our operations to fund network expansion and modernization, repay external financing, pay dividends and invest in new businesses. Additional external financing is utilized when necessary. While our current liabilities typically exceed current assets, our sources of funds, primarily from operations and, to the extent necessary, from readily available external financing arrangements, are sufficient to meet ongoing operating and investing requirements. We expect that capital spending requirements will continue to be financed primarily through internally generated funds. Additional debt or equity financing may be needed to fund additional development activities or to maintain our capital structure to ensure our financial flexibility.

Cash Flows Provided By Operating Activities

Our primary source of funds continues to be cash generated from operations. The decrease in cash from operating activities for the nine months ended September 30, 2004 compared to the similar period in 2003 was primarily due to a higher decrease in current liabilities (use of cash) in the current year period and a higher decrease in receivables (source of cash) in the prior year period. Higher severance payments were recorded in 2004 and higher tax refunds were recorded in the nine months ended September 30, 2003. In addition, the higher decrease in receivables in the nine months ended September 30, 2003 was driven by a greater reduction of days sales outstanding in that period compared to the similar period in 2004.

Cash Flows Used In Investing Activities

Capital expenditures continue to be our primary use of capital resources and facilitate the introduction of new products and services, enhance responsiveness to competitive challenges and increase the operating efficiency and productivity of our networks. Including capitalized software, we invested $4,703 million in our Domestic Telecom segment in the nine months ended September 30, 2004 compared to $4,765 million in the similar period in 2003. We also invested $4,121 million in our Domestic Wireless segment in the nine months ended September 30, 2004 compared to $3,079 million in the similar period in 2003. The consistent level of capital investment in Domestic

Telecom and the increase in capital spending in Domestic Wireless represent our continuing effort to invest in high growth areas including wireless, long distance, DSL and Enterprise Advance.

Capital spending, including capitalized software, is expected to be at the higher end of the range of $12 billion to $13 billion in 2004. The range includes $6.5 billion to $7.0 billion for Domestic Telecom, $5.0 billion to $5.5 billion for Domestic Wireless (expected to be the high end of the range) and a total of $.5 billion for Information Services, International and corporate and other businesses.

We invested $300 million in acquisitions and investments in businesses during the nine months ended September 30, 2004, including a deposit of $186 million for wireless licenses and $104 million related to Verizon's limited partnership investments in entities that invest in affordable housing projects. During the nine months ended September 30, 2003, we invested $1,097 million in acquisitions and investments in businesses, including $762 million to acquire 50 Personal Communications Services licenses and related network assets from Northcoast Communications LLC, $177 million related to Verizon's limited partnership investments in entities that invest in affordable housing projects and $157 million for other wireless properties. In the nine months ended September 30, 2004, we received cash proceeds of $117 million from the sale of a small business unit. In the nine months ended September 30, 2003, we received cash proceeds of $229 million from the sale of our directory publication operations in Austria, the Czech Republic, Gibraltar, Hungary, Poland and Slovakia.

Other, net investing activities for the nine months ended September 30, 2004 includes net cash proceeds of $171 million received in connection with the sale of investments, including Iowa Telecom preferred stock. Other, net investing activities for the nine months ended September 30, 2003 includes net cash proceeds of $415 million in connection with sales of our shares in various investments, primarily TCC and Crown Castle International Corp.

Under the terms of an investment agreement, Vodafone may require Verizon Wireless to purchase up to an aggregate of $20 billion worth of Vodafone's interest in Verizon Wireless at designated times at its then fair market value. In the event Vodafone exercises its put rights, we have the right, exercisable at our sole discretion, to purchase up to $12.5 billion of Vodafone's interest instead of Verizon Wireless for cash or Verizon stock at our option. Vodafone had the right to require the purchase of up to $10 billion during a 61-day period opening on June 10 and closing on August 9 in 2004, and did not exercise that right. As a result, Vodafone still has the right to require the purchase of up to $20 billion worth of its interest, not to exceed $10 billion in any one year, during a 61-day period opening on June 10 and closing on August 9 in 2005 through 2007. Vodafone also may require that Verizon Wireless pay for up to $7.5 billion of the required repurchase through the assumption or incurrence of debt.

Cash Flows Used In Financing Activities

Cash of $4,444 million was used to reduce our total debt during the nine months ended September 30, 2004. We repaid $2,314 million and $2,477 million of Domestic Telecom and corporate long-term debt, respectively. The Domestic Telecom debt repayment includes the early retirement of $1,275 million of long-term debt. The corporate debt repayment includes $1,984 million of zero-coupon convertible notes redeemed by Verizon Global Funding Corp. Also during the nine months ended September 30, 2004, we decreased our short-term borrowings by $79 million and Verizon Global Funding issued $500 million of long-term debt.

Cash of $7,313 million was used to reduce our total debt during the nine months ended September 30, 2003. We repaid $5,646 million of Verizon Global Funding, $2,015 million of Domestic Telecom and $1,116 million of other corporate long-term debt, and reduced our short-term borrowings by $1,274 million with cash from operations and the issuance of Verizon Global Funding and Domestic Telecom long-term debt. Verizon Global Funding and Domestic Telecom issued long-term debt with principal amounts of $1,500 million and $1,350 million, respectively, resulting in total cash proceeds of $2,766 million, net of discounts, costs and a payment related to a hedge on the interest rate for an anticipated financing.

Our ratio of debt to debt combined with shareowners' equity was 53.5% at September 30, 2004 compared to 56.4% at September 30, 2003.

As of September 30, 2004, we had $137 million in bank borrowings outstanding. In addition, we had approximately $5.8 billion of unused bank lines of credit and our financing subsidiary had shelf registrations for the issuance of up to $10.5 billion of unsecured debt securities. The debt securities of our telephone and financing subsidiaries continue to be accorded high ratings by primary rating agencies. In March 2004, Standard & Poor's announced that it put Verizon's debt on review with negative implications, citing general industry issues. In September 2004, Standard &

Poor's affirmed the long term debt rating of Verizon and related entities, including Verizon Wireless at A+, and changed our credit rating outlook to negative from stable. The short-term debt rating of Verizon Network Funding was lowered to A-1 from A-1+. We have adopted a debt portfolio strategy that continues our overall debt reduction efforts through the remainder of the year.

We and our consolidated subsidiaries are in compliance with all of our debt covenants.

As in prior quarters, dividend payments were a significant use of capital resources. We determine the appropriateness of the level of our dividend payments on a periodic basis by considering such factors as long-term growth opportunities, internal cash requirements, and the expectations of our shareowners. In the first, second and third quarters of 2004 and 2003, we announced quarterly cash dividends of $.385 per share.

Decrease in Cash and Cash Equivalents

Our cash and cash equivalents at September 30, 2004 totaled $616 million, a $53 million decrease from cash and cash equivalents at December 31, 2003 of $669 million.

Market Risk

We are exposed to various types of market risk in the normal course of our business, including the impact of interest rate changes, foreign currency exchange rate fluctuations, changes in equity investment prices and changes in corporate tax rates. We employ risk management strategies using a variety of derivatives, including interest rate swap agreements, interest rate locks, foreign currency forwards, equity options and basis swap agreements. We do not hold derivatives for trading purposes.

It is our general policy to enter into interest rate, foreign currency and other derivative transactions only to the extent necessary to achieve our desired objectives in limiting our exposures to the various market risks. Our objectives include maintaining a mix of fixed and variable rate debt to lower borrowing costs within reasonable risk parameters and to protect against earnings and cash flow volatility resulting from changes in market conditions. We do not hedge our market risk exposure in a manner that would completely eliminate the effect of changes in interest rates, equity prices and foreign exchange rates on our earnings. We do not expect that our net income, liquidity and cash flows will be materially affected by these risk management strategies.

Exchangeable Notes

In 1998, Verizon Global Funding issued notes exchangeable into shares of Telecom Corporation of New Zealand Limited (TCNZ) and into shares of Cable & Wireless Communications plc (subsequently Cable & Wireless plc and NTL Incorporated) as described in Note 7 to the unaudited condensed consolidated financial statements. These financial instruments exposed us to market risk, including (i) equity price risk, because the notes were exchangeable into shares that are traded on the open market and routinely fluctuate in value, (ii) foreign exchange rate risk, because the notes were exchangeable into shares that are denominated in a foreign currency, and (iii) interest rate risk, because the notes carried fixed interest rates.

On April 1, 2003, all of the outstanding $2,455 million principal amount of the 5.75% notes that were exchangeable into shares of TCNZ were redeemed at maturity. On March 15, 2003, Verizon Global Funding redeemed all of the outstanding 4.25% notes. The cash redemption price for the 4.25% notes was $1,048.29 for each $1,000 principal amount of the notes. The principal amount of the 4.25% notes outstanding, before unamortized discount, at the time of redemption, was $2,839 million.

Foreign Currency Translation

The functional currency for nearly all of our foreign operations is the local currency. The translation of income statement and balance sheet amounts of these entities into U.S. dollars are recorded as cumulative translation adjustments, which are included in Accumulated Other Comprehensive Loss in our unaudited condensed consolidated balance sheets. At September 30, 2004, our primary translation exposure was to the Venezuelan bolivar, Dominican Republic peso, Canadian dollar and the euro. During the third quarter of 2004, we entered into foreign currency forward contracts to hedge our net investment in two international operations. We have not hedged

our accounting translation exposure to foreign currency fluctuations relative to the carrying value of our other investments.

Our earnings were affected by foreign currency gains or losses associated with the U. S. dollar denominated assets and liabilities at Verizon Dominicana and at Iusacell prior to selling Iusacell in July 2003 (see "Consolidated Results of Operations – Other Consolidated Results – Discontinued Operations").

Other Factors That May Affect Future Results

Recent Developments

Spectrum Purchases

On November 4, 2004, we announced the signing of a definitive agreement with NextWave Telecom Inc. (NextWave) to purchase all of NextWave's remaining personal communications services spectrum licenses in 23 markets for $3,000 million. The 10 MHz and 20 MHz licenses, in the 1.9 GHz personal communications services frequency range, cover a population of 73 million people and will be used to expand Verizon Wireless's network capacity in 22 key existing markets, including New York, Boston, Washington, D.C. and Los Angeles, as well as to expand into Tulsa, Oklahoma. The transaction is subject to approval by the U.S. Bankruptcy Court and the FCC as well as antitrust regulatory review and is expected to close by mid-2005.

We announced on July 8, 2004 that we had won an auction for a spectrum license covering the New York metropolitan area held by NextWave. The transaction closed on October 29, 2004. Under the terms of the purchase agreement, we paid $930 million for the license, $186 million of which was paid as a deposit in the third quarter of 2004. In addition, on July 1, 2004 we announced an agreement to purchase Qwest Wireless's spectrum licenses and wireless network assets for $418 million covering several existing and new markets. The transaction is subject to federal reviews and is expected to close in the first quarter of 2005.

Sales of Businesses and Investments

Telephone Access Lines

In October 2004, Verizon announced that it had suspended discussions with potential buyers related to its upstate New York access lines, pending an evaluation of its strategic options. However, we are continuing to consider plans for a reduction in the size of our access line business, including through a spin-off mechanism or otherwise, so that we may pursue our strategy of placing greater focus on the higher growth businesses of broadband and wireless.

During the second quarter of 2004, we entered into an agreement to sell our wireline-related businesses in Hawaii, which operates 707,000 switched access lines, for $1,650 million in cash, less debt. The closing of the transaction, expected in early 2005, is contingent on state regulatory approval; the FCC and the U.S. Department of Justice have provided the necessary approvals.

Sale of Verizon Information Services Canada

On September 8, 2004, we announced the signing of a definitive agreement to sell our directory operations in Canada to an affiliate of Bain Capital, a global private investment firm, for $1,540 million (Cdn. $1,985 million). The sale is expected to close in the fourth quarter of 2004.

Environmental Matters

During 2003, under a government-approved plan, remediation of the site of a former facility in Hicksville, New York that processed nuclear fuel rods in the 1950s and 1960s commenced. Remediation beyond original expectations proved to be necessary and a reassessment of the anticipated remediation costs was conducted. In addition, a reassessment of costs related to remediation efforts at several other former facilities was undertaken. As a result, an additional environmental remediation expense of $240 million was recorded in the fourth quarter of 2003.

New York Recovery Funding

In August 2002, President Bush signed the Supplemental Appropriations bill that included $5.5 billion in New York recovery funding. Of that amount, approximately $750 million has been allocated to cover utility restoration and infrastructure rebuilding as a result of the September 11th terrorist attacks. These funds will be distributed through the Lower Manhattan Development Corporation following an application and audit process. As of September 30,

2004, we have applied for reimbursement of approximately $266 million. We received an advance of $11 million in December 2003 and an additional advance of $77 million in June 2004. We are awaiting the results of an audit relating to the total amount that we have applied for reimbursement, including funds already received.

Telecommunications Act of 1996

We face increasing competition in all areas of our business. The Telecommunications Act of 1996 (1996 Act), regulatory and judicial actions and the development of new technologies, products and services have created opportunities for alternative telecommunication service providers, many of which are subject to fewer regulatory constraints. We are unable to predict definitively the impact that the ongoing changes in the telecommunications industry will ultimately have on our business, results of operations or financial condition. The financial impact will depend on several factors, including the timing, extent and success of competition in our markets, the timing and outcome of various regulatory proceedings and any appeals, and the timing, extent and success of our pursuit of new opportunities resulting from the 1996 Act and technological advances.

In-Region Long Distance

Under the 1996 Act, our ability to offer in-region long distance services in the regions where the former Bell Atlantic telephone subsidiaries operate as local exchange carriers was largely dependent on satisfying specified requirements. These requirements included a 14-point "competitive checklist" of steps that we must take to help competitors offer local services through resale, through purchase of UNEs, or by interconnecting their own networks to ours. We were required to demonstrate to the FCC that our entry into the in-region long distance market would be in the public interest. We now have authority from the FCC to offer in-region long distance service in all 14 of the former Bell Atlantic jurisdictions.

FCC Regulation and Interstate Rates

Our telephone operations are subject to the jurisdiction of the FCC with respect to interstate services and related matters.

Access Charges and Universal Service

On May 31, 2000, the FCC adopted the Coalition for Affordable Local and Long Distance Services (CALLS) plan as a comprehensive five-year plan for regulation of interstate access charges. The CALLS plan has three main components. First, it establishes a portable interstate access universal service support of $650 million for the industry. This explicit support replaces implicit support embedded in interstate access charges. Second, the plan simplifies the patchwork of common line charges into one subscriber line charge (SLC) and provides for de-averaging of the SLC by zones and class of customers in a manner that will not undermine comparable and affordable universal service. Third, the plan sets into place a mechanism to transition to a set target of $.0055 per minute for switched access services. Once that target rate is reached, local exchange carriers are no longer required to make further annual price cap reductions to their switched access prices. The annual reductions leading to the target rate, as well as annual reductions for the subset of special access services that remain subject to price cap regulation was set at 6.5% per year.

As a result of tariff adjustments that became effective in July 2003, virtually all of our switched access lines reached the $.0055 benchmark. On June 29, 2004, the U.S. Court of Appeals for the D.C. Circuit upheld the FCC's prior approval of an increase in the SLC cap. The current cap is $6.50.

The FCC previously initiated investigations of the interstate access rates charged by Verizon's local telephone companies during the 1993 to 1996 tariff years under the price cap rules that were in place prior to the adoption of the CALLS plan. On July 30, 2004, the FCC released an order resolving one of the issues in those pending investigations, and concluded that some of Verizon's local telephone companies had incorrectly calculated the impact of their obligation to "share" a portion of their earnings above certain prescribed levels with their access customers. The amount of any refund as a result of that finding will be determined in a further phase of the proceeding. Other issues remain under investigation.

The FCC has adopted rules for special access services that provide for pricing flexibility and ultimately the removal of services from price regulation when prescribed competitive thresholds are met. Approximately 55% of special access revenues are now removed from price regulation.

In November 1999, the FCC adopted a new mechanism for providing universal service support to high-cost areas served by large local telephone companies. This funding mechanism provides additional support for local telephone services in several states served by our telephone operations. This system has been supplemented by the new FCC access charge plan described above. On October 16, 2003, in response to a previous court decision, the FCC announced a decision providing additional justification for its non-rural high-cost universal support mechanism and modifying it in part. That decision also has been appealed. The FCC also has proceedings underway to evaluate possible changes to its current rules for assessing contributions to the universal service fund. Any change in the current assessment mechanism could result in a change in the contribution that local telephone companies must make and that would have to be collected from customers.

Unbundling of Network Elements

On February 20, 2003, the FCC announced a decision adopting new rules defining the obligations of incumbent local exchange carriers to provide competing carriers with access to UNEs. The decision was the culmination of an FCC rulemaking referred to as its triennial review of its UNE rules, and also was in response to a decision by the U.S. Court of Appeals for the D.C. Circuit. The U.S. Court of Appeals for the D.C. Circuit had overturned the FCC's previous unbundling rules on the grounds that the FCC did not adequately consider the limitations of the "necessary and impair" standards of the 1996 Act when it chose national rules for unbundling and that it failed to consider the relevance of competition from other types of service providers, including cable and satellite.

The text of the order and accompanying rules was released on August 21, 2003. With respect to broadband facilities, such as mass market fiber to the premises loops and packet switching, that order generally removed unbundling obligations under Section 251 of the 1996 Act. With respect to narrowband services, the order generally left unbundling obligations in place, with certain limited exceptions, and delegated to state regulatory proceedings a further review. The order also provided a new set of criteria relating to when carriers may purchase a combination of unbundled loops and transport elements known as enhanced extended loops (EELs).

The FCC's order significantly increases arbitrage opportunities by making it easier for carriers to use EELs for non-local service at regulated prices set using the pricing formula that applies to UNEs rather than competitive special access prices. In addition, the FCC's order eliminates important safeguards that protected against this kind of arbitrage, including the FCC's previous rule against co-mingling unbundled elements and other services. As a result, we estimate the impact on earnings related to this portion of the FCC's order to be potentially 2 cents to 4 cents per diluted share in 2004.

Multiple parties, including Verizon, appealed various aspects of the decision. On March 2, 2004, the U.S. Court of Appeals for the D.C. Circuit issued an order upholding the FCC in part, and overturning its order in part. The court upheld the FCC with respect to broadband facilities. On the narrowband unbundling requirements the court reversed and vacated key aspects of the FCC decision that had required unbundled access to mass market switching and high capacity transmission facilities. The court's order vacating those aspects of the FCC's rules went into effect on June 16, 2004 after both the U.S. Court of Appeals for the D.C. Circuit and the U.S. Supreme Court denied motions to further stay the decision. Petitions by state regulators and other carriers seeking U.S. Supreme Court review of the U.S. Court of Appeals for the D.C. Circuit decision were denied on October 12, 2004.

On August 20, 2004, the FCC issued interim narrowband unbundling rules and a Notice of Rulemaking to establish new permanent unbundling rules. In the interim rules order, the FCC required incumbent carriers to continue providing, for six months from the effective date of its order, unbundled mass market switching and high capacity transmission facilities on the same terms that they were available under interconnection agreements as of June 15, 2004. It also proposed transition rules that would apply during a second six-month period for elements that the FCC determines in the rulemaking do not need to be unbundled.

On August 23, 2004, Verizon and other parties petitioned the U.S. Court of Appeals for the D.C. Circuit for a writ of mandamus to overturn the interim rules and eliminate the affected unbundled obligations unless and until the FCC makes a finding of competitive impairment. On October 7, 2004, the U.S. Court of Appeals for the D.C. Circuit held the petition in abeyance and directed the parties to report on the status of the FCC proceedings no later than January 4, 2005.

The FCC also has taken steps to clarify its rules for broadband facilities in response to requests of various parties. Verizon petitioned the FCC to make clear that any broadband facilities that do not have to be unbundled under Section 251 of the 1996 Act also do not have to be unbundled under another provision of the 1996 Act, specifically Section 271. On October 22, 2004, the FCC announced that it has granted that petition. In addition, the FCC has

clarified that mass market fiber to the curb loops qualify for the same regulatory treatment as mass market fiber to the premises loops, that fiber loops to serve customers in multiple unit buildings also qualify for that same regulatory treatment as long as the building is predominantly residential, and that carriers that deploy new broadband network facilities are not required to equip those facilities with legacy capabilities that could render them subject to unbundling.

Intercarrier Compensation

On April 27, 2001, the FCC released an order addressing intercarrier compensation for dial-up connections for Internet-bound traffic. The FCC found that Internet-bound traffic is interstate and subject to the FCC's jurisdiction. Moreover, the FCC again found that Internet-bound traffic is not subject to reciprocal compensation under Section 251(b)(5) of the 1996 Act. Instead, the FCC established federal rate caps per minute for this traffic that decline from $.0015 to $.0007 over a three-year period. The FCC order also sets caps on the total minutes of this traffic that may be subject to any compensation, barred carriers from obtaining compensation on Internet-bound traffic in markets where they previously had not received it and required that incumbent local exchange carriers must offer to both bill and pay reciprocal compensation for local traffic at the same rate as they are required to pay on Internet-bound traffic. On May 3, 2002, the U.S. Court of Appeals for the D.C. Circuit rejected part of the FCC's rationale for its April 27, 2001 order, but declined to vacate the order while it is on remand. As a result, pending further action by the FCC, the FCC's underlying order remains in effect. On October 8, 2004, the FCC announced that it had denied a petition to discontinue the $.0007 rate cap on this traffic, but had decided to remove the new markets bar and the cap on the total minutes of Internet-bound traffic that are subject to compensation.

More generally, the FCC has an ongoing rulemaking that could fundamentally restructure the regulatory regime for intercarrier compensation, including, but not limited to, access charges, compensation for Internet traffic, and reciprocal compensation for local traffic. As noted above, the FCC also has pending before it the issues relating to intercarrier compensation for dial-up Internet-bound traffic that were remanded by the U.S. Court of Appeals for the D.C. Circuit, including whether to affirm, reverse or modify its previous determinations that this traffic is not subject to reciprocal compensation under Section 251(b)(5) of the 1996 Act. Disputes also remain pending in a number of forums relating to the appropriate compensation for Internet-bound traffic during previous periods under the terms of our interconnection agreements with other carriers.

The FCC also is considering multiple petitions asking it to declare whether, and under what circumstances, services that employ Internet protocol are subject to access charges under current law, or asking it to forbear from any requirement to pay access charges on some such services. On March 10, 2004, the FCC initiated a rulemaking proceeding to address the regulation of services that use Internet protocol, including voice services. The FCC also concluded in response to one such petition that one provider's peer-to-peer Internet protocol service that does not use the public switched network is an interstate information service and is not subject to access charges. In addition, during April 2004, the FCC issued an order in connection with another such petition that stated that the petitioning company's service that utilizes Internet protocol for only one intermediate part of a call's transmission is a telecommunications service subject to access charges.

Broadband Services

The FCC has several ongoing rulemakings considering the regulatory treatment of broadband services. Among the questions at issue are whether to require local telephone companies like Verizon to offer such services as a common carrier or whether such services may be offered under a potentially less regulated private carriage arrangement, and whether to declare broadband services offered by local telephone companies as non-dominant and what the effect should be of any such classification.

Recent Accounting Pronouncements

Impairment Testing of Domestic Wireless Licenses

On September 29, 2004, the staff of the Securities and Exchange Commission (SEC) issued a Staff Announcement, "Use of the Residual Method to Value Acquired Assets Other Than Goodwill." The Staff Announcement requires SEC registrants to adopt a direct value method of assigning value to intangible assets acquired in a business combination under SFAS No. 141, "Business Combinations," effective for all acquisitions completed after September 29, 2004. Further, all intangible assets valued under the residual method prior to this adoption are required to be tested for impairment using a direct value method no later than the beginning of 2005. Any impairment of intangible assets recognized upon application of a direct value method by entities previously applying the residual method should be reported as a cumulative effect of a change in accounting principle. Under this Staff Announcement, the

reclassification of recorded balances between goodwill and intangible assets prior to the adoption of this Staff Announcement is prohibited. Verizon is currently evaluating the provisions of this Staff Announcement to determine the impact of adopting a direct value method, if any, on its results of operations and financial position.

Contingently Convertible Debt

In September 2004, the Emerging Issues Task Force (EITF) of the Financial Accounting Standards Board reached a conclusion in EITF Issue No. 04-8 pertaining to including contingently convertible debt in fully diluted earnings per share. Verizon's zero-coupon convertible notes, which are convertible into Verizon common stock, will be included in current and prior periods' fully diluted earnings per share calculation. Verizon anticipates the impact of adopting EITF Issue No. 04-8, effective year-end 2004, will be a reduction of earnings per diluted share of approximately 2 cents in prior years and 1 cent in 2004 and future years.

Other Matters

Verizon's independent auditor, Ernst & Young LLP (E&Y), recently informed the SEC and the Audit Committee of our Board of Directors that a foreign affiliate of E&Y performed a tax-related non-audit service that has raised a question regarding E&Y's independence with respect to E&Y's performance of audit services for Verizon. In connection with the preparation of a foreign tax return for an employee of Verizon during 2002, E&Y's foreign affiliate made a tax payment on behalf of the employee to a local tax authority. As a result, E&Y's foreign affiliate had temporary custody of an inconsequential amount of Verizon tax-related funds. Under the SEC's rules regarding auditor independence, a company's independent auditor cannot have custody of any amount of an audit client's assets. This payment service was discontinued. The fee paid by Verizon to E&Y's foreign affiliate for the preparation of this tax return, including the payment service, was approximately $1,500 for the year ended December 31, 2002. Our Audit Committee and E&Y have discussed E&Y's independence with respect to its audit of the consolidated financial statements of Verizon in light of this matter. E&Y has informed the Audit Committee that it does not believe that the provision of the tax service described above has impaired E&Y's independence with respect to Verizon because the service was administrative in nature and has been discontinued and the amount of fee and funds involved was insignificant. The Audit Committee concurred with E&Y's assessment.

Cautionary Statement Concerning Forward-Looking Statements

In this Management's Discussion and Analysis of Results of Operations and Financial Condition, and elsewhere in this Quarterly Report, we have made forward-looking statements. These statements are based on our estimates and assumptions and are subject to risks and uncertainties. Forward-looking statements include the information concerning our possible or assumed future results of operations. Forward-looking statements also include those preceded or followed by the words "anticipates," "believes," "estimates," "hopes" or similar expressions. For those statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

The following important factors, along with those discussed elsewhere in this Quarterly Report, could affect future results and could cause those results to differ materially from those expressed in the forward-looking statements:

- materially adverse changes in economic and industry conditions and labor matters, including workforce levels and labor negotiations, and any resulting financial and/or operational impact, in the markets served by us or by companies in which we have substantial investments;
- material changes in available technology;
- technology substitution;
- an adverse change in the ratings afforded our debt securities by nationally accredited ratings organizations;
- the final results of federal and state regulatory proceedings concerning our provision of retail and wholesale services and judicial review of those results;
- the effects of competition in our markets;
- our ability to satisfy regulatory merger conditions;
- the timing, scope and financial impacts of our deployment of fiber-to-the-premises broadband technology;
- the ability of Verizon Wireless to continue to obtain sufficient spectrum resources; and
- changes in our accounting assumptions that regulatory agencies, including the SEC, may require or that result from changes in the accounting rules or their application, which could result in an impact on earnings.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Information relating to market risk is included in Item 2, Management's Discussion and Analysis of Results of Operations and Financial Condition in the section under the caption "Market Risk."

Item 4. Controls and Procedures

Our chief executive officer and chief financial officer have evaluated the effectiveness of the registrant's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934), as of the end of the period covered by this quarterly report, that ensure that information relating to the registrant which is required to be disclosed in this report is recorded, processed, summarized and reported, within required time periods. Based on this evaluation, which disclosed no significant deficiencies or material weaknesses, they have concluded that the registrant's disclosure controls and procedures were adequate and effective to ensure that material information relating to the registrant and its consolidated subsidiaries would be made known to them by others within those entities, particularly during the period in which this quarterly report was being prepared. There were no changes in the registrant's internal control over financial reporting during the period covered by this quarterly report that have materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

Part II – Other Information

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table provides information about Verizon's common stock repurchases during the third quarter of 2004.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (2)
July 2004	650,000	$35.75	650,000	76,938,200
August 2004	1,430,000	$39.04	1,430,000	75,508,200
September 2004	2,295,000	$40.23	2,295,000	73,213,200
Total	4,375,000	$39.18	4,375,000	73,213,200

(1) On January 22, 2004, Verizon's Board of Directors authorized a common stock repurchase program.

(2) The program authorizes total repurchases of up to 80 million common shares and expires no later than the close of business on February 28, 2006. Under the plan, Verizon has the option to repurchase shares for the corporation over time, with the amount and timing of repurchases depending on market conditions and corporate needs.

Item 6. Exhibits

(a) Exhibits:

Exhibit Number	
10.1	Verizon Communications Inc. Long-Term Incentive Plan – Year 2004 Stock Option Grant.
10.2	Verizon Communications Inc. Long-Term Incentive Plan – Performance Stock Unit Agreement 2004-06 Award Cycle.
12	Computation of Ratio of Earnings to Fixed Charges.
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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.

VERIZON COMMUNICATIONS INC.

Date: November 8, 2004

By /s/ David H. Benson

David H. Benson
Senior Vice President and Controller
(Principal Accounting Officer)

UNLESS OTHERWISE INDICATED, ALL INFORMATION IS AS OF NOVEMBER 3, 2004.

Exhibit 10.1

VERIZON COMMUNICATIONS INC. LONG-TERM INCENTIVE PLAN
YEAR 2004 STOCK OPTION AGREEMENT

AGREEMENT between Verizon Communications Inc. ("Verizon") and you (the "Participant").

1. Purpose of Stock Option Agreement. The purpose of this Stock Option Agreement (the "Agreement") is to provide a grant of stock options to the Participant. This grant shall be known as the "Year 2004 Stock Option" or the "Option."

2. Stock Option Agreement. This Agreement is entered into pursuant to the terms of the Verizon Communications Inc. 2001 Long-Term Incentive Plan (the "Plan") and evidences the grant of a nonqualified stock option (the "Option") to the Participant to purchase shares of Verizon's Common Stock ("Common Stock") pursuant to the Plan. This Option is not an incentive stock option. The Option and this Agreement (including the covenants set forth in Exhibit A (the "Covenants"), which are incorporated into and shall be a part of the Agreement) are subject to the terms and provisions of the Plan. (The Participant may request a copy of the Plan from the Verizon Compensation and Executive Benefits Department.) By executing this Agreement, the Participant agrees to be bound by the terms and provisions of the Plan, and by the actions of the Plan Administrator, the Human Resources Committee of Verizon's Board of Directors or any successor thereto (the "Committee") or any designee of the Committee, and Verizon's Board of Directors pursuant to the Plan.

3. Contingency. The grant of stock options is contingent on the Participant's timely acceptance of this Agreement and satisfaction of certain other conditions contained herein. If the Participant does not properly accept (or revokes acceptance of) this Agreement the Participant shall not be entitled to the Year 2004 Stock Option.

4. Date. The date of the grant of the Year 2004 Stock Option is February 4, 2004 (the "Grant Date").

5. Number of Shares. The number of shares of Common Stock as to which the Option is granted is specified on the cover letter provided in conjunction with this Agreement.

6. Option Price. The option price per share is $36.75.

7. (a) Option Period and Vesting Schedule. The period for which the Option is granted is from the Grant Date until February 3, 2014 (the "Option Period"). In no event shall the Option be exercisable after the expiration of the Option Period, and the Option shall expire and be terminated earlier as set forth in section 7(b) ("Separation from Employment"). Except as set forth in section 7(b), the Option shall become exercisable over a three-year period as follows: on February 4, 2005, the Option shall become exercisable with respect to one-third of the Option shares; on February 4, 2006, the Option shall become exercisable with respect to an additional one-third of the Option shares; and on February 4, 2007, the Option shall become exercisable with respect to the remaining Option shares. Notwithstanding the foregoing, upon the occurrence of a Change in Control (as defined in the Plan), the Option shall immediately become exercisable in full.

(b) Separation from Employment. The Option may be terminated prior to the expiration of the Option Period, and the date when the Option may first be exercised may be modified, in accordance with the following terms and conditions:

(i) *Voluntary Separation or Discharge for Cause.* If the Participant quits or otherwise separates from the Company under circumstances not described in section 7(b)(ii) or (b)(iii) below, or if the Participant is discharged from employment with the Company for Cause (as defined below) and

the Participant does not Retire (as defined below), the Option shall be forfeited and canceled immediately, even if otherwise exercisable, except to the extent the Committee decides otherwise.

(ii) *Retirement, Involuntary Discharge Without Cause, or Disability.* If (A) the Participant Retires (as defined below), (B) the Company discharges the Participant without Cause (as defined below), such as by reason of a Company-initiated, voluntary or involuntary, force management or force reduction program or initiative, or (C) the Participant's separation from employment with the Company occurs as a result of total and permanent Disability (as defined below), the Option shall immediately become exercisable in full and shall remain exercisable until the earlier of (I) February 3, 2014, or (II) the fifth anniversary of the date the Participant separates from employment with the Company, provided that the Participant does not commit a material breach of any of the Covenants and provided that the Participant executes a release satisfactory to the Company waiving any claims he may have against the Company. If at any time the Participant commits a breach of any of the Covenants, the Option and the right to exercise the Option are immediately forfeited. In the case of an involuntary discharge without Cause, a Participant's separation from employment with the Company occurs on the last day the Participant is on the payroll of the Company. In the case of Disability, a Participant's separation from employment with the Company occurs on the later of the last day the Participant is on the payroll of the Company or on short-term disability.

(iii) *Death.* If the Participant's separation from employment with the Company occurs as a result of death, the Option shall be immediately exercisable in full by the Participant's beneficiary and shall remain exercisable until the earlier of (A) February 3, 2014, or (B) the fifth anniversary of the date of death. If the Participant dies after separation from employment with the Company, but while the Option is still exercisable in accordance with subsection (b)(ii) above, the Participant's beneficiary may exercise the Option in accordance with such subsection.

(iv) *Termination of Option.* Upon the expiration of any period during which the Option is exercisable in accordance with the preceding provisions of this section 7, the Option and the right to exercise the Option shall terminate and the Option shall not thereafter be exercisable.

(v) *Transfer.* Transfer of employment from Verizon to a Related Company (as defined in section 15 of this Agreement), from a Related Company to Verizon, or from one Related Company to another Related Company shall not constitute a separation from employment with the Company hereunder.

(vi) *Retirement.* For purposes of this section 7(b), "Retire" means (A) to retire after having attained at least 15 years of Net Credited Service (as defined under the Verizon Management Pension Plan) and a combination of age and years of Net Credited Service that equals or exceeds 75 points, or (B) retirement under any other circumstances determined in writing by the Plan Administrator.

(vii) *Cause.* For purposes of this section 7(b), "Cause" is defined as (A) grossly incompetent performance or substantial or continuing inattention to or neglect of the duties and responsibilities assigned to the Participant; fraud, misappropriation or embezzlement involving the Company or a material breach of the Code of Business Conduct or any of the Covenants set forth in Exhibit A, which is incorporated herein by reference, as determined by the Plan Administrator in his discretion, or (B) commission of any felony of which the Participant is finally adjudged guilty by a court of competent jurisdiction.

(viii) *Disability*. For purposes of this section 7(b), "Disability" is defined under the Company-sponsored long-term disability plan that applies to the Participant or, if the Participant is not covered by a long-term disability plan, as defined in such manner as the Plan Administrator determines.

8. (a) Exercise. The Option may be exercised, in whole or in part, as permitted under this Agreement, by making payment in accordance with subsection (b), below, or in any other manner approved by the Plan Administrator.

(b) Payment of Option Price and Withholding Taxes. In order to exercise the Option, the Participant must pay the Option Price and any required withholding taxes (including FICA) by one of the following methods:

(i) (A) check, wire transfer or through the cashless exercise procedure established by the Plan Administrator, (B) tender of Common Stock that has been held by the Participant (either directly or through a brokerage account) for at least six months, or (C) a combination of both (A) and (B); or

(ii) subject to the prior written approval of the Plan Administrator, payment of the Option Price and withholding taxes by the administrator of the stock option program on behalf of the Participant subject to such terms and conditions as the administrator may impose.

For purposes of an exchange of Common Stock in subsection (b)(i), above, the value of a share of Common Stock used to pay the Option Price or the withholding taxes shall be equal to the current market price of Verizon's Common Stock on the New York Stock Exchange at the time that the exercise is initiated by the administrator of the stock option program. The Participant may be charged an administrative fee or fees in connection with the exercise of the Option.

(c) Deferral Feature. The Participant may elect, pursuant to procedures adopted by the Plan Administrator, to defer the delivery of the additional shares of Common Stock that otherwise would be issued to the Participant upon a stock for stock exercise of the Option.

(d) Reload Feature. If the Participant, while employed by the Company, exercises all or part of the Year 2004 Option and pays all of the Option Price and the withholding taxes associated with the option exercise by tendering shares of Verizon Common Stock in accordance with this section 8, the Company shall immediately grant the Participant an option (a "Replacement Option") to purchase the number of shares of Verizon Common Stock that the Participant used to pay the Option Price and any withholding taxes. The option price per share under such Replacement Option shall be equal to the market value of a share of Common Stock at the time that such exercise occurred, and such Replacement Option shall expire on the same date as the Year 2004 Option then being exercised. This Replacement Option fully vests 6 months following the date it is granted. Except as provided in this section 8(d), the Replacement Option shall have the same terms and conditions as the Year 2004 Option. A Participant will be limited to a maximum of three exercises that will be eligible for the granting of Replacement Options under the terms of this section 8(d).

9. Notice and Date of Exercise. The exercise request shall indicate the number of shares with respect to which the Option is being exercised. The Option may not be exercised with respect to fractional shares. In addition, the Option may not be exercised if the administrator of the stock option program determines that, at the time of an attempted exercise, the market value of the shares with respect to which the Option is being exercised is either below the Option Price with respect to such shares or not sufficiently above such Option Price to cover any applicable taxes and administrative fees. Subject to the conditions and

restrictions set forth in this Agreement, the date of exercise of the Option shall be the date on which either (a) full payment of the Option Price and the withholding taxes is received by the administrator of the stock option program or (b) the administrator of the stock option program is irrevocably committed to make such payment. Notwithstanding the preceding sentence, no shares shall be issued until full payment is received by the administrator of the stock option program. Upon the exercise of the Option and receipt of full payment, Verizon shall, as soon as practicable, issue or deliver certificates for the number of shares acquired thereby, subject to the conditions and restrictions set forth in this Agreement. If the Participant dies following the exercise of all or part of the Option, but before issuance or delivery of the shares, such shares shall be issued or delivered to the Participant's beneficiary.

10. Shareholder Rights. The Participant shall have no rights as a shareholder with respect to shares of Common Stock to which the Option relates until the date on which the Participant becomes the holder of record of such shares. Except as provided by the Plan, no adjustment shall be made for dividends or other rights for which the record date is prior to such date.

11. Revocation or Amendment of Agreement. Except to the extent required by law or specifically contemplated under this Agreement (including, but not limited to, the determination of whether the Participant has been terminated for Cause, has a disability, is eligible to Retire, or has separated from employment), the Committee may not, without the written consent of the Participant, (a) revoke this Agreement insofar as it relates to the Option granted hereunder, or (b) make or change any determination or change any term, condition or provision affecting the Option if the determination or change would materially and adversely affect the Option or the Participant's rights thereto. Nothing in the preceding sentence shall preclude the Committee from exercising reasonable administrative discretion with respect to the Plan or this Agreement.

12. Assignment. The Option shall not be assignable or transferable except by will or by the laws of descent and distribution. During the Participant's lifetime, the Option may be exercised only by the Participant or by the Participant's guardian or legal representative.

13. Beneficiary. The Participant shall designate a beneficiary in writing and in such manner as is acceptable to the Plan Administrator. If the Participant fails to so designate a beneficiary, or if no such designated beneficiary survives the Participant, the Participant's beneficiary shall be the Participant's estate.

14. Other Plans and Agreements. Any gain realized by the Participant pursuant to this Agreement shall not be taken into account as compensation in the determination of the Participant's benefits under any pension, savings, group insurance, or other benefit plan maintained by the Company, except as determined by the board of directors of Verizon or, in the case of a plan not maintained by Verizon, the Related Company that maintains the plan. The Participant acknowledges that receipt of this Agreement or any prior stock option agreement shall not entitle the Participant to any other benefits under the Plan or any other plans maintained by the Company.

15. Company and Related Company. For purposes of this Agreement, "Company" means collectively Verizon and Related Companies. "Related Company" means (a) any corporation, partnership, joint venture or other entity in which Verizon holds a direct or indirect ownership or proprietary interest of 50 percent or more, or (b) any corporation, partnership, joint venture or other entity in which Verizon holds an ownership or proprietary interest of less than 50 percent but which, in the discretion of the Committee, is treated as a Related Company for purposes of this Agreement.

16. Employment Status. The grant of the Option shall not be deemed to constitute a contract of employment between the Company and the Participant, nor shall it constitute a right to remain in the employ of the Company.

17. Withholding. It shall be a condition to the issuance or delivery of shares of Common Stock as to which the Option shall have been exercised that provisions satisfactory to the Company shall have been made for payment of any taxes reasonably determined by the Company to be required to be paid or withheld pursuant to any applicable law or regulation. The Participant may irrevocably elect to have the minimum required amount of any withholding tax obligation satisfied by (a) having shares withheld that are otherwise to be issued or delivered to the Participant with respect to the exercise of the Option, (b) delivering to the administrator of the stock option program a check or wire transfer in full satisfaction of the withholding obligation, or (c) any other method approved by the Plan Administrator of which the Participant may be informed in writing.

18. Securities Laws. If at the time of any exercise of the Option in whole or in part, the Company deems it to be a violation of any federal or state securities law or regulation to issue or deliver its shares pursuant to such exercise, the Company, at its sole option, may reject such exercise and return the tender or make application for such qualification or registration as the Company deems advisable. The Company shall not be required to issue or deliver any shares of Common Stock prior to the admission of such shares to listing on any stock exchange on which the stock may then be listed and the completion of any registration or qualification of such shares under any federal or state law or rulings or regulations of any government body that the Company, in its sole discretion, determines to be necessary or advisable.

19. Committee Authority. The Committee shall have complete discretion in the exercise of its rights, powers, and duties under this Agreement. Any interpretation or construction of any provision of, and the determination of any question arising under, this Agreement shall be made by the Committee in its sole discretion and shall be final, conclusive, and binding. The Committee may designate any individual or individuals to perform any of its functions hereunder.

20. Successors. This Agreement shall be binding upon, and inure to the benefit of, any successor or successors of Verizon and the person or entity to whom the Option may have been transferred by will, the laws of descent and distribution, or beneficiary designation. All terms and conditions of this Agreement imposed upon the Participant shall, unless the context clearly indicates otherwise, be deemed, in the event of the Participant's death, to refer to and be binding upon such last-mentioned person or entity.

21. Construction. This Agreement is intended to grant the Option upon the terms and conditions authorized by the Plan. Any provisions of this Agreement that cannot be so administered, interpreted, or construed shall be disregarded. If any provision of this Agreement is held invalid or unenforceable by a court of competent jurisdiction, such provision shall be considered separate and apart from the remainder of this Agreement, which shall remain in full force and effect. If any provision is held to be enforceable for being unduly broad as written, such provision shall be deemed amended to narrow its application to the extent necessary to make the provision enforceable according to applicable law and shall be enforced as amended.

22. Defined Terms. Except where the context clearly indicates otherwise, all capitalized terms used herein shall have the definitions ascribed to them by the Plan, and the terms of the Plan shall apply where appropriate.

23. Execution of Agreement. The Participant shall indicate consent to the terms of this Agreement (including its Exhibit) and the Plan by executing this Agreement pursuant to the instructions provided and otherwise complying with the requirements of section 3. The Participant and Verizon hereby expressly

agree that the use of electronic media to indicate confirmation, consent, signature, acceptance, agreement and delivery shall be legally valid and have the same legal force and effect as if the Participant and Verizon executed this Agreement (including its Exhibit) in paper form.

24. Confidentiality. The Participant shall not disclose, in whole or in part, any of the terms of this Agreement, except to the extent (a) otherwise required by law or (b) the Company has publicly disclosed the terms of this Agreement. This section 24 does not prevent the Participant from disclosing the terms of this Agreement to the Participant's spouse or to the Participant's legal, tax, or financial adviser, provided that the Participant take all reasonable measures to assure that such spouse and advisers do not disclose the terms of this Agreement to a third party except as otherwise required by law.

25. Additional Remedies. In addition to any other rights or remedies, whether legal, equitable, or otherwise, that each of the parties to this Agreement may have (including the right of the Company to terminate the Participant for Cause), the Participant acknowledges that—

(a) The Covenants in Exhibit A to this Agreement are essential to the continued goodwill and profitability of the Company;

(b) The Participant has broad-based skills that will serve as the basis for employment opportunities that are not prohibited by the Covenants in Exhibit A;

(c) When the Participant's employment with the Company terminates, the Participant shall be able to earn a livelihood without violating any of the covenants incorporated in Exhibit A;

(d) Irreparable damage to the Company shall result in the event that the Covenants in Exhibit A are not specifically enforced and that monetary damages will not adequately protect the Company from a breach of these Covenants;

(e) If any dispute arises concerning the violation by the Participant of the Covenants in Exhibit A, an injunction may be issued restraining such violation pending the determination of such controversy, and no bond or other security shall be required in connection therewith;

(f) Such Covenants shall continue to apply after any expiration, termination, or cancellation of this Agreement; and

(g) The Participant's breach of any of such Covenants shall result in the Participant's immediate termination of all rights and benefits, including the right to exercise an Option, under this Agreement.

Exhibit A - Covenants

1. Noncompetition — In consideration for the benefits described in the Agreement to which this Exhibit A is attached, you, the Participant, agree that:

(a) Prohibited Conduct — During the period of your employment with the Company, and for the period ending six months after your termination of employment for any reason from the Company, you shall not, without the prior written consent of the Plan Administrator:

(1) personally engage in Competitive Activities (as defined below); or

(2) work for, own, manage, operate, control, or participate in the ownership, management, operation, or control of, or provide consulting or advisory services to, any individual, partnership, firm, corporation, or institution engaged in Competitive Activities, or any company or person affiliated with such person or entity engaged in Competitive Activities; provided that your purchase or holding, for investment purposes, of securities of a publicly traded company shall not constitute "ownership" or "participation in ownership" for purposes of this paragraph so long as your equity interest in any such company is less than a controlling interest;

provided that this paragraph (a) shall not prohibit you from (i) being employed by, or providing services to, a consulting firm, provided that you do not personally engage in Competitive Activities or provide consulting or advisory services to any individual, partnership, firm, corporation, or institution engaged in Competitive Activities, or any company or person affiliated with such person or entity engaged in Competitive Activities, or (ii) engaging in the private practice of law as a sole practitioner or as a partner in (or as an employee of or counsel to) a law firm in accordance with applicable legal and professional standards.

(b) Competitive Activities — For purposes of the Agreement to which this Exhibit A is attached, "Competitive Activities" means business activities relating to products or services of the same or similar type as the products or services (1) which are sold (or, pursuant to an existing business plan, will be sold) to paying customers of the Company, and (2) for which you then have responsibility to plan, develop, manage, market, oversee or perform, or had any such responsibility within your most recent 24 months of employment with the Company. Notwithstanding the previous sentence, a business activity shall not be treated as a Competitive Activity if the geographic marketing area of the relevant products or services sold by you or a third party does not overlap with the geographic marketing area for the applicable products and services of the Company.

2. Interference With Business Relations — During the period of your employment with the Company, and for a period ending with the expiration of twelve (12) months following your termination of employment for any reason from the Company, you shall not, without the written consent of the Plan Administrator:

(a) recruit or solicit any employee of the Company for employment or for retention as a consultant or service provider;

(b) hire or participate (with another company or third party) in the process of hiring (other than for the Company) any person who is then an employee of the Company, or provide names or other information about Company employees to any person, entity or business (other than the Company) under circumstances that could lead to the use of any such information for purposes of recruiting or hiring;

(c) interfere with the relationship of the Company with any of its employees, agents, or representatives;

(d) solicit or induce, or in any manner attempt to solicit or induce, any client, customer, or prospect of the Company (1) to cease being, or not to become, a customer of the Company or (2) to divert any business of such customer or prospect from the Company; or

(e) otherwise interfere with, disrupt, or attempt to interfere with or disrupt, the relationship, contractual or otherwise, between the Company and any of its customers, clients, prospects, suppliers, consultants, or employees.

3. Return Of Property; Intellectual Property Rights — You agree that on or before your termination of employment for any reason with the Company, you shall return to the Company all property owned by the Company or in which the Company has an interest, including files, documents, data and records (whether on paper or in tapes, disks, or other machine-readable form), office equipment, credit cards, and employee identification cards. You acknowledge that the Company is the rightful owner of any programs, ideas, inventions, discoveries, patented or copyrighted material, or trademarks that you may have originated or developed, or assisted in originating or developing, during your period of employment with the Company, where any such origination or development involved the use of Company time, information or resources, or the exercise of your responsibilities for or on behalf of the Company. You shall at all times, both before and after termination of employment, cooperate with the Company in executing and delivering documents requested by the Company, and taking any other actions, that are necessary or requested by the Company to assist the Company in patenting, copyrighting, protecting, enforcing or registering any programs, ideas, inventions, discoveries, works of authorship, data, information, patented or copyrighted material, or trademarks, and to vest title thereto solely in the Company.

4. Proprietary And Confidential Information — You shall at all times preserve the confidentiality of all Proprietary Information (defined below) and trade secrets of the Company, except and to the extent that disclosure of such information is legally required. "Proprietary information" means information or data related to the Company, including information entrusted to the Company by others, which has not been fully disclosed to the public by the Company and which is treated as confidential or protected within the business of the Company or is of value to competitors, such as strategic or tactical business plans; undisclosed financial data; ideas, processes, methods, techniques, systems, non-public information, models, devices, programs, computer software, or related information; documents relating to regulatory matters and correspondence with governmental entities; undisclosed information concerning any past, pending, or threatened legal dispute; pricing and cost data; reports and analyses of business prospects; business transactions that are contemplated or planned; research data; personnel information and data; identities of users and purchasers of the Company's products or services; and other confidential matters pertaining to or known by the Company, including confidential information of a third party that you know or should know the Company is obligated to protect.

5. Definitions — Except where clearly provided to the contrary, all capitalized terms used in this Exhibit A shall have the definitions given to those terms in the Agreement to which this Exhibit A is attached.

6. Agreement to Covenants. You shall indicate your agreement to these Covenants in accordance with the instructions provided. You and Verizon hereby expressly agree that the use of electronic media to indicate confirmation, consent, signature, acceptance, agreement and delivery shall be legally valid and have the same legal force and effect as if you and Verizon executed these Covenants in paper form.

Exhibit 10.2

VERIZON COMMUNICATIONS INC. LONG-TERM INCENTIVE PLAN
PERFORMANCE STOCK UNIT AGREEMENT
2004–06 AWARD CYCLE

AGREEMENT between Verizon Communications Inc. ("Verizon") and you (the "Participant").

1. Purpose of Agreement. The purpose of this Agreement is to provide a one-time grant of performance stock units ("PSUs") to the Participant.

2. Agreement. This Agreement is entered into pursuant to the terms of the 2001 Verizon Communications Inc. Long-Term Incentive Plan (the "Plan"), and evidences the grant of a performance stock award in the form of PSUs pursuant to the Plan. This Agreement is designed to comply with the requirements of Section 162(m) of the Code and the Treasury Department Regulations thereunder. The PSUs and this Agreement (including the covenants set forth in Exhibit A (the "Covenants"), which are incorporated into and shall be a part of the Agreement) are subject to the terms and provisions of the Plan. (The Participant may request a copy of the Plan from the Verizon Compensation and Executive Benefits Department.) By executing this Agreement, the Participant agrees to be bound by the terms and provisions of the Plan, and by the actions of the Plan Administrator, the Human Resources Committee of Verizon's Board of Directors or any successor thereto (the "Committee"), and any designee of the Committee.

3. Contingency. The grant of PSUs is contingent on the Participant's timely acceptance of this Agreement and satisfaction of certain other conditions contained herein. If the Participant does not properly accept (or revokes acceptance of) this Agreement the Participant shall not be entitled to the PSUs.

4. Number of Units. The Participant is granted the number of PSUs specified on the cover letter provided in conjunction with this Agreement. A PSU is a hypothetical share of Verizon's common stock. The value of a PSU on any given date shall be equal to the closing price of Verizon's common stock as of such date. A PSU does not represent an equity interest in Verizon and carries no voting rights. A Dividend Equivalent Unit ("DEU") or fraction thereof shall be added to each PSU each time that a dividend is paid on Verizon's common stock. The amount of each DEU shall be equal to the dividend paid on a share of Verizon's common stock. The DEU shall be converted into PSUs or fractions thereof based upon the average of the high and low sales prices of Verizon's common stock traded on the New York Stock Exchange on the dividend payment date of each declared dividend on Verizon's common stock, and such PSUs or fractions thereof shall be added to the Participant's PSU balance.

5. Vesting.

(a) General. The Participant shall vest in the PSUs to the extent provided in paragraph 5(b) ("Performance Requirement") only if the Participant satisfies the requirements of paragraph 5(c) ("Three-Year Continuous Employment Requirement"), except as otherwise provided in paragraph 7 ("Early Cancellation/Accelerated Vesting of PSUs").

(b) Performance Requirement.

(1) The PSUs shall vest based on the average annual total shareholder return ("TSR") of Verizon's common stock during the three-year period beginning January 1, 2004, and ending December 31, 2006, relative to the combined weighted average annual TSR of the companies in the Standard & Poor's 500 ("S&P 500®") Index and the companies in the Telecom Peer Company ("TPC") Index during the same three-year period as provided in the following table:

Relative TSR Position	Vested Percentage of PSUs*
Below 20%	0%
20%	40%
30%	60%
40%	80%
50%	100%
60%	120%
70%	140%
80% or more	200%

* For amounts between 20% and 80%, the vested percentage of PSUs shall equal twice the Relative TSR Position (e.g., a Relative TSR Position of 52% equals a 104% vested percentage). However, the Committee's discretion to administer the Plan includes the absolute discretion to reduce the vested percentage of PSUs at any Relative TSR Position, and the Committee's exercise of this discretion shall be final, conclusive and binding.

Note: No PSUs shall vest if the Relative TSR Position is less than 20% and the maximum percentage of PSUs to vest shall be 200%.

(2) For purposes of the table set forth in paragraph 5(b)(1)—

(i) "Relative TSR Position" shall equal (A) 40% of the average annual Verizon S&P 500 TSR Position during the Award Cycle, plus (B) 60% of the average annual Verizon TPC TSR Position during the Award Cycle. The Committee's discretion to administer the Plan includes the absolute discretion to substitute or eliminate companies in the Telecom Peer Index and determine the Relative TSR Position for any period, and the Committee's exercise of this discretion shall be final, conclusive and binding.

(ii) "Verizon S&P 500 TSR Position" shall be, as determined by the Committee, Verizon's rank among companies in the S&P 500 Index in terms of TSR, expressed as a percentage equal to the number of companies in the S&P 500 Index with a TSR less than or equal to that of Verizon divided by the total number of companies in such index.

(iii) "Verizon TPC TSR Position" shall be, as determined by the Committee, where Verizon would rank among companies in the Telecom Peer Company Index in terms of TSR if Verizon were included in such index, expressed as a percentage equal to the number of companies in the TPC Index with a TSR less than or equal to that of Verizon divided by the total number of companies in such index.

(iv) "TSR" or "Total Shareholder Return" shall mean the change in the price of a share of common stock from the beginning of a period (as measured by the closing price of a share of such stock on the last trading day preceding the beginning of the period) until the end of such period (as measured by the closing price of a share of such stock on the last trading day of the period), adjusted to reflect the reinvestment of dividends (if any) through the purchase of common stock and as may be necessary to take into account stock splits or other events similar to those described in Section 4.3 of the Plan.

(v) "Award Cycle" shall mean the three-year period beginning on January 1, 2004, and ending at the close of business on December 31, 2006.

(c) Three-Year Continuous Employment Requirement. Except as otherwise determined by the Committee, the PSUs shall vest only if the Participant is continuously employed by the Company from the date the PSUs are granted through the end of the Award Cycle.

(d) Transfer. Transfer of employment from Verizon to a Related Company (as defined in paragraph 13), from a Related Company to Verizon, or from one Related Company to another Related Company shall not constitute a separation from employment hereunder, and service with a Related Company shall be treated as service with the Company for purposes of the three-year continuous employment requirement in paragraph 5(c).

6. Payment. All payments under this Agreement shall be made in cash. As soon as practicable after the end of the Award Cycle, except as described in paragraph 7(c), the value of the PSUs (minus any withholding for income taxes) shall be paid to the Participant (subject, however, to any deferral application that the Participant has made under the deferral plan (if any) then available to the Participant and under procedures adopted by the Plan Administrator). If the Participant dies before any payment due hereunder is made, such payment shall be made to the Participant's beneficiary. Once a payment has been made with respect to a PSU, the PSU shall be canceled.

7. Early Cancellation/Accelerated Vesting of PSUs. Subject to the provisions of paragraph 7(c), PSUs may vest or be forfeited before vesting in accordance with paragraph 5 as follows:

(a) Voluntary Separation or Discharge for Cause.

(1) If the Participant is not eligible to Retire (as defined in paragraph 7(b)(5)) and (i) quits, (ii) is terminated for Cause (as defined below), or (iii) separates from employment under circumstances not described in paragraph 7(b), all then-unvested PSUs shall be canceled immediately and shall not be payable.

(2) For purposes of this Agreement, "Cause" means (i) grossly incompetent performance or substantial or continuing inattention to or neglect of the duties and responsibilities assigned to the Participant; fraud, misappropriation or embezzlement involving the Company; or a material breach of the Code of Business Conduct or any of the Covenants set forth in Exhibit A to this Agreement, all as determined by the Plan Administrator in its discretion, or (ii) commission of any felony of which the Participant is finally adjudged guilty by a court of competent jurisdiction.

(b) Retirement, Involuntary Termination Without Cause, Death or Disability.

(1) This paragraph 7(b) shall apply if, on or before the last day of the Award Cycle, the Participant:

(i) Retires (as defined below), or

(ii) Separates from employment by reason of an involuntary termination without Cause (as determined by the Plan Administrator), death, or disability.

(2) Subject to paragraph 7(b)(3), if the Participant separates from employment under circumstances described in paragraph 7(b)(1), the Participant's then-unvested PSUs shall be subject to the vesting provisions set forth in paragraph 5 (a), except that the three-year continuous

employment requirement set forth in paragraph 5(c) shall not apply, provided that the Participant does not commit a material breach of any of the Covenants and provided that the Participant executes a release satisfactory to the Company waiving any claims he may have against the Company.

(3) The Participant shall vest under this paragraph 7(b) only in a percentage of the PSUs that would otherwise have vested based upon the ratio of (i) the number of months the Participant was actively at work during the Award Cycle to (ii) the total number of months in the Award Cycle. For this purpose, a Participant who is actively at work through and including the 15th day of any month shall receive credit for the full month, and a Participant who is not actively at work through and including the 15th day of the month shall not receive any credit for that month.

(4) Any PSUs that vest pursuant to paragraph 7(b)(3) shall be payable as soon as practicable after the end of the Award Cycle, except as described in paragraph 7(c). However, the Plan Administrator's discretion to administer the Plan includes the absolute discretion to determine whether and the extent to which the Participant is eligible to receive DEUs with respect to dividends declared after the Participant's separation from employment, and the Plan Administrator's exercise of this discretion shall be final, conclusive and binding.

(5) For purposes of this Agreement, "Retire" means (i) to retire after having attained at least 15 years of Net Credited Service (as defined under the Verizon Management Pension Plan) and a combination of age and years of Net Credited Service that equals or exceeds 75 points, or (ii) retirement under any other circumstances determined in writing by the Plan Administrator.

(c) Change in Control. Upon the occurrence of a Change in Control (as defined in the Plan) on or before the last day of the Award Cycle, all then-unvested PSUs shall vest and be payable immediately (without prorating of the award) at 50% of the maximum award payout without regard to the performance requirement in paragraph 5(b) or the three-year continuous employment requirement in paragraph 5(c); provided, however, that if the Participant terminates employment before the Change in Control occurs under the circumstances described in paragraph 7(b)(3), the immediately payable award described in this sentence shall be prorated as described in paragraph 7(b)(3). A Change in Control that occurs after the end of the Award Cycle shall have no effect on whether any PSUs vest or become payable. A Participant who receives the immediate award payment provided in this paragraph 7(c) shall be entitled to receive payment for all dividends declared before the Change in Control, even if such dividends are paid or payable after the Change in Control.

(d) Vesting Schedule. Except as provided in paragraphs 7(b) and (c), nothing in this paragraph 7 shall alter the vesting schedule prescribed by paragraph 5.

8. Shareholder Rights. The Participant shall have no rights as a shareholder with respect to shares of common stock to which this grant relates. Except as provided in the Plan or in this Agreement, no adjustment shall be made, for dividends or other rights for which the record date occurs while the PSUs are outstanding.

9. Revocation or Amendment of Agreement. Except to the extent required by law or specifically contemplated under this Agreement (including, but not limited to, the determination of Relative TSR Position, Verizon S&P 500 TSR Position, and Verizon TPC TSR Position, and whether the Participant has been terminated for Cause, has a disability, or has satisfied the three-year continuous employment requirement), the Committee may not, without the written consent of the Participant, (a) revoke this Agreement insofar as it relates to the PSUs granted hereunder, or (b) make or change any determination or change any term, condition or provision affecting the PSUs if the determination or change would

materially and adversely affect the PSUs or the Participant's rights thereto. Nothing in the preceding sentence shall preclude the Committee from exercising reasonable administrative discretion with respect to the Plan or this Agreement.

10. Assignment. The PSUs shall not be assignable or transferable except by will or by the laws of descent and distribution. During the Participant's lifetime, the PSUs may be deferred only by the Participant or by the Participant's guardian or legal representative.

11. Beneficiary. The Participant shall designate a beneficiary in writing and in such manner as is acceptable to the Plan Administrator. If the Participant fails to so designate a beneficiary, or if no such designated beneficiary survives the Participant, the Participant's beneficiary shall be the Participant's estate.

12. Other Plans and Agreements. Any gain realized by the Participant pursuant to this Agreement shall not be taken into account as compensation in the determination of the Participant's benefits under any pension, savings, group insurance, or other benefit plan maintained by Verizon or a Related Company, except as determined by the board of directors of such company. The Participant acknowledges that receipt of this Agreement or any prior PSU agreement shall not entitle the Participant to any other benefits under the Plan or any other plans maintained by the Company.

13. Company and Related Company. For purposes of this Agreement, "Company" means collectively Verizon and Related Companies. "Related Company" means (a) any corporation, partnership, joint venture, or other entity in which Verizon holds a direct or indirect ownership or proprietary interest of 50 percent or more, or (b) any corporation, partnership, joint venture, or other entity in which Verizon holds an ownership or other proprietary interest of less than 50 percent but which, in the discretion of the Committee, is treated as a Related Company for purposes of this Agreement.

14. Employment Status. The grant of the PSUs shall not be deemed to constitute a contract of employment between the Company and the Participant, nor shall it constitute a right to remain in the employ of any such company.

15. Withholding. The Participant shall be responsible for any income taxes and the employee portion of any employment taxes that arise in connection with this grant of PSUs, and the Company shall make such arrangements as it deems necessary for withholding of any taxes it determines are required to be withheld pursuant to any applicable law or regulation.

16. Securities Laws. The Company shall not be required to make payment with respect to any shares of common stock prior to the admission of such shares to listing on any stock exchange on which the stock may then be listed and the completion of any registration or qualification of such shares under any federal or state law or rulings or regulations of any government body that the Company, in its sole discretion, determines to be necessary or advisable.

17. Committee Authority. The Committee shall have complete discretion in the exercise of its rights, powers, and duties under this Agreement. Any interpretation or construction of any provision of, and the determination of any question arising under, this Agreement shall be made by the Committee in its sole discretion and shall be final, conclusive, and binding. The Committee may designate any individual or individuals to perform any of its functions hereunder.

18. Successors. This Agreement shall be binding upon, and inure to the benefit of, any successor or successors of the Company and the person or entity to whom the PSUs may have been transferred by will, the laws of descent and distribution, or beneficiary designation. All terms and conditions of this

Agreement imposed upon the Participant shall, unless the context clearly indicates otherwise, be deemed, in the event of the Participant's death, to refer to and be binding upon such last-mentioned person or entity.

19. Construction. This Agreement is intended to grant the PSUs upon the terms and conditions authorized by the Plan. Any provisions of this Agreement that cannot be so administered, interpreted, or construed shall be disregarded. In the event that any provision of this Agreement is held invalid or unenforceable by a court of competent jurisdiction, such provision shall be considered separate and apart from the remainder of this Agreement, which shall remain in full force and effect. In the event that any provision is held to be unenforceable for being unduly broad as written, such provision shall be deemed amended to narrow its application to the extent necessary to make the provision enforceable according to applicable law and shall be enforced as amended.

20. Defined Terms. Except where the context clearly indicates otherwise, all capitalized terms used herein shall have the definitions ascribed to them by the Plan, and the terms of the Plan shall apply where appropriate.

21. Execution of Agreement. The Participant shall indicate consent to the terms of this Agreement (including its Exhibit) and the Plan by executing this Agreement pursuant to the instructions provided and otherwise complying with the requirements of paragraph 3. The Participant and Verizon hereby expressly agree that the use of electronic media to indicate confirmation, consent, signature, acceptance, agreement and delivery shall be legally valid and have the same legal force and effect as if the Participant and Verizon executed this Agreement (including its Exhibit) in paper form.

22. Confidentiality. Except to the extent otherwise required by law, the Participant shall not disclose, in whole or in part, any of the terms of this Agreement. This paragraph 22 does not prevent the Participant from disclosing the terms of this Agreement to the Participant's spouse or to the Participant's legal, tax, or financial adviser, provided that the Participant take all reasonable measures to assure that he or she does not disclose the terms of this Agreement to a third party except as otherwise required by law.

23. Additional Remedies. In addition to any other rights or remedies, whether legal, equitable, or otherwise, that each of the parties to this Agreement may have (including the right of the Company to terminate the Participant for Cause), the Participant acknowledges that—

(a) The Covenants in Exhibit A to this Agreement are essential to the continued goodwill and profitability of the Company;

(b) The Participant has broad-based skills that will serve as the basis for employment opportunities that are not prohibited by the Covenants in Exhibit A;

(c) When the Participant's employment with the Company terminates, the Participant shall be able to earn a livelihood without violating any of the Covenants in Exhibit A;

(d) Irreparable damage to the Company shall result in the event that the Covenants in Exhibit A are not specifically enforced and that monetary damages will not adequately protect the Company from a breach of these Covenants;

(e) If any dispute arises concerning the violation by the Participant of the Covenants in Exhibit A, an injunction may be issued restraining such violation pending the determination of such controversy, and no bond or other security shall be required in connection therewith;

(f) Such Covenants shall continue to apply after any expiration, termination, or cancellation of this Agreement; and

(g) The Participant's breach of any of such Covenants shall result in the Participant's immediate forfeiture of all rights and benefits under this Agreement.

Exhibit A - Covenants

1. Noncompetition — In consideration for the benefits described in the Agreement to which this Exhibit A is attached, you, the Participant, agree that:

(a) Prohibited Conduct — During the period of your employment with the Company, and for the period ending six months after your termination of employment for any reason from the Company, you shall not, without the prior written consent of the Plan Administrator:

(1) personally engage in Competitive Activities (as defined below); or

(2) work for, own, manage, operate, control, or participate in the ownership, management, operation, or control of, or provide consulting or advisory services to, any individual, partnership, firm, corporation, or institution engaged in Competitive Activities, or any company or person affiliated with such person or entity engaged in Competitive Activities; provided that your purchase or holding, for investment purposes, of securities of a publicly traded company shall not constitute "ownership" or "participation in ownership" for purposes of this paragraph so long as your equity interest in any such company is less than a controlling interest;

provided that this paragraph (a) shall not prohibit you from (i) being employed by, or providing services to, a consulting firm, provided that you do not personally engage in Competitive Activities or provide consulting or advisory services to any individual, partnership, firm, corporation, or institution engaged in Competitive Activities, or any company or person affiliated with such person or entity engaged in Competitive Activities, or (ii) engaging in the private practice of law as a sole practitioner or as a partner in (or as an employee of or counsel to) a law firm in accordance with applicable legal and professional standards.

(b) Competitive Activities — For purposes of the Agreement to which this Exhibit A is attached, "Competitive Activities" means business activities relating to products or services of the same or similar type as the products or services (1) which are sold (or, pursuant to an existing business plan, will be sold) to paying customers of the Company, and (2) for which you then have responsibility to plan, develop, manage, market, oversee or perform, or had any such responsibility within your most recent 24 months of employment with the Company. Notwithstanding the previous sentence, a business activity shall not be treated as a Competitive Activity if the geographic marketing area of the relevant products or services sold by you or a third party does not overlap with the geographic marketing area for the applicable products and services of the Company.

2. Interference With Business Relations — During the period of your employment with the Company, and for a period ending with the expiration of twelve (12) months following your termination of employment for any reason from the Company, you shall not, without the written consent of the Plan Administrator:

(a) recruit or solicit any employee of the Company for employment or for retention as a consultant or service provider;

(b) hire or participate (with another company or third party) in the process of hiring (other than for the Company) any person who is then an employee of the Company, or provide names or other information about Company employees to any person, entity or business (other than the Company) under circumstances that could lead to the use of any such information for purposes of recruiting or hiring;

(c) interfere with the relationship of the Company with any of its employees, agents, or representatives;

(d) solicit or induce, or in any manner attempt to solicit or induce, any client, customer, or prospect of the Company (1) to cease being, or not to become, a customer of the Company or (2) to divert any business of such customer or prospect from the Company; or

(e) otherwise interfere with, disrupt, or attempt to interfere with or disrupt, the relationship, contractual or otherwise, between the Company and any of its customers, clients, prospects, suppliers, consultants, or employees.

3. Return Of Property; Intellectual Property Rights — You agree that on or before your termination of employment for any reason with the Company, you shall return to the Company all property owned by the Company or in which the Company has an interest, including files, documents, data and records (whether on paper or in tapes, disks, or other machine-readable form), office equipment, credit cards, and employee identification cards. You acknowledge that the Company is the rightful owner of any programs, ideas, inventions, discoveries, patented or copyrighted material, or trademarks that you may have originated or developed, or assisted in originating or developing, during your period of employment with the Company, where any such origination or development involved the use of Company time, information or resources, or the exercise of your responsibilities for or on behalf of the Company. You shall at all times, both before and after termination of employment, cooperate with the Company in executing and delivering documents requested by the Company, and taking any other actions, that are necessary or requested by the Company to assist the Company in patenting, copyrighting, protecting, enforcing or registering any programs, ideas, inventions, discoveries, works of authorship, data, information, patented or copyrighted material, or trademarks, and to vest title thereto solely in the Company.

4. Proprietary And Confidential Information — You shall at all times preserve the confidentiality of all Proprietary Information (defined below) and trade secrets of the Company, except and to the extent that disclosure of such information is legally required. "Proprietary information" means information or data related to the Company, including information entrusted to the Company by others, which has not been fully disclosed to the public by the Company and which is treated as confidential or protected within the business of the Company or is of value to competitors, such as strategic or tactical business plans; undisclosed financial data; ideas, processes, methods, techniques, systems, non-public information, models, devices, programs, computer software, or related information; documents relating to regulatory matters and correspondence with governmental entities; undisclosed information concerning any past, pending, or threatened legal dispute; pricing and cost data; reports and analyses of business prospects; business transactions that are contemplated or planned; research data; personnel information and data; identities of users and purchasers of the Company's products or services; and other confidential matters pertaining to or known by the Company, including confidential information of a third party that you know or should know the Company is obligated to protect.

5. Definitions — Except where clearly provided to the contrary, all capitalized terms used in this Exhibit A shall have the definitions given to those terms in the Agreement to which this Exhibit A is attached.

6. Agreement to Covenants. You shall indicate your agreement to these Covenants in accordance with the instructions provided. You and Verizon hereby expressly agree that the use of electronic media to indicate confirmation, consent, signature, acceptance, agreement and delivery shall be legally valid and have the same legal force and effect as if you and Verizon executed these Covenants in paper form.

Exhibit 12

Computation of Ratio of Earnings to Fixed Charges
Verizon Communications Inc. and Subsidiaries

(Dollars in Millions)	Nine Months Ended September 30, 2004
Income before provision for income taxes, discontinued operations and cumulative effect of accounting change	$ 6,809
Minority interest	1,835
Equity in earnings of unconsolidated businesses	(635)
Dividends from unconsolidated businesses	148
Interest expense	1,809
Portion of rent expense representing interest	334
Amortization of capitalized interest	79
Income, as adjusted	$ 10,379
Fixed charges:	
Interest expense	$ 1,809
Portion of rent expense representing interest	334
Capitalized interest	115
Preferred stock dividend requirement	6
Fixed charges	$ 2,264
Ratio of earnings to fixed charges	4.58

EXHIBIT 31.1

I, Ivan G. Seidenberg, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Verizon Communications Inc.;
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 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 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 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: November 8, 2004

/s/ Ivan G. Seidenberg
Ivan G. Seidenberg
Chairman and Chief Executive Officer

EXHIBIT 31.2

I, Doreen A. Toben, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Verizon Communications Inc.;
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 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 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 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: November 8, 2004

/s/ Doreen A. Toben
Doreen A. Toben
Executive Vice President
and Chief Financial Officer

EXHIBIT 32.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002, PURSUANT TO SECTION 1350 OF CHAPTER 63 OF TITLE 18 OF THE UNITED STATES CODE

I, Ivan G. Seidenberg, Chairman and Chief Executive Officer of Verizon Communications Inc. (the "Company"), certify that:

(1) the report of the Company on Form 10-Q for the quarterly period ending September 30, 2004 (the "Report") fully complies with the requirements of section 13(a) of the Securities Exchange Act of 1934 (the "Exchange Act"); and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of the dates and for the periods referred to in the Report.

Date: November 8, 2004

/s/ Ivan G. Seidenberg

Ivan G. Seidenberg
Chairman and Chief Executive Officer

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Verizon Communications Inc. and will be retained by Verizon Communications Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

EXHIBIT 32.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002, PURSUANT TO SECTION 1350 OF CHAPTER 63 OF TITLE 18 OF THE UNITED STATES CODE

I, Doreen A. Toben, Executive Vice President and Chief Financial Officer of Verizon Communications Inc. (the "Company"), certify that:

(1) the report of the Company on Form 10-Q for the quarterly period ending September 30, 2004 (the "Report") fully complies with the requirements of section 13(a) of the Securities Exchange Act of 1934 (the "Exchange Act"); and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of the dates and for the periods referred to in the Report.

Date: November 8, 2004

/s/ Doreen A. Toben

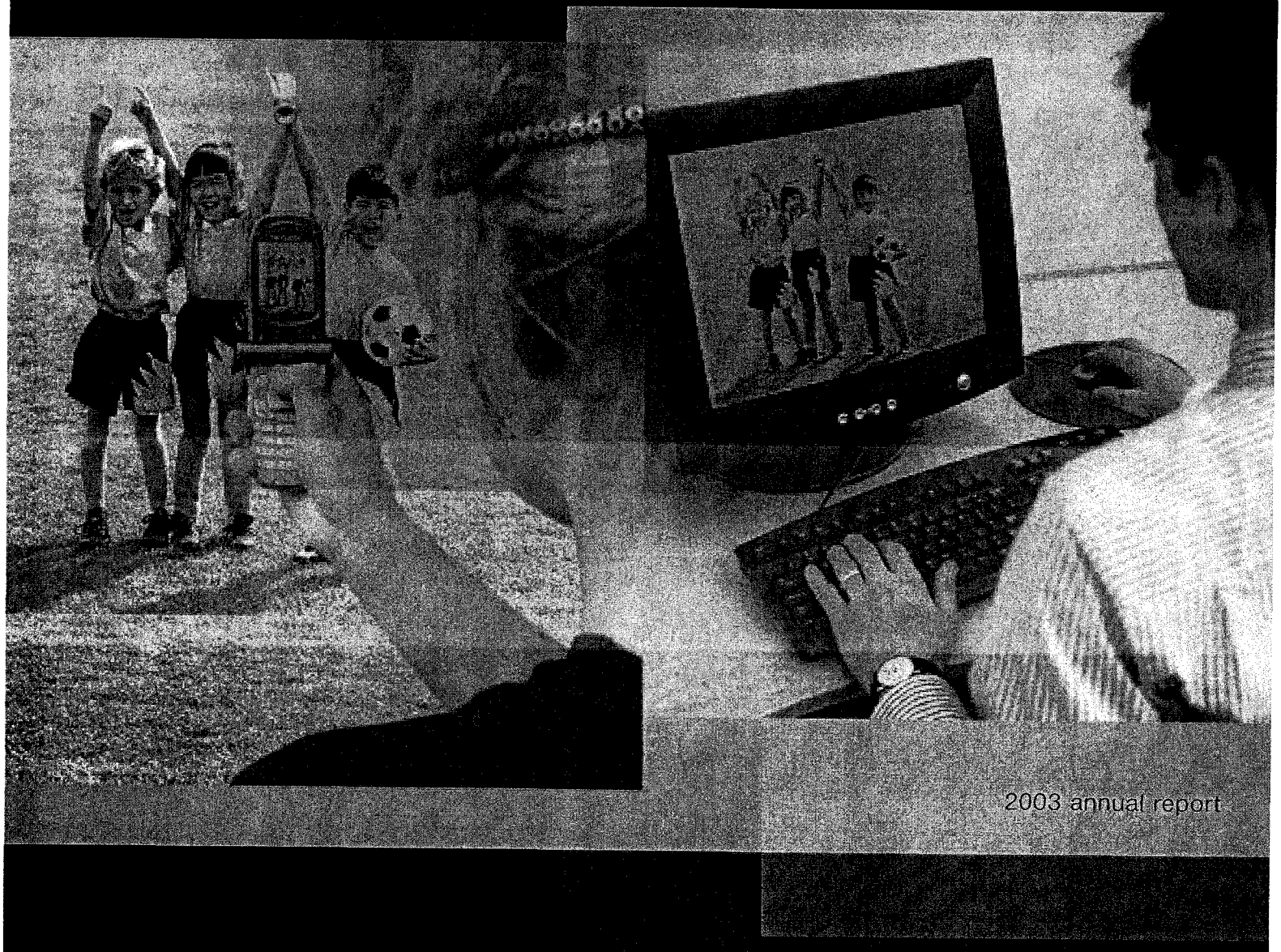
Doreen A. Toben
Executive Vice President
and Chief Financial Officer

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Verizon Communications Inc. and will be retained by Verizon Communications Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

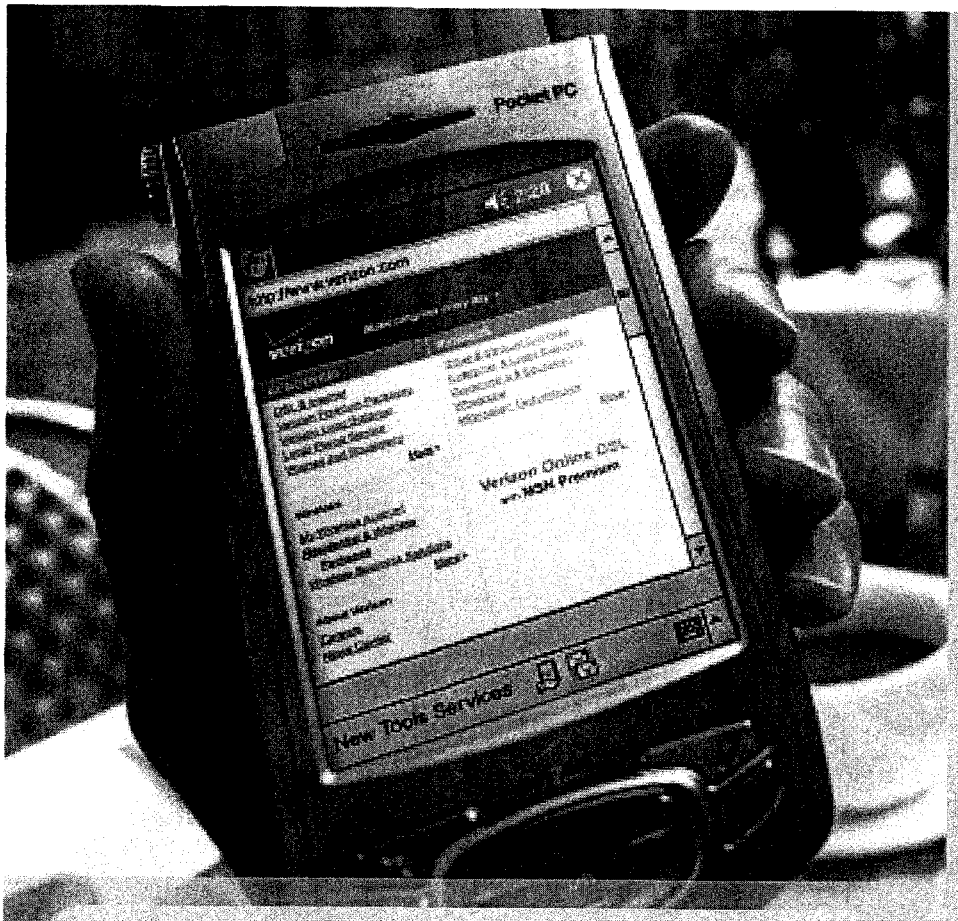
EXHIBIT 7

verizon

delivering the new world of communications



2003 annual report



company profile

Corporate
Largest U.S. wireline and wireless telecommunications provider
— Revenues of $67.8 billion
— $3.1 billion in net income
— $11.9 billion capital investment
— More than 200,000 employees

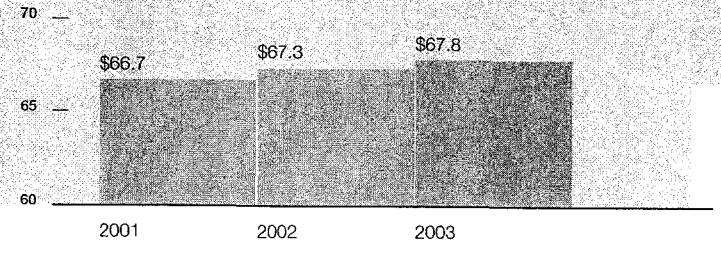
Domestic Telecom
Leading provider of local, long-distance, data and broadband services
— Revenues of $39.6 billion
— Over 27 million households
— Nearly 2.4 million business customers
— $6.8 billion capital investment

Verizon Wireless
#1 national wireless provider
— Revenues of $22.5 billion
— 37.5 million customers
— $4.6 billion capital investment

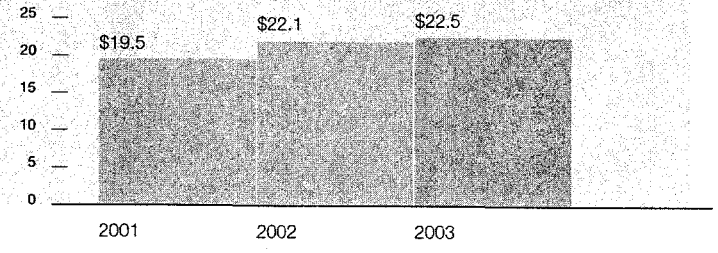
Information Services
Leading print and online directory publisher and content provider
— Revenues of $4.1 billion
— 137 million circulation worldwide
— 1.5 million advertising customers
— 93 million monthly searches on SuperPages.com

International
Wireline and wireless operations and investments primarily in the Americas and Europe
— Revenues of $1.9 billion

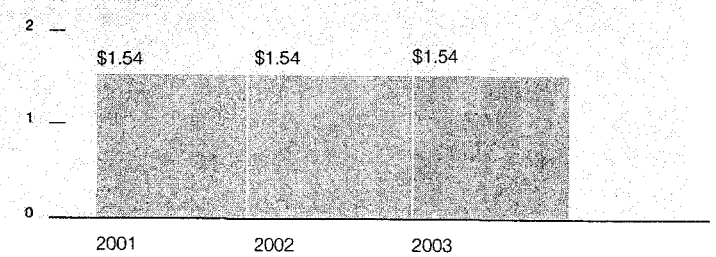
CONSOLIDATED REVENUES
(billions)



CASH FLOW FROM OPERATIONS
(billions)

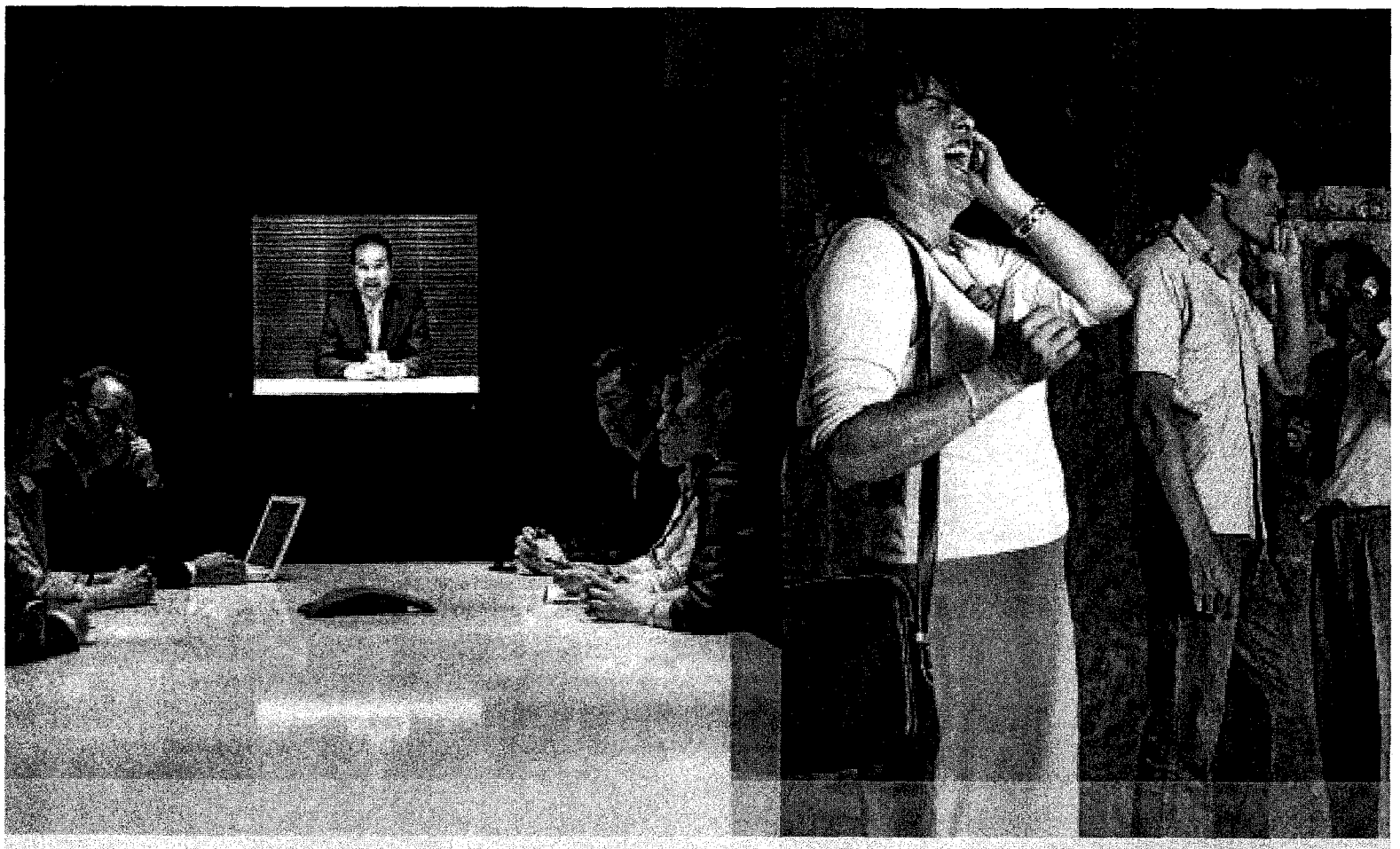


DIVIDENDS PER SHARE



In keeping with Verizon's commitment to protecting the environment, this Annual Report is printed on non-glossy, recycled paper. To read more about our environmental initiatives – including energy conservation and recycling – visit our website (www.verizon.com) and follow the link to "Verizon Community Involvement."

On the cover: A Verizon customer uses a camera phone to take photos, which are then downloaded from the Internet using Verizon Online DSL.



delivering the new world of communications

From analog to digital, wired to wireless, narrowband to broadband, Verizon has been at the forefront of the transformation in the communications industry – reinventing ourselves to put technology to work for customers. As Internet-based technologies transform communications once again, we are committed to leading the way by deploying the high-speed wireline and wireless networks and developing the e-business capabilities that will usher in a new era of innovation in voice and data services for homes and businesses. With world-class networks, an expanding portfolio of advanced services and an overriding belief in the power of innovation to differentiate us in the marketplace, Verizon is changing the way people communicate... and continuing to invent the future for ourselves and our customers.

fellow shareowners:

Ivan G. Seidenberg

Last year was another tough year in the communications industry, particularly for shareowners. Despite the turmoil, Verizon delivered solid operating results while we continued transforming ourselves for the future.

The more dynamic the industry, the more important it is to stick with your beliefs about what it takes to grow over the long term.

At Verizon, we believe that new technologies are expanding the market for communications, so we continued in 2003 to shift our investment and management focus to the growth markets of wireless and broadband.

We believe that leaders in competitive, technology-driven industries differentiate themselves through innovation and a superior value proposition, so we turned up the heat on developing new products and packaging them in ways customers want to receive them.

We believe that, in a consolidating communications industry, a sound business model based on superior assets, financial strength and a leading brand is the key to controlling your own destiny.

And we believe that great companies must do more than deliver great service. They must operate with ethics and integrity, and give something back to society.

We have built a company capable of sustaining its leadership in a restructuring industry, and we are committed to breaking through the remaining barriers to growth in communications to deliver the full value of our assets to customers and shareowners.

2003 Financial Performance

Verizon's 2003 operating revenues rose slightly over 2002, up 0.7 percent to $67.8 billion. We offset declining revenues in our traditional local telephone business with continued growth in long-distance and broadband and, especially, another spectacular year of profitable growth from Verizon Wireless.

Earnings for the year were $3.1 billion, which included net charges of $4.2 billion related to accounting changes; the sale of assets; and the severance, pensions and benefits for employees who left the business under voluntary separation plans we offered in 2003. These plans reduced our total workforce by more than 25,000 people, most of them in slower-growth areas of the business, and put our traditional business on a more competitive footing by making us a leaner organization while lowering our cost structure going forward.

While the stock market rebounded in 2003, telecom stocks did not, and Verizon was no exception. Our total return declined by 5.6 percent on the year. When we look at our performance over the last five years, we have outperformed our peers in the S&P Telecom Services Index but lag the S&P 500 Index as a whole.

Although our stock performed better in the first two months of 2004, the fact remains that, in general, shareowners have not benefited from the transformation in communications in the way customers have.

Our core businesses continue to produce extremely healthy cash flows. And while others in the communications industry scramble to assemble the assets they need to compete, we used our financial strength to improve our balance sheet by reducing debt nearly 15 percent, or $8 billion; invested almost $12 billion in our networks; and paid $4.2 billion in dividends. This puts us among the leaders in corporate America in terms of capital investment and dividends.

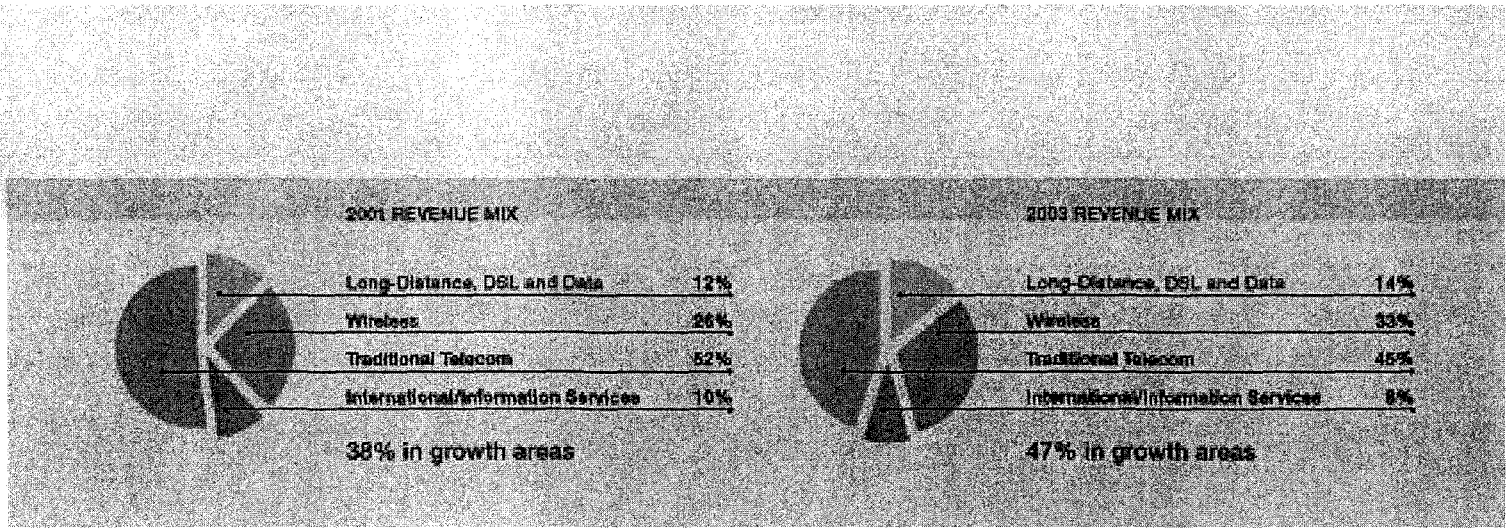
Market leaders are obliged to show the path to growth, and that's what we intend to do. Verizon will continue to demonstrate to investors that we believe in the long-term growth of this industry and have the people, strategies and resources to achieve it.

2003 Operating Results

Our 2003 operating results show that we are executing our strategic plans.

Results from Verizon Wireless show what happens when you commit yourself to leadership. As competition heated up, we actually widened our lead on the rest of the industry, turning in the highest revenue growth, best margins and lowest cost structure of all the major carriers. We maintained our edge in network quality and introduced a steady stream of new products and pricing plans, including a number of wireless data products that will account for an increasing percentage of revenue growth.

We also made progress in shifting the revenue base of our Domestic Telecom business from the declining traditional voice business to the growth markets of data, broadband, large business and long-distance. Long-distance is now a $2 billion business, up almost 20 percent for the year, and we entered 2004 with 2.3 million broadband customers. We also had good success in penetrating the large-business market by building out our national fiber-optic network and offering an enhanced suite of advanced data services to major customers.



Verizon's growth areas – Wireless, Long-Distance, DSL and Data—have increased their share of overall revenue in recent years.

Our Information Services unit put its core print directory product on a healthier footing by improving efficiency and increasing cash flow. We are leveraging the strength of our print product to transform Information Services into a multi-platform directory provider – in print, online and over wireless phones.

In International, we continued to dispose of non-strategic assets and focus our investments on businesses that enhance our domestic strategies. As we extend the Verizon brand into new areas, as we did recently in the Dominican Republic, our goal is to operate these businesses with the same standards of quality and integrity as our domestic operations.

In the chart at the top of this page, you can see the results of our efforts to change the growth profile of Verizon: since 2001, we have increased the portion of revenues from growth businesses from 38 percent to 47 percent. To keep that momentum going, we are moving quickly to shift capital investment toward new technologies that will produce higher revenue streams: expanding the reach of DSL; deploying a national wireless data network; becoming the first in the nation to offer wide-area wireless broadband service; and, in 2004, beginning to deploy fiber to the mass market and transform our network infrastructure around Internet protocols.

One more accomplishment of 2003 is worth noting because it demonstrates our commitment to doing the right thing for shareowners while meeting our obligations to employees and retirees. Under extremely challenging circumstances, we negotiated a five-year labor contract with 79,000 union-represented employees in our Domestic Telecom business that stabilizes future increases in labor costs, provides innovative solutions to escalating medical costs and preserves long-term health care benefits for retirees. This landmark contract provides stability and certainty not only for the company, but also for our employees and retirees, making us more competitive now and in the future.

Looking Ahead

As I write this letter, the wireless segment of the industry has begun to consolidate with Cingular's plan to purchase AT&T Wireless. In our judgment, consolidation is a stabilizing factor for the wireless industry. And, while competitors play catch-up to extend the reach and improve the quality of their networks, we believe the most immediate beneficiary is likely to be the acknowledged market leader, Verizon Wireless.

The same can be said of Verizon's position overall in an industry being restructured by competition and new technologies.

While others in the industry attempt to emulate Verizon's integrated national structure, we can focus on using this period of disruptive change to widen the gap between us and our competitors. Across all our businesses, we are drawing upon deep management experience, a strong nationwide brand and our investments in advanced technology in order to gain market share today, and create new sources for growth in 2004 and beyond.

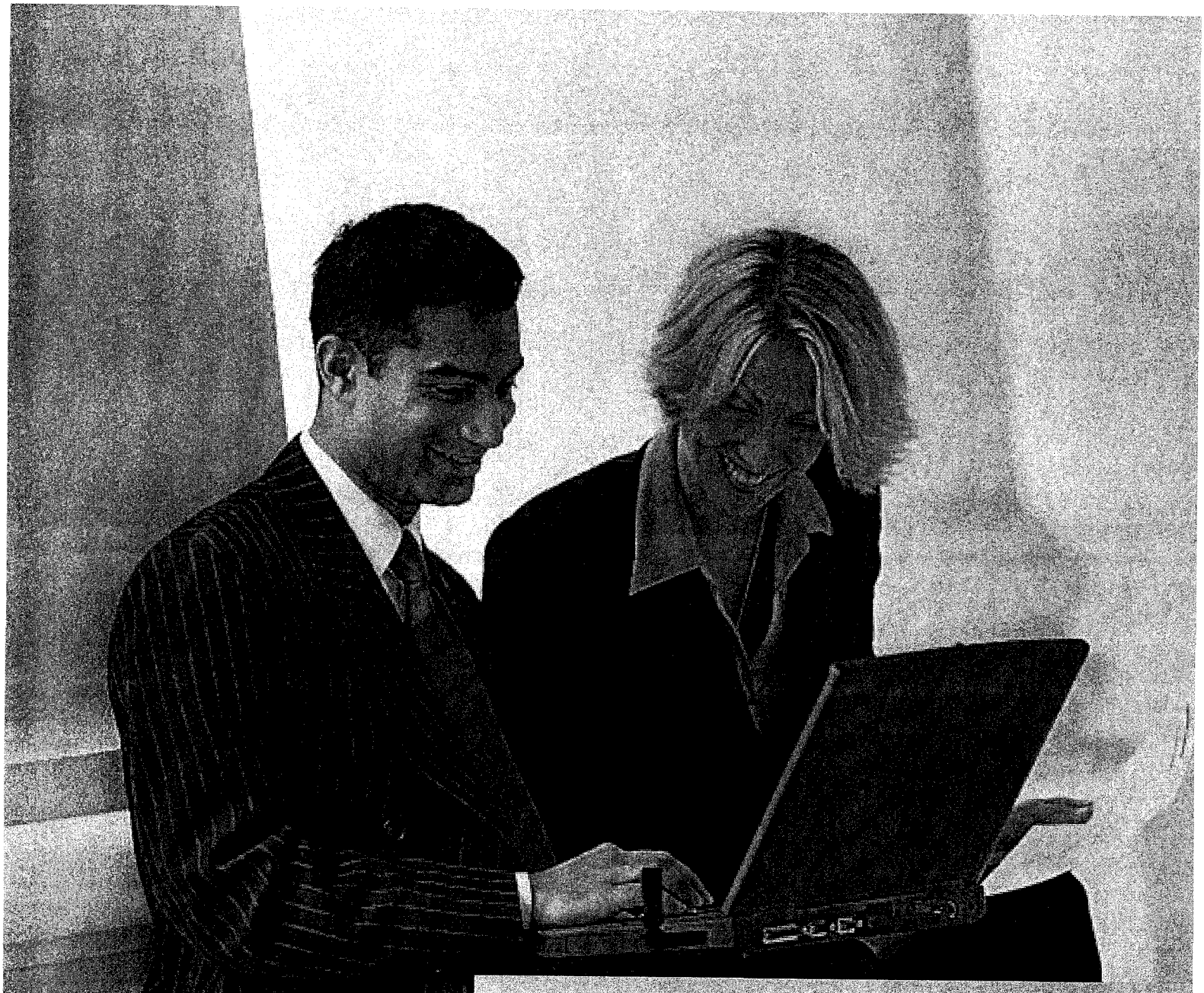
As we have done in the past, we will continue to use our strong cash flows to strengthen our balance sheet without jeopardizing the capital needed for future growth.

We are confident that we have the assets and business model to steer our own ship in a consolidating industry. More important, we have the people. Our senior leaders have consistently demonstrated their ability to execute and willingness to raise our standards of performance. They lead the organization with their focus on accountability, integrity and doing things the right way. Our Board of Directors has guided our growth over the years as we built the best collection of assets in the communications industry. And our employees have responded to extraordinary operational and competitive challenges with determination, creativity and dedication to customer service.

I would like to thank our two retiring directors, Chuck Lee and Russ Palmer, for their vision and guidance over the years. And I would especially like to thank our amazing employees, who kept customers connected last year through blackouts, rains, hurricanes and fires. Their love of this business is an inspiration to us all.

We look forward to the future with confidence in the fundamental strength of our company and with a commitment to deliver the benefits of a new world of communications to our customers, our employees and our shareowners.

Ivan G. Seidenberg
Chairman and Chief Executive Officer

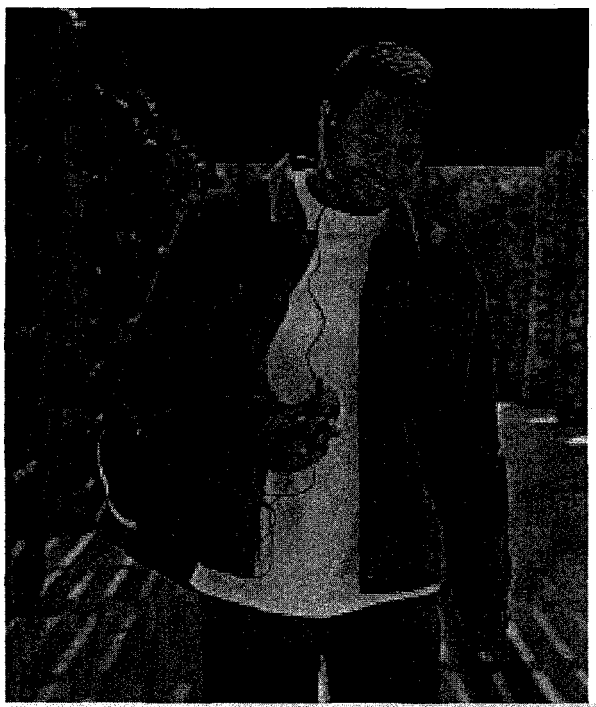


Fast Wireless Data Gets Even Faster

In 2003, Verizon Wireless not only completed our nationwide deployment of a high-speed wireless data network and service, we also launched an ultra-high-speed wide-area broadband network and service in San Diego and Washington, D.C., that gives customers wireless access to the Internet, intranets, e-mail and other applications at broadband speeds. This new service, BroadbandAccess, delivers average speeds of 300-500 kilobits per second, making it the *fastest commercial wide-area wireless data technology* available today. With BroadbandAccess, Verizon Wireless users can get a super-fast connection on the road, at the job site, in a taxi, on the train or anywhere within the coverage area.

In 2004, our commitment is to continue expanding this innovative technology in major markets across the country. This will enable a host of applications especially valuable to small and large business customers, and it will transform the wireless experience for more customers through broadband applications such as video messaging, multiplayer-gaming, video and music content, at speeds previously unavailable over wireless networks.

the best wireless company widens its lead



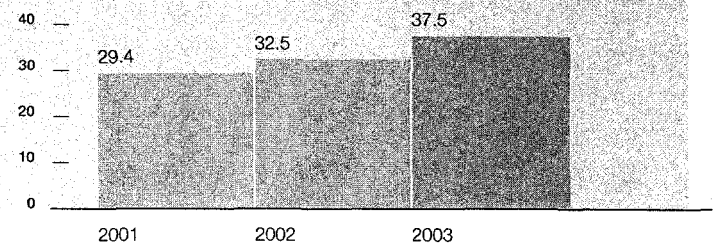
By nearly every measure – customer satisfaction, profitability, innovation, network reliability, revenue, cash flow generation and customer growth – Verizon Wireless is the nation's leading wireless provider. We continue to outperform the rest of the industry, and last year we were recognized as having the best wireless network by a major research organization and several national publications.

That record of superior service and network quality gives Verizon Wireless the most loyal customer relationships in the industry and continues to fuel our growth. In the fourth quarter of 2003, as new local number portability rules allowed wireless customers to switch carriers without changing phone numbers, Verizon Wireless's "churn" rate of customer turnover reached record lows. We added a net of 5 million customers in 2003 – increasing our customer base by 15.5 percent, to more than 37.5 million, in a highly competitive market.

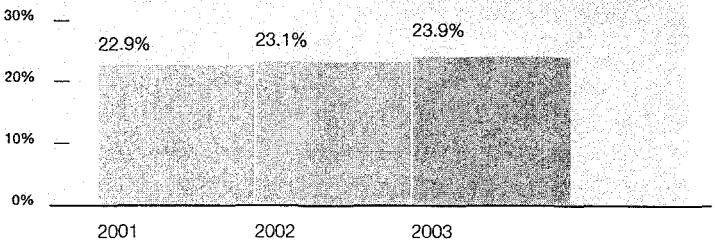
Verizon Wireless also extended its lead by rolling out several popular new services, including picture messaging; Push To Talk walkie-talkie service; and a host of downloadable games, ring tones and applications like SuperPages.com On The Go. We completed deployment of our high-speed wireless data technology nationwide, which enables applications popular with large business customers. And this year, we will use innovation to differentiate us even further as we begin expanding our BroadbandAccess service in additional markets across the country. BroadbandAccess from Verizon Wireless will be the fastest wireless wide-area data connection available.

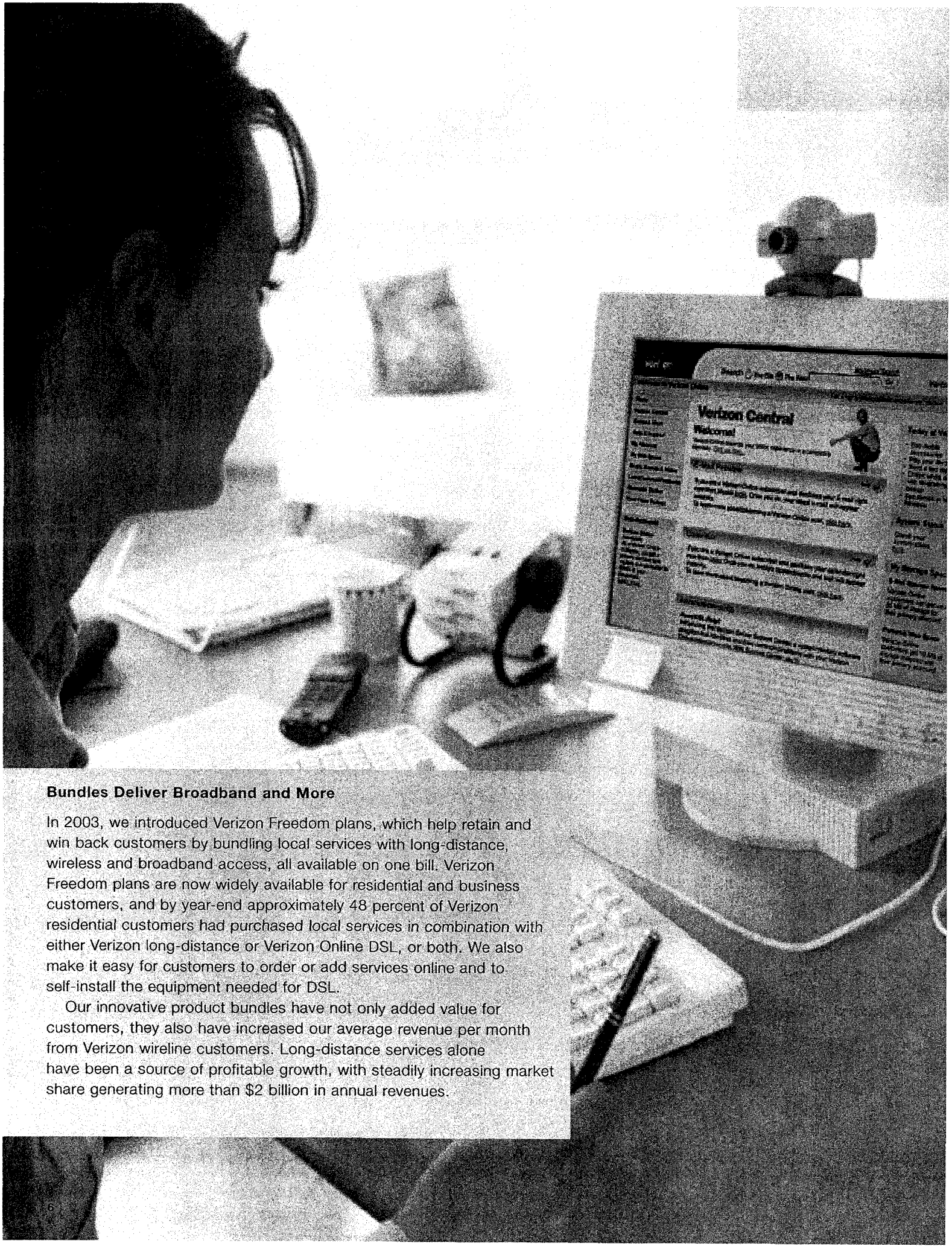
We saw a dramatic rise in data revenue and usage in 2003, and we expect this momentum to continue. To help our customers take full advantage of our data capabilities, we will continue to roll out an array of applications and advanced mobile devices customized to present visual content that will further increase usage of data and messaging services for home and business customers.

WIRELESS SUBSCRIBERS
(millions)



U.S. WIRELESS MARKET SHARE



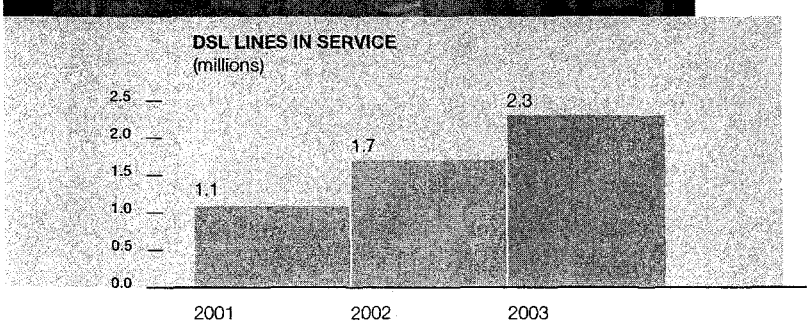


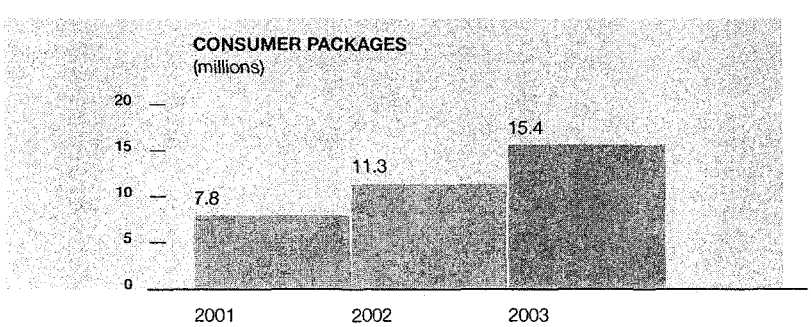
Bundles Deliver Broadband and More

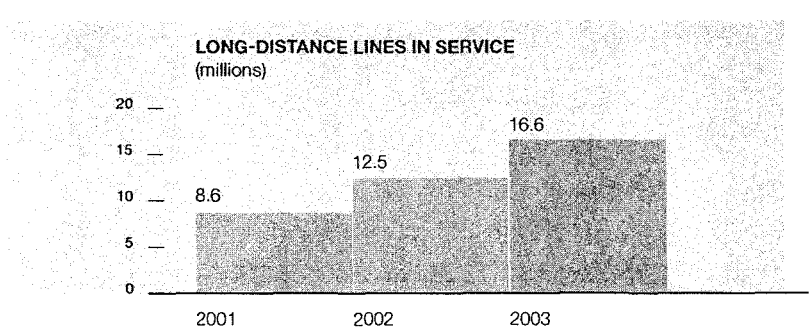
In 2003, we introduced Verizon Freedom plans, which help retain and win back customers by bundling local services with long-distance, wireless and broadband access, all available on one bill. Verizon Freedom plans are now widely available for residential and business customers, and by year-end approximately 48 percent of Verizon residential customers had purchased local services in combination with either Verizon long-distance or Verizon Online DSL, or both. We also make it easy for customers to order or add services online and to self-install the equipment needed for DSL.

Our innovative product bundles have not only added value for customers, they also have increased our average revenue per month from Verizon wireline customers. Long-distance services alone have been a source of profitable growth, with steadily increasing market share generating more than $2 billion in annual revenues.

we bring broadband to the home and office







Remember the world before the Internet?

You may wonder how kids did their homework without it – or how you worked from home, or kept in touch with your grandchildren at college, or did your holiday shopping at the last minute.

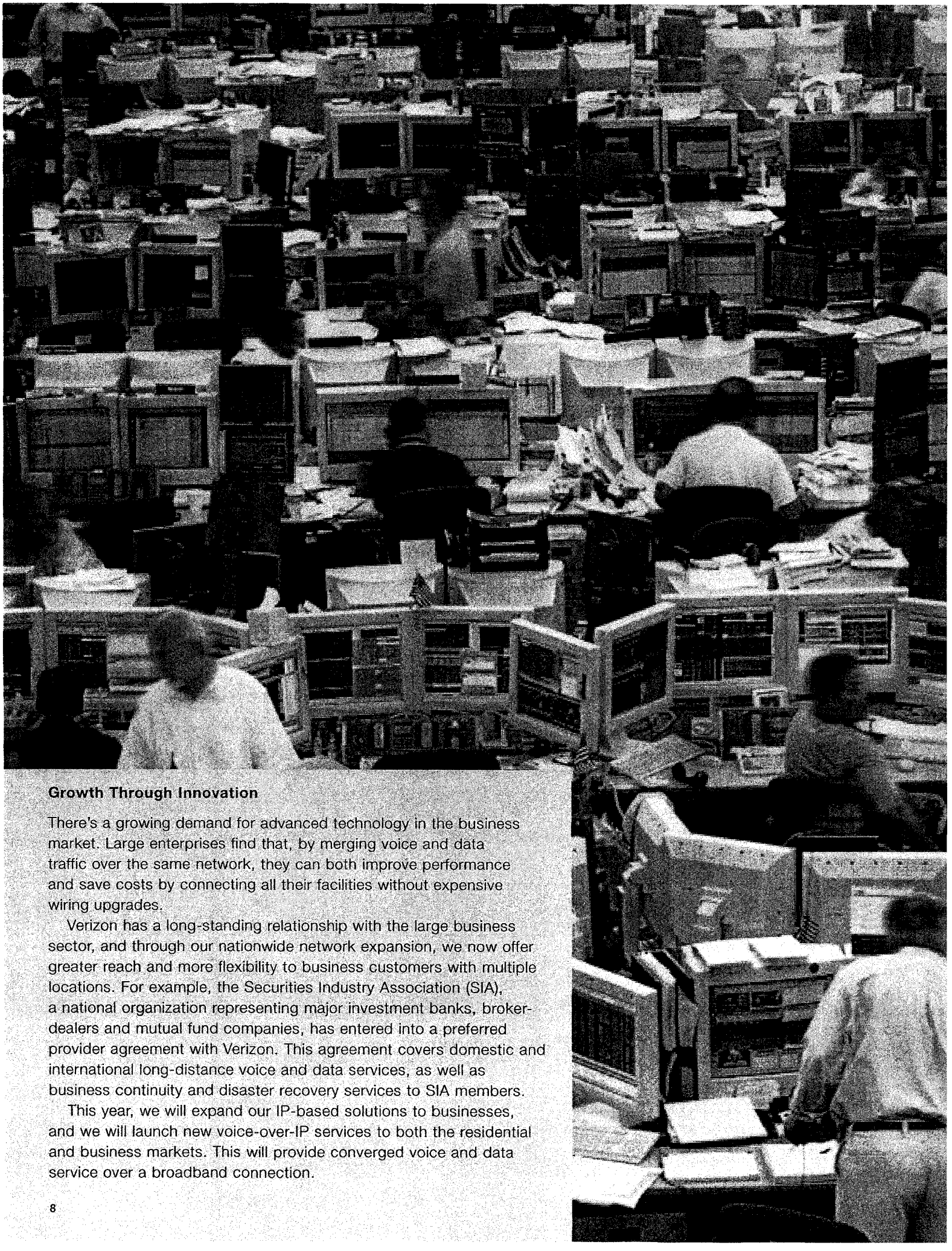
High-speed access to the Internet is an ever more important part of modern life. To support this "all-broadband, all-the-time" lifestyle, Verizon has been transforming our wireless and wireline networks to deliver high-speed connectivity to more customers than ever before.

In 2003, we extended the reach of our high-speed DSL service and grew our customer base by almost 40 percent, to 2.3 million. SuperPages.com, our online directory product, helps consumers find what they need on the Internet and has seen a dramatic increase in user searches. For the large-business Enterprise market, we have expanded our advanced, high-speed data networking services over our national fiber-optic network. And at Verizon Wireless, we operate a nationwide data network and have launched the fastest commercial wide-area wireless data technology available today.

Now we're about to take the next step to bring broadband to the mass market.

This year, Verizon will begin a widespread deployment of fiber-optic technology to homes and small businesses, delivering Internet, video, music and other content at speeds far greater than cable modems. We also will begin to deploy Internet switches and other next-generation technologies to enable our networks to handle voice, data and video simultaneously. And we will expand our wireless broadband network in major markets across the country, adding new capabilities for large business customers.

These next-generation networks will link to all kinds of devices – anywhere, anytime – and enable a whole new generation of services, from voice-over-the-Internet to video messaging to interactive learning, and more. We are committed to unleashing the full potential of broadband to the marketplace – inspiring innovative new products and improving the quality of life for our customers at home and at work.



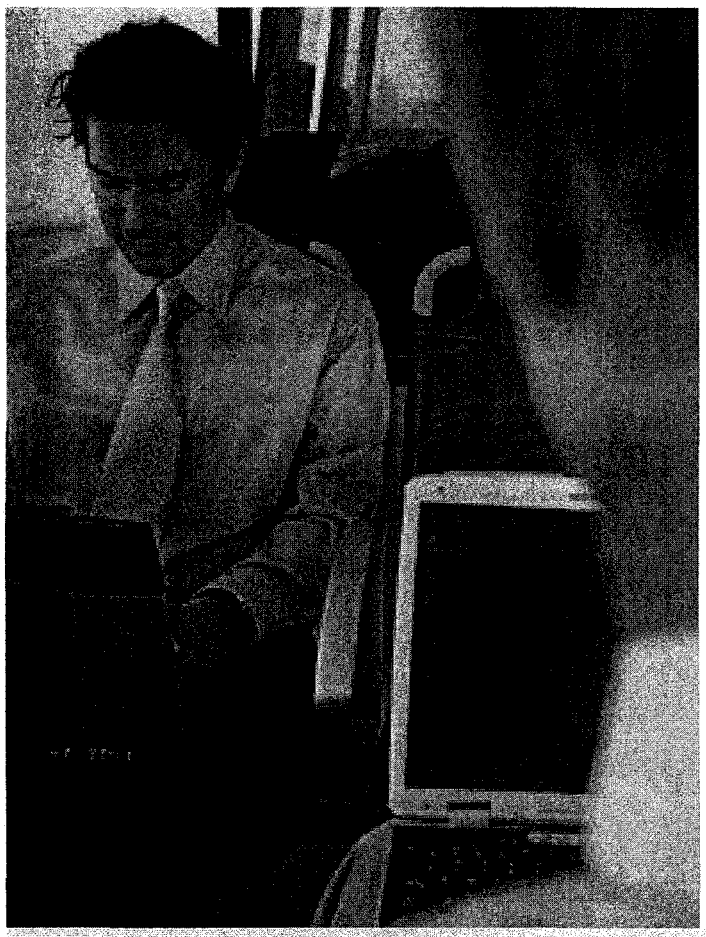
Growth Through Innovation

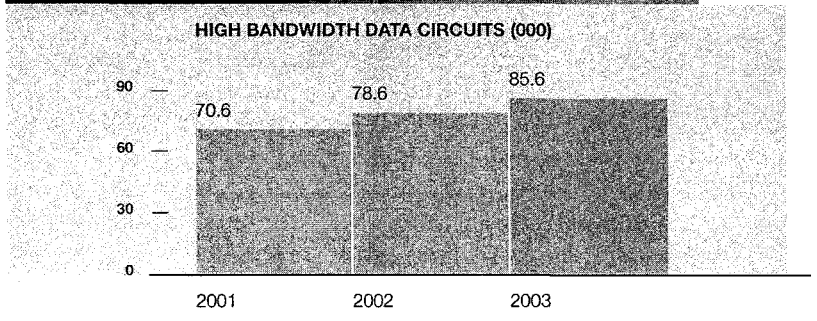
There's a growing demand for advanced technology in the business market. Large enterprises find that, by merging voice and data traffic over the same network, they can both improve performance and save costs by connecting all their facilities without expensive wiring upgrades.

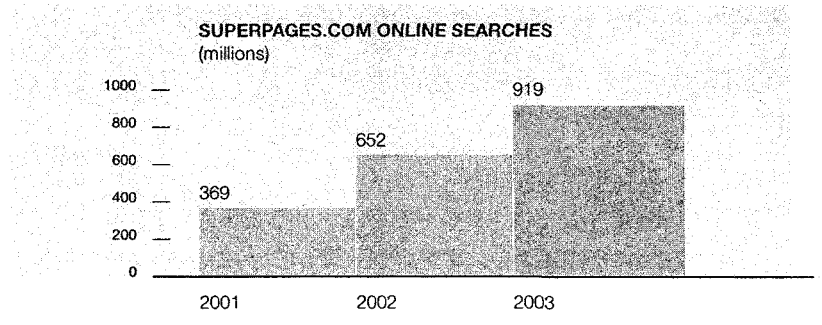
Verizon has a long-standing relationship with the large business sector, and through our nationwide network expansion, we now offer greater reach and more flexibility to business customers with multiple locations. For example, the Securities Industry Association (SIA), a national organization representing major investment banks, broker-dealers and mutual fund companies, has entered into a preferred provider agreement with Verizon. This agreement covers domestic and international long-distance voice and data services, as well as business continuity and disaster recovery services to SIA members.

This year, we will expand our IP-based solutions to businesses, and we will launch new voice-over-IP services to both the residential and business markets. This will provide converged voice and data service over a broadband connection.

Verizon gains share in the business market







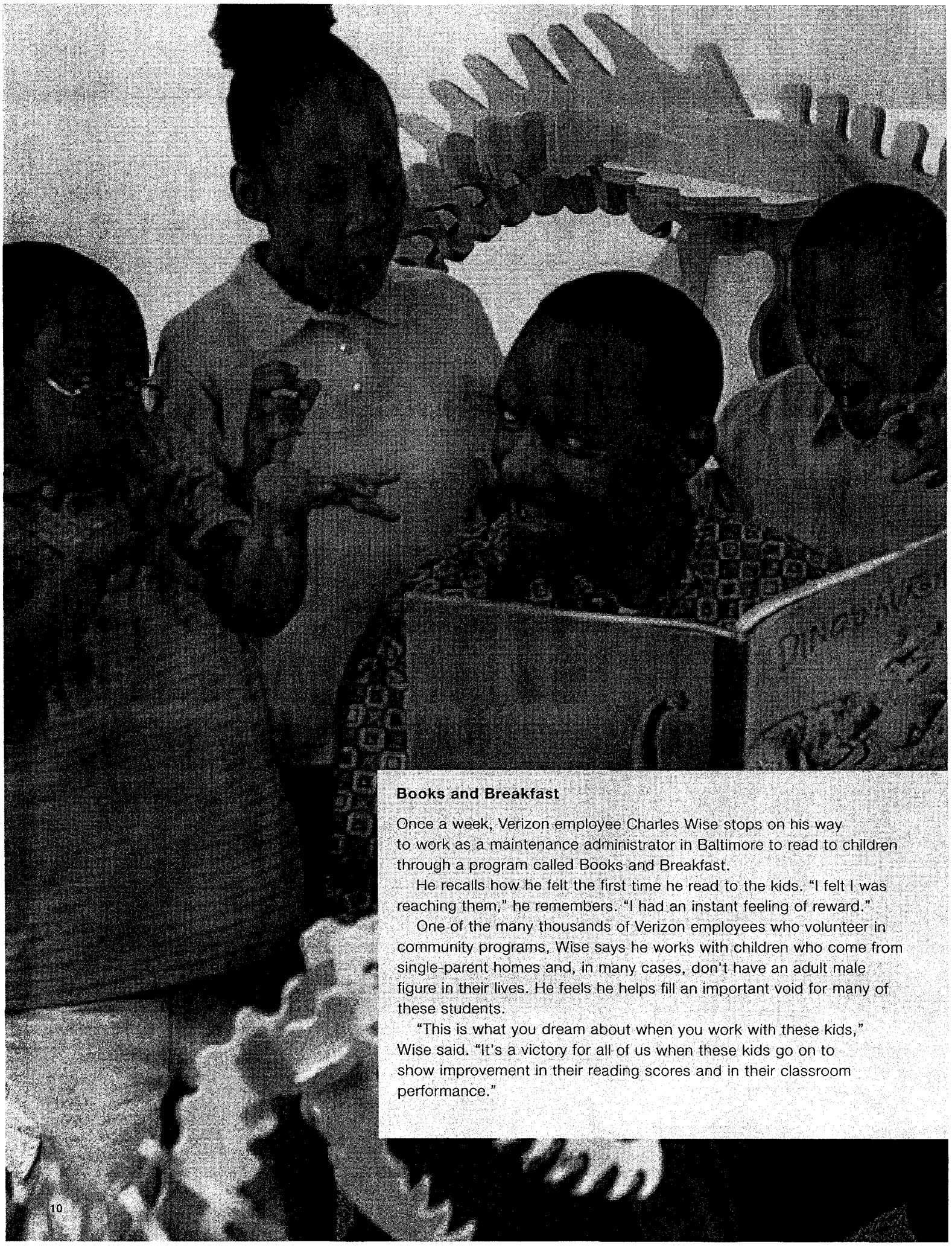
Verizon provides sophisticated, integrated communications solutions to large business customers by leveraging the strength of our wireline and wireless networks.

Our strategy is to build on our strong existing customer relationships and use our ability to carry interstate voice and data traffic to grow our share of the large-business, education and government markets. We are investing for growth by expanding our advanced, high-speed wireline data network to major markets across the country. We also have the nation's biggest and most reliable wireless voice and data network. We are launching a number of services tailored for the business market, such as the EV-DO technology behind Verizon Wireless's new BroadbandAccess service, and wireless remote access. For smaller businesses, the expanded capabilities of our SuperPages.com online directory give advertisers an effective way to reach more customers by offering them a Web presence and a greater ability to be found in local Internet searches when customers are ready to buy.

To grow our share of the large-business market, we have launched a major network expansion called Enterprise Advance, which builds on our close customer relationships with Fortune 1000 companies. Enterprise Advance not only expands the geographic reach of existing products – such as long-distance, data, fiber rings and optical transport – but also introduces new, Internet-protocol services such as voice-over-IP and virtual private networks. With this expanded capability, we can offer customers greater speeds, more bandwidth, and the increasing flexibility to merge and manage their voice and data traffic on a single network. We anchor this offer with our unsurpassed record of service and reliability.

As a result of our increased focus on this important marketplace, Verizon is gaining market share among large business customers. By transforming from a local carrier to a national carrier, Verizon is creating a promising new growth market and providing additional value to our largest customers.

Verizon is fast becoming an "all-distance" company in the eyes of our customers. Large businesses are now turning to Verizon when looking for a communications partner that can provide local, long-distance and wireless services, with the expertise to design and manage their most sophisticated data networks.



Books and Breakfast

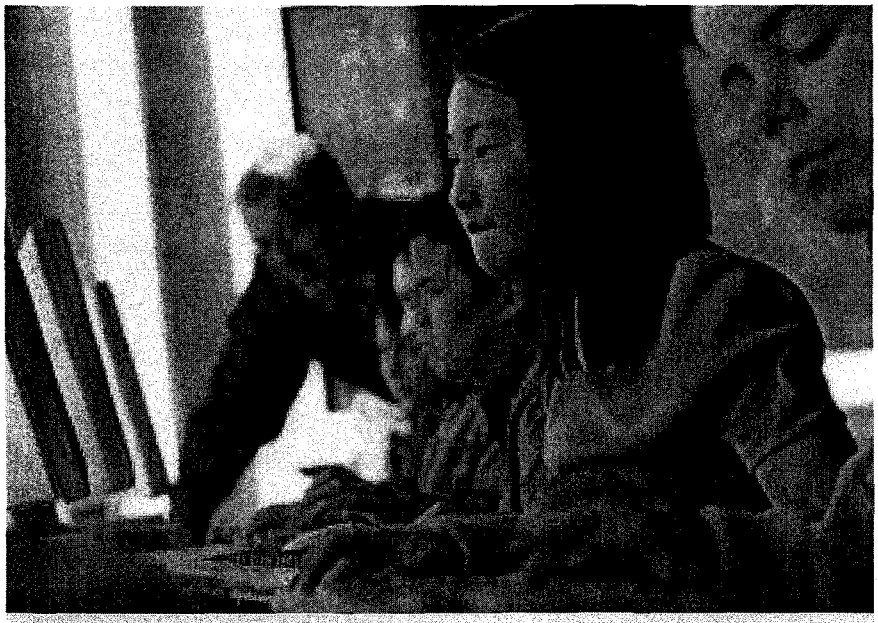
Once a week, Verizon employee Charles Wise stops on his way to work as a maintenance administrator in Baltimore to read to children through a program called Books and Breakfast.

He recalls how he felt the first time he read to the kids. "I felt I was reaching them," he remembers. "I had an instant feeling of reward."

One of the many thousands of Verizon employees who volunteer in community programs, Wise says he works with children who come from single-parent homes and, in many cases, don't have an adult male figure in their lives. He feels he helps fill an important void for many of these students.

"This is what you dream about when you work with these kids," Wise said. "It's a victory for all of us when these kids go on to show improvement in their reading scores and in their classroom performance."

Verizon makes our communities stronger



2003 GOOD WORKS INDEX

Total funds given by the Verizon Foundation	**$70 million**
Hours donated to nonprofit organizations by Verizon employees	**595,000**
Employee matching gifts and grants awarded to nonprofits by the Verizon Foundation	**$13.9 million**
Number of nonprofit organizations receiving grants directly from the Verizon Foundation	**3,600**
Grants to literary organizations nationwide	**$16 million**

Verizon has promises to keep – making our company even stronger in corporate character as well as on the bottom line.

Our commitment to social responsibility includes: corporate governance; financial reporting and customer privacy guidelines; environmental and diversity programs; investments to promote economic growth and community development; and support for local and national charitable organizations through volunteerism and contributions.

While we have thousands of nonprofit partners and contribute to a broad range of charitable concerns, literacy is one priority that extends across all Verizon business units. Under the banner of our signature Verizon Reads program, we engage in a number of initiatives to increase awareness of this critical issue, raise money and encourage collaboration among literacy organizations.

One of our most effective weapons in the fight for literacy is our engaged and committed workforce. For example, every year employees all across Verizon participate in Season's Readings, our holiday book drive for children. We also have an online literacy resource on SuperPages.com called Enlighten Me, as well as a number of international literacy programs.

More broadly, Verizon matches employee contributions and volunteer hours to any qualified nonprofit organization, which helped extend our helping hand to a wide range of concerns – from the United Way to Junior Achievement, to mentoring programs such as Aspira, to global needs such as disaster relief and the fight against AIDS.

Verizon Wireless also operates a signature program called HopeLine, which resells, refurbishes or recycles used cell phones to provide resources to combat domestic violence.

Corporate responsibility has many dimensions, and Verizon has a long record of leadership in all these areas.

straight talk from Ivan Seidenberg

What is Verizon's dividend policy? Are you considering dividend increases?

We view a stable dividend as an important way to return value to shareowners. Over the past three years, we've paid more than $12.6 billion in dividends, putting us among the top dividend-paying companies in the Fortune 500.

Dividends are only one way to use cash to return value. Another way is to strengthen our balance sheet, which is why we've reduced our debt by more than $18 billion since year-end 2001. We're also investing in next-generation technology that will make us more competitive and accelerate our long-term revenue growth. We'll continue to evaluate these three priorities – dividend increases, debt reduction and capital investment – to strike the right balance as we increase the value of your investment.

With the stock price decline last year, why didn't Verizon buy back any shares?

Our number-one priority for using free cash flow over the last two years has been reducing debt. While our goal is to continue to reduce our debt levels, we have flexibility to consider other uses for cash in 2004 and beyond.

You reduced your workforce by 25,000 in 2003. With so many employees leaving the company, what are the financial impacts?

First, I am pleased that we were able to do almost all of this downsizing through voluntary programs. Having a smaller workforce has made us financially stronger. The charges for severance, pension enhancements and related payments will be recovered over a relatively short timeframe through cost savings, and we recorded pension and other post-retirement benefit costs in 2003 that we would otherwise have incurred in future years. The resulting lower cost structure, particularly in Domestic Telecom, will make us more competitive.

How much confidence can investors place in Verizon's corporate governance processes?

I know that we are absolutely doing the right things in this area. Our goal is to operate our business with the highest level of integrity and accountability and to continue to build on the trust that we have earned over the years. We have a strong, active and independent Board of Directors which oversees, as well as challenges, our management. Our commitment to outstanding governance doesn't stop at the Board. It is reinforced with our employees worldwide through a comprehensive Code of Business Conduct. I invite shareowners to evaluate our Corporate Governance Guidelines and Code of Business Conduct for themselves on our investor Web site (www.verizon.com/investor).

Verizon has had little revenue growth for the last two years. When will growth begin to accelerate?

It's significant that Verizon did grow revenues slightly in 2003 while others in our industry saw them decline. Certainly, that's largely attributable to our having the fastest-growing, most profitable wireless company in the business. At the same time, we've used the healthy cash flows generated by our telecom and directory businesses to reinvest in technology and expand into new markets that will transform our growth profile in the future. I think that investors can feel confident about our positioning for accelerated revenue growth in the future.

Every year it seems we hear about another new communications technology that seems to present a competitive threat. How real are these threats?

Given the sophistication of our networks, we don't view technology as a threat. As we upgrade our networks year after year, we routinely incorporate new technologies on an unprecedented scale. So we view any great new technology as an opportunity to re-energize the market and re-excite our imagination. We're already deploying fast, secure 3-G (third-generation) technology to deliver broadband speeds to wireless customers. We're already redesigning our network around IP (Internet protocol) "softswitches" and other packet technologies – which is a driver for voice-over-IP deployment on a mass scale. And, most recently, we've made a commitment to bring fiber directly to the customer premises, which will deliver unprecedented broadband speeds to customers.

Why would an investor maintain Verizon as an investment over other alternatives?

We have done the work to build a market leader in wireless, telecom and information services, and we've shown that we know how to manage major shifts in technology and customer requirements. By continuing to invest in the latest technologies and the development of new services, we differentiate Verizon from our competitors and position ourselves as a top-choice communications provider in the eyes of our customers. These actions have allowed us to slightly improve our revenues in 2003 and position us for the best revenue opportunities in the years ahead.

Verizon will be one of the winners in the expanding world of communications because we have invested in the right assets at the right time.

selected financial data

(dollars in millions, except per share amounts)

	2003	2002	2001	2000	1999
Results of Operations					
Operating revenues	**$ 67,752**	$ 67,304	$ 66,713	$ 64,236	$ 57,823
Operating income	**7,494**	15,004	11,473	16,737	15,923
Income before discontinued operations, extraordinary items and cumulative effect of accounting change	**3,509**	4,661	584	10,850	8,198
Per common share – basic	**1.27**	1.71	.22	4.00	2.99
Per common share – diluted	**1.27**	1.70	.21	3.96	2.95
Net income	**3,077**	4,079	389	11,797	8,260
Net income available to common shareowners	**3,077**	4,079	389	11,787	8,260
Per common share – basic	**1.12**	1.49	.14	4.34	3.02
Per common share – diluted	**1.11**	1.49	.14	4.31	2.97
Cash dividends declared per common share	**1.54**	1.54	1.54	1.54	1.54
Financial Position					
Total assets	**$165,968**	$167,468	$170,795	$164,735	$112,830
Long-term debt	**39,413**	44,003	44,873	41,858	31,661
Employee benefit obligations	**16,759**	15,389	11,898	12,543	13,744
Minority interest, including a portion subject to redemption requirements	**24,348**	24,057	21,915	21,698	1,749
Shareowners' investment	**33,466**	32,616	32,539	34,578	26,376

- Significant events affecting our historical earnings trends in 2001 through 2003 are described in Management's Discussion and Analysis of Results of Operations and Financial Condition.
- 2000 data includes gains on investments and sales of businesses, merger-related costs and other special and/or non-recurring items.
- 1999 data includes a net gain on the sale of businesses, merger-related costs and other special and/or non-recurring items.

management's discussion and analysis
of results of operations and financial condition

OVERVIEW

Verizon Communications Inc. is one of the world's leading providers of communications services. Verizon companies are the largest providers of wireline and wireless communications in the United States, with 140.3 million access line equivalents and 37.5 million wireless customers. Verizon is the third largest long distance carrier for U.S. consumers, with 16.6 million long distance lines, and the company is also the largest directory publisher in the world, as measured by directory titles and circulation. Verizon's international presence extends primarily to the Americas, as well as investments in Europe. Stressing diversity and commitment to the communities in which we operate, Verizon has a highly diverse workforce of over 200,000 employees.

We are comprised of four strategic business units: Domestic Telecom, Domestic Wireless, Information Services and International. Domestic Telecom includes local, long distance and other communication services. Domestic Wireless products and services include wireless voice and data services and equipment sales. Information Services consists of our domestic and international publishing businesses, including print SuperPages® and online SuperPages.com™ directories, and electronic commerce services. International operations include wireline and wireless communications operations and investments primarily in the Americas and Europe.

The sections that follow provide information about the important aspects of our operations and investments, both at the consolidated and segment levels, and include discussions of our results of operations, financial position and sources and uses of cash, as well as significant future commitments. In addition, we have highlighted key trends and uncertainties to the extent practicable. The content and organization of the financial and non-financial data presented in these sections are consistent with information used by our chief operating decision makers for, among other purposes, evaluating performance and allocating resources. We also monitor several key economic indicators as well as the state of the economy in general, primarily in the United States where the majority of our operations are located, in evaluating our operating results and analyzing and understanding business trends. While most key economic indicators impact our operations to some degree, including gross domestic product, we have noted higher correlations to housing starts, non-farm employment, personal consumption expenditures and capital spending, as well as more general economic indicators such as inflation and unemployment rates.

Our results of operations, financial position and sources and uses of cash in the current and future periods reflect Verizon management's focus on the following four key areas:

- Revenue Growth – Our emphasis is on revenue transformation, devoting more resources, including capital spending, from traditional services to the higher growth markets such as wireless, digital subscriber lines (DSL), long distance and other data services as well as expanded services to enterprise markets. In 2003, approximately 47% of our revenues were earned in these growth areas, compared to 38% in 2001.
- Operational Efficiency – While focusing resources on growth markets, we are continually challenging our management team to lower expenses through technology-assisted productivity improvements. The effect of these and other efforts, such as 2003's labor agreements and voluntary separation plans, has been to significantly change the company's cost structure. Verizon now has significantly lower workforce levels, which will provide ongoing expense benefits.
- Capital Allocation – Capital spending has been, and will continue to be directed toward growth markets. High-speed wireless data (EV-DO), replacement of copper lines with fiber optics to the home, as well as voice over the Internet and expanded services to enterprise markets, are examples of areas of capital spending in support of these growth markets.
- Cash Flow Generation – The financial statements reflect the emphasis of management in not only directing resources to growth markets, but also using cash provided by our operating and investing activities for significant repayments of debt in addition to providing a stable dividend to our shareowners.

Supporting these key focus areas are continuing initiatives to more effectively package and add more value to our products and services. Innovative product bundles include local wireline services, long distance, wireless and DSL for consumer and general business retail customers. In 2004, we will be expanding our bundles to include iobi[sm] and Verizon One as well as under an agreement with DIRECTV, we will also be adding video to the retail bundle. In our enterprise markets, we are expanding our presence by completing the build-out of our nationwide network and expanding our portfolio of advanced data services. These efforts will also help counter the effects of competition and technology substitution that have resulted in access line losses in recent years that have contributed to declining Domestic Telecom revenues over the past three years. In our wireless business, we will continue to execute on the fundamentals of our network superiority and value proposition to deliver growth for the business.

While recent domestic economic indicators have suggested stabilization or growth, there still exists significant uncertainty about when or to what extent economic improvement will impact our financial performance. However, the ongoing impact on operating expenses of reductions in the workforce during the fourth quarter of 2003, less higher pension and other employee benefit costs, will help stabilize the Domestic Telecom operating income margins.

CONSOLIDATED RESULTS OF OPERATIONS

In this section, we discuss our overall results of operations and highlight special and non-recurring items. In the following section, we review the performance of our four reportable segments. We exclude the effects of the special and non-recurring items from the segments' results of operations since management does not consider them in assessing segment performance, due primarily to their non-recurring and/or non-operational nature. We believe that this presentation will assist readers in better understanding our results of operations and trends from period to period. This section on consolidated results of operations carries forward the segment results, which exclude the special and non-recurring items, and highlights and describes those items separately to ensure consistency of presentation in this section and the "Segment Results of Operations" section.

The special and non-recurring items include operating results through the sale date of 1.27 million non-strategic access lines sold in 2002 which are not in segment results of operations to enhance comparability. In addition, consolidated operating results include several other events and transactions that are highlighted because of their non-recurring and/or non-operational nature. See "Special Items" for additional discussion of these items.

Consolidated Revenues

Years Ended December 31,	2003	2002	% Change	2002	2001	% Change
				(dollars in millions)		
Domestic Telecom	**$ 39,602**	$ 40,839	(3.0)%	$ 40,839	$ 42,148	(3.1)%
Domestic Wireless	**22,489**	19,473	15.5	19,473	17,560	10.9
Information Services	**4,114**	4,287	(4.0)	4,287	4,313	(0.6)
International	**1,949**	2,219	(12.2)	2,219	1,581	40.4
Corporate & Other	**(402)**	(137)	193.4	(137)	114	nm
Revenues of access lines sold	**–**	623	(100.0)	623	997	(37.5)
Consolidated Revenues	**$ 67,752**	$ 67,304	0.7	$ 67,304	$ 66,713	0.9

nm – Not meaningful

2003 Compared to 2002

Consolidated revenues in 2003 were higher by $448 million, or 0.7% compared to 2002 revenues. This increase was primarily the result of higher revenues at Domestic Wireless, partially offset by lower revenues at Domestic Telecom and the impact of sales of 1.27 million non-strategic access lines in 2002.

Domestic Wireless's revenues increased by $3,016 million, or 15.5% in 2003 as a result of 5.0 million net customer additions and higher revenue per customer per month. Average revenue per customer per month increased by 1.0% to $48.85 in 2003 compared to 2002, primarily due to a larger number of customers on higher access price plan offerings as well as an increase in data revenues per subscriber, partially offset by decreased roaming revenue as a result of rate reductions with third-party carriers and decreased long distance revenue due to bundled pricing.

Domestic Telecom's revenues in 2003 were lower than 2002 by $1,237 million, or 3.0%, primarily due to lower local and network access services, partially offset by higher long distance revenues. The decline in local service revenues of $817 million, or 4.0% in 2003 was mainly due to lower demand and usage of our basic local exchange and accompanying services, as reflected by a decline in switched access lines in service of 4.2% in 2003. This revenue decline was mainly driven by the effects of competition, regulatory pricing rules for unbundled network elements (UNEs) and technology substitution, including switching from traditional landline to wireless services and a shift of basic business access lines to high-speed, high-volume special access lines. In addition, our network access revenues declined by $708 million, or 5.3% in 2003 principally due to decreasing switched minutes of use (MOUs) and access lines, as well as price reductions associated with federal and state price cap filings and other regulatory decisions. Further, our special access revenues in 2003 were negatively impacted by a reduction in rates for modem aggregation services provided to WorldCom, Inc. (now operating as MCI) under Verizon's CyberPOP tariff. Domestic Telecom's long distance service revenues increased $618 million, or 19.5% in 2003 principally as a result of customer growth from our interLATA long distance services. In the first quarter of 2003, we received final Federal Communications Commission (FCC) approval to offer long distance services in our remaining three jurisdictions: Maryland, West Virginia and the District of Columbia. We now offer long distance services throughout the United States, capping a seven-year effort.

Lower revenue of access lines sold of $623 million in 2003 was the result of the sales of non-strategic access lines in the third quarter of 2002.

2002 Compared to 2001

Consolidated revenues were $591 million, or 0.9% higher in 2002 compared to 2001. This increase was primarily the result of higher revenues at Domestic Wireless and International, partially offset by lower revenues at Domestic Telecom and the impact of sales of non-strategic access lines in the third quarter of 2002.

Domestic Wireless's revenues were higher by $1,913 million in 2002, largely due to customer additions and higher revenue per customer per month. Our Domestic Wireless segment ended 2002 with 32.5 million customers, an increase of 10.5% over year-end 2001 and average revenue per customer per month was $48.35 in 2002, or 1.1% higher than in 2001.

Revenues earned by Domestic Telecom in 2002 were lower than 2001 by $1,309 million, primarily due to lower local and other services, partially offset by higher network access services. Local services revenue declined $1,167 million, or 5.4% in 2002 largely resulting from lower demand and usage of our basic local wireline services, driven by regulatory pricing rules for UNEs and technology substitution. In 2002, revenue from other services declined $634 million, or 13.8% due to lower customer premises equipment and supply sales to some major customers, lower volumes at some of our non-regulated businesses due to declines in customer demand and a decline in public telephone revenues as more customers substituted wireless communications for pay telephone services. However, our network access services revenue increased $435 million, or 3.3% in 2002 mainly as a result of higher customer demand for high-capacity and data services.

International's revenues were higher by $638 million in 2002 primarily due to the consolidation of Telecomunicaciones de Puerto Rico, Inc. (TELPRI), partially offset by the deconsolidation of CTI Holdings, S.A. (CTI) in 2002. Adjusting 2001 for the consolidation of TELPRI and the deconsolidation of CTI to be comparable with 2002, revenues generated by our international businesses declined by $197 million, or 8.2% in 2002 due primarily to the weak economies and increased competition in our Latin America markets as well as reduced software sales.

Lower revenue from access lines sold in 2002 of $374 million was the result of the sales of non-strategic access lines in the third quarter of 2002, compared to a full year of results of operations for those lines in 2001.

Consolidated Operating Expenses

Years Ended December 31,	2003	2002	% Change	2002	2001	% Change
				(dollars in millions)		
Cost of services and sales	**$ 21,783**	$ 19,911	9.4%	$ 19,911	$ 20,538	(3.1)%
Selling, general and administrative expense	**24,999**	21,846	14.4	21,846	20,829	4.9
Depreciation and amortization expense	**13,617**	13,290	2.5	13,290	13,523	(1.7)
Sales of businesses, net	**(141)**	(2,747)	(94.9)	(2,747)	350	nm
Consolidated Operating Expenses	**$ 60,258**	$ 52,300	15.2	$ 52,300	$ 55,240	(5.3)

nm – Not meaningful

2003 Compared to 2002

Cost of Services and Sales

Cost of services and sales of $21,783 million increased by $1,872 million, or 9.4% in 2003 compared to 2002. This increase was driven by lower income provided by pension income net of other postretirement benefit expense, principally at Domestic Telecom, and higher equipment costs associated with Domestic Wireless customer additions and equipment upgrades. The overall impact of pension and other postretirement benefit plan assumption changes, combined with the impact of lower than expected actual asset returns over the past three years, reduced pension income, net of postretirement benefit expenses, by $1,385 million in 2003 (primarily in cost of services and sales), compared to 2002. In addition, costs of removal in excess of salvage for outside plant assets, resulting from the adoption of Statement of Financial Accounting Standards (SFAS) No. 143, "Accounting for Asset Retirement Obligations," effective January 1, 2003, were approximately $165 million in 2003. Previously, we had included costs of removal for these assets in our depreciation rates. Higher costs associated with growth businesses at Domestic Telecom such as long distance and data services, as well as the impact of annual wage increases, additional overtime pay due to higher weather-related repair volumes, contingency costs to maintain operational readiness during recent labor negotiations and direct wireless network costs associated with increased Domestic Wireless MOUs further contributed to cost increases in 2003. Cost increases in 2003 were partially offset by lower access and transport costs, the effects of workforce reductions, disciplined expense controls and lower wireless roaming rates. In addition, we incurred merger-related costs in 2002 of $143 million.

Selling, General and Administrative Expense

Selling, general and administrative expense of $24,999 million was $3,153 million, or 14.4% higher in 2003 compared to 2002. This increase was driven by higher 2003 special charges of $2,297 million, higher costs associated with an increase in the employee base at Domestic Wireless and higher sales commissions related to an increase in wireless customer additions and renewals during the year. These cost increases were partially offset by lower bad debt expense due to a reduction in uncollectible accounts receivable, improved collections and additional customer deposit requirements and lower advertising costs at Domestic Telecom in 2003 compared to 2002.

Special charges recorded in selling, general and administrative expense related to severance, pension and benefits were $3,474 million higher in 2003 compared to 2002, driven primarily by fourth quarter 2003 charges incurred in connection with the voluntary separation of approximately 21,000 employees. Higher special charges recorded in selling, general and administrative expense in 2002 pertained to merger-related costs and investment-related charges.

Depreciation and Amortization Expense

Depreciation and amortization expense of $13,617 million increased by $327 million, or 2.5% in 2003 compared to 2002. This increase was primarily due to increased depreciation expense related to the increase in depreciable assets and higher software amortization costs, partially offset by lower rates of depreciation on telephone plant, as well as the favorable impact on depreciation expense of adopting SFAS No. 143, effective January 1, 2003.

Sales of Businesses, Net

In 2003, Information Services completed the sale of its directory businesses in Europe, which consisted of publishing operations in Austria, the Czech Republic, Gibraltar, Hungary, Poland and Slovakia. We recorded a net gain of $141 million ($88 million after-tax, or $.03 per diluted share).

During the third quarter of 2002, we sold 1.27 million of our switched access lines in Alabama, Missouri and Kentucky and recorded a pretax gain of $2,527 million ($1,550 million after-tax, or $.56 per diluted share). Also during 2002, we recorded a net pretax gain of $220 million ($116 million after-tax, or $.04 per diluted share), primarily resulting from a pretax gain on the sale of TSI Telecommunication Services Inc. (TSI) of $466 million ($275 million after-tax, or $.10 per diluted share), partially offset by an impairment charge in connection with our exit from the video business and other charges of $246 million ($159 million after-tax, or $.06 per diluted share).

2002 Compared to 2001

Cost of Services and Sales

Cost of services and sales in 2002 were $19,911 million, a decrease of $627 million, or 3.1% compared to 2001. This decrease was driven by reduced spending for materials and contracted services due to lower capital expenditures and strong cost control management. Lower overtime for installation and maintenance activity at Domestic Telecom was the result of reduced volumes at our dispatch and call centers. Lower employee costs associated with declining workforce levels also contributed to the decline in operating costs. In addition, lower cost of sales at our customer premises equipment and supply business was driven by declining business volumes. These cost reductions were partially offset by higher costs associated with our growth businesses at Domestic Telecom such as data and long distance services and higher costs associated with increased Domestic Wireless MOUs and an increase in cost of equipment sales, driven by growth in new wireless customer additions. Cost of services and sales increased at International by $188 million in 2002 primarily as a result of the consolidation of TELPRI, partially offset by the deconsolidation of CTI. Adjusting 2001 to be comparable with 2002, cost of services and sales decreased $55 million reflecting lower variable costs associated with reduced sales volumes. In addition, we

recorded $285 million in 2001 in connection with the September 11, 2001 terrorist attacks.

Selling, General and Administrative Expense

Selling, general and administrative expense of $21,846 million was $1,017 million, or 4.9% higher in 2002 compared to 2001. This increase was driven by higher sales commissions related to the growth in wireless customer additions and increased salary and wage expense at Domestic Wireless, higher costs associated with uncollectible accounts receivable for competitive local exchange carriers (CLECs) and other wholesale customers, higher costs for pension and other employee benefits and higher special charges of $327 million. These cost increases were partially offset by strong cost control management and the effects of business integration activities and achievement of merger synergies.

Special charges recorded in selling, general and administrative expense related to severance, pension and benefits were $352 million higher in 2002 compared to 2001. In addition, higher special charges associated with investments, our financial statement exposure to MCI and the settlement of a litigation matter in 2002 more than offset higher merger-related costs in 2001.

Depreciation and Amortization Expense

Depreciation and amortization expense of $13,290 million decreased by $233 million, or 1.7% in 2002 compared to 2001. This decrease was mainly attributable to a reduction of amortization expense from the adoption of SFAS No. 142, "Goodwill and Other Intangible Assets," effective January 1, 2002, which required that goodwill and indefinite-lived intangible assets no longer be amortized, partially offset by increased depreciation expense related to the increase in depreciable assets and increased software amortization costs.

Sales of Businesses, Net

During 2002, we recorded a pretax gain of $2,527 million ($1,550 million after-tax, or $.56 per diluted share) related to the sale of 1.27 million non-strategic access lines and a net gain of $220 million ($116 million after-tax, or $.04 per diluted share), primarily resulting from a pretax gain on the sale of TSI, partially offset by impairment and exit charges, as previously described.

During 2001, we recorded a pretax gain of $80 million ($48 million after-tax, or $.02 per diluted share) on the sale of the Cincinnati wireless market and a pretax loss of $172 million ($108 million after-tax, or $.04 per diluted share) related to the sale of the Chicago wireless market. In addition, we recorded charges totaling $258 million ($166 million after-tax, or $.06 per diluted share) during 2001 related to exiting several businesses, including our video business and some leasing activities.

Pension and Other Postretirement Benefits

As of December 31, 2003, we evaluated our key employee benefit plan assumptions in response to current conditions in the securities markets. The expected rate of return on pension and postretirement benefit plan assets will be maintained at 8.50%. However, the discount rate assumption has been lowered from 6.75% in 2003 to 6.25% in 2004, consistent with interest rate levels at the end of the year. As of December 31, 2002, we changed key employee benefit plan assumptions in response to conditions in the securities markets at that time and medical and prescription drug cost trends. The expected rate of return on pension plan assets was changed from 9.25% in 2002 to 8.50% in 2003 and the expected rate of return on other postretirement benefit plan assets was changed from 9.10% in 2002 to 8.50% in 2003. The discount rate assumption was lowered from 7.25% in 2002 to 6.75% in 2003 and the medical cost trend rate assumption was increased from 10.00% in 2002 to 11.00% in 2003.

As a result of extending and increasing limits (caps) on company payments toward retiree health care costs in connection with the union contracts ratified in the fourth quarter of 2003, we began recording retiree health care costs as if there were no caps in the fourth quarter of 2003 relative to these union contracts.

During 2003, we recorded pension income, net of postretirement benefit expenses before special items (see "Special Items" for additional discussion) of $209 million ($127 million after-tax, or $.05 per diluted share), compared to $1,594 million ($971 million after-tax, or $.35 per diluted share) in 2002 and $1,578 million ($963 million after-tax, or $.35 per diluted share) in 2001. Based on our current pension and postretirement benefit plan assumptions, the events of 2003 including the impact of the labor contract negotiations, employee severance activity and cost reductions associated with the Medicare Prescription Drug, Improvement and Modernization Act of 2003, we anticipate recording net pension and postretirement benefit expenses in 2004 of between $.18 to $.22 per diluted share.

Other Consolidated Results

Equity in Earnings (Loss) of Unconsolidated Businesses

Equity in earnings (loss) of unconsolidated businesses increased by $2,825 million in 2003 compared to 2002. In 2002, we recorded losses of $1,400 million and $580 million in connection with determinations that market value declines of our investments in Compañia Anónima Nacional Teléfonos de Venezuela (CANTV) and TELUS Corporation (TELUS), respectively, were considered other than temporary. In addition, the increase in 2003 reflects tax benefits arising from a reorganization at our Italian investment Vodafone Omnitel N.V. (Omnitel), a contribution tax reversal benefiting Omnitel, continued operational growth of Verizon's equity investments and favorable foreign exchange rates. We also recorded a pretax gain of $348 million in 2003 in connection with the sale of our interest in Eurotel Praha, spol. s r.o. (Eurotel Praha), a wireless joint venture in the Czech Republic.

Equity in earnings (loss) of unconsolidated businesses decreased by $1,993 million in 2002 compared to 2001. The decrease was driven primarily by investment-related charges in 2002, as previously described. Investment-related charges were $281 million in 2001.

Income (Loss) From Other Unconsolidated Businesses

Income (loss) from other unconsolidated businesses increased by $3,188 million in 2003 compared to 2002. The increase includes a $176 million net gain recorded in 2003 as a result of a payment received in connection with the liquidation of Genuity Inc. (Genuity), which filed for bankruptcy in 2002. During 2002, we recorded a write-down of $2,624 million related to our investment in Genuity, a net pretax loss of $347 million to market value of our investment in Cable & Wireless plc (C&W), losses of $289 million due to the other than temporary decline in the market value of our investments in Metromedia Fiber Network, Inc. (MFN), partially offset by a pretax gain of $383 million related to the sale of the majority of our investment in Telecom Corporation of New Zealand Limited (TCNZ).

Income (loss) from other unconsolidated businesses was $(2,857) million in 2002 compared to $(5,486) million in 2001. During 2001, we recorded pretax losses of $4,335 million primarily related to our investments in C&W, NTL Incorporated (NTL) and MFN due to the other than temporary decline in the market value of those investments. In 2001, we also recorded a pretax loss of $1,251 million due to the other than temporary decline in the fair value of our investment in Genuity.

Other Income and (Expense), Net			(dollars in millions)
Years Ended December 31,	**2003**	2002	2001
Interest income	**$ 96**	$ 187	$ 393
Foreign exchange gains (losses), net	**(11)**	3	(9)
Other, net	**(47)**	2	(185)
Total	**$ 38**	$ 192	$ 199

The changes in Other Income and (Expense), Net were primarily due to the changes in interest income and other, net. The decrease in interest income in 2003 is primarily the result of lower average cash balances. In 2001, we recorded additional interest income primarily as a result of interest on several notes receivable and the settlement of tax-related matters. During 2003, we recorded higher charges in connection with the early retirement of debt included in other, net. During 2002, we recorded lower charges related to financial instrument mark-to-market adjustments compared to 2001, primarily related to decreases in fair value of the MFN debt conversion option included in other, net.

Interest Expense			(dollars in millions)
Years Ended December 31,	**2003**	2002	2001
Total interest expense	**$ 2,797**	$ 3,130	$ 3,276
Capitalized interest costs	**144**	185	368
Total interest costs on debt balances	**$ 2,941**	$ 3,315	$ 3,644
Average debt outstanding	**$ 49,181**	$ 59,145	$ 61,891
Effective interest rate	**6.0%**	5.6%	5.9%

The decrease in interest costs in 2003 and 2002 was principally attributable to lower average debt levels. Increased cash provided by operating activities, asset sales and other favorable cash flows reduced our financing needs in both 2003 and 2002. Lower capital expenditures in both periods contributed to lower capitalized interest costs. The decrease in interest cost in 2003 was partially offset by higher average interest rates, which primarily resulted from lower commercial paper borrowings which have lower interest rates compared to long-term debt. Our average interest rates in 2002 were lower than 2001 principally as a result of the general decline in short-term interest rates.

Minority Interest			(dollars in millions)
Years Ended December 31,	**2003**	2002	2001
Minority interest	**$ 1,583**	$ 1,404	$ 625

The increase in minority interest expense in 2003 and 2002 was primarily due to higher earnings at Domestic Wireless, which has a significant minority interest attributable to Vodafone Group Plc (Vodafone) (see "Segment Results of Operations – Domestic Wireless").

Provision for Income Taxes			(dollars in millions)
Years Ended December 31,	**2003**	2002	2001
Provision for income taxes	**$ 1,252**	$ 1,597	$ 2,147
Effective income tax rate	**26.3%**	25.5%	78.6%

The effective income tax rate is the provision for income taxes as a percentage of income from continuing operations before the provision for income taxes. The effective income tax rate in 2003 was favorably impacted by higher equity income from Omnitel, a decrease in state taxes and a benefit related to a deferred tax balance adjustment. Omnitel income is not taxable until received in the form of dividends. The 2002 effective income tax rate was favorably impacted by tax benefits recorded in 2002 in connection with other than temporary declines in fair value of several of our investments recorded during 2002 and 2001. Those tax benefits were not available at the time the investments were written down, as the decline in fair value was not recognizable at the time of the impairment (see "Special Items – Investment-Related Charges and Related Tax Benefits"). The 2002 effective tax rate was also reduced by a tax law change relating to employee stock ownership plan dividend deductions, increased state tax benefits and capital loss utilization, partially offset by investment charges in 2002 associated with other than temporary declines in fair value for which an associated tax benefit was not available.

The effective income tax rate for 2001 was not consistent with other periods primarily because tax benefits were not available on many of the losses resulting from the other than temporary decline in market value of several of our investments during 2001.

A reconciliation of the statutory federal income tax rate to the effective rate for each period is included in Note 16 to the consolidated financial statements.

Discontinued Operations

Discontinued operations represent the results of operations of Grupo Iusacell, S.A. de C.V. (Iusacell) prior to the sale of Iusacell in July 2003. In connection with our decision to sell our interest in Iusacell and a comparison of expected net sale proceeds to the net book value of our investment in Iusacell, we recorded a pretax loss of $957 million ($931 million after-tax, or $.33 per diluted share) in the second quarter of 2003. Losses reported by Iusacell in 2002 and 2001 are primarily driven by its declining revenue base and the impact of fluctuations of the Mexican peso on Iusacell's U.S. dollar-denominated debt.

Cumulative Effect of Accounting Change

Directory Accounting Change

During 2003, we changed our method for recognizing revenues and expenses in our directory business from the publication-date method to the amortization method. The publication-date method recognizes revenues and direct expenses when directories are published. Under the amortization method, which is increasingly becoming the industry standard, revenues and direct expenses, primarily printing and distribution costs, are recognized over the life of the directory, which is usually 12 months. This accounting change affects the timing of the recognition of revenues and expenses. As required by generally accepted accounting principles (GAAP), the directory accounting change was recorded effective January 1, 2003. The cumulative effect of the accounting change resulted in a one-time charge of $2,697 million ($1,647 million after-tax, or $.59 per diluted share).

Impact of SFAS No. 143

We adopted the provisions of SFAS No. 143 on January 1, 2003. SFAS No. 143 requires that companies recognize the fair value of a liability for asset retirement obligations in the period in which the obligations are incurred and capitalize that amount as part of the book value of the long-lived asset. We have determined that Verizon does not have a material legal obligation to remove long-lived assets as described by this statement. However, prior to the adoption of SFAS No. 143, we included estimated removal costs in our group depreciation models. These costs have increased depreciation expense and accumulated depreciation for future removal costs for existing assets. These removal costs were recorded as a reduction to accumulated depreciation when the assets were retired and removal costs were incurred.

For some assets, such as telephone poles, the removal costs exceeded salvage value. Under the provisions of SFAS No. 143, we are required to exclude costs of removal from our depreciation rates for assets for which the removal costs exceed salvage. Accordingly, in connection with the initial adoption of this standard on January 1, 2003, we have reversed accrued costs of removal in excess of salvage from our accumulated depreciation accounts for these assets. The adjustment was recorded as a cumulative effect of an accounting change, resulting in the recognition of a gain of $3,499 million ($2,150 million after-tax, or $.77 per diluted share).

Impact of SFAS No. 142

We adopted the provisions of SFAS No. 142 on January 1, 2002. SFAS No. 142 no longer permits the amortization of goodwill and indefinite-lived intangible assets. Instead, these assets must be reviewed annually (or more frequently under various conditions) for impairment in accordance with this statement. Results for the year ended December 31, 2002 include the initial impact of adoption charge recorded as a cumulative effect of an accounting change of $496 million after-tax ($.18 per diluted share). In accordance with SFAS No. 142, starting January 1, 2002, we no longer amortize goodwill, acquired workforce intangible assets and wireless licenses which we determined have an indefinite life. On a comparable basis, had we not amortized these intangible assets during the year ended December 31, 2001, net income before discontinued operations and cumulative effect of accounting change would have been $950 million ($.35 per diluted share).

Impact of SFAS No. 133

We adopted the provisions of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," and SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities" on January 1, 2001. The impact on Verizon pertains to the recognition of changes in the fair value of derivative instruments. Results for the year ended December 31, 2001 include the initial impact of adoption recorded as a cumulative effect of an accounting change of $182 million after-tax ($.07 per diluted share) in the first quarter of 2001. This cumulative effect charge primarily relates to the change in the fair value of the MFN debt conversion option prior to January 1, 2001.

SEGMENT RESULTS OF OPERATIONS

We have four reportable segments, which we operate and manage as strategic business units and organize by products and services. Our segments are Domestic Telecom, Domestic Wireless, Information Services and International. You can find additional information about our segments in Note 17 to the consolidated financial statements.

We measure and evaluate our reportable segments based on segment income. This segment income excludes unallocated corporate expenses and other adjustments arising during each period. The other adjustments include transactions that the chief operating decision makers exclude in assessing business unit performance due primarily to their non-recurring and/or non-operational nature. Although such transactions are excluded from business segment results, they are included in reported consolidated earnings. We previously highlighted the more significant of these transactions in the "Consolidated Results of Operations" section. Gains and losses that are not individually significant are included in all segment results, since these items are included in the chief operating decision makers' assessment of unit performance. These gains and losses are primarily contained in Information Services and International since they actively manage investment portfolios.

Effective January 1, 2003, we transferred our Global Solutions Inc. subsidiary from our International segment to our Domestic Telecom segment. Prior years' segment results of operations have been reclassified to reflect the transfer to enhance comparability. The transfer of Global Solutions' revenues and costs of operations were not significant to the results of operations of Domestic Telecom or International.

Domestic Telecom

Domestic Telecom provides local telephone services, including voice and data transport, enhanced and custom calling features, network access, directory assistance, private lines and public telephones in 29 states and the District of Columbia. As discussed earlier under "Consolidated Results of Operations," in the third quarter of 2002 we sold wireline properties representing approximately 1.27 million access lines or 2% of the total Domestic Telecom switched access lines in service. For comparability purposes, the results of operations discussed in this section exclude the properties that have been sold. This segment also provides long distance services, customer premises equipment distribution, data solutions and systems integration, billing and collections, Internet access services and inventory management services.

Operating Revenues			(dollars in millions)
Years Ended December 31,	**2003**	2002	2001
Local services	**$ 19,454**	$ 20,271	$ 21,438
Network access services	**12,719**	13,427	12,992
Long distance services	**3,788**	3,170	3,113
Other services	**3,641**	3,971	4,605
	$ 39,602	$ 40,839	$ 42,148

Local Services

Local service revenues are earned by our telephone operations from the provision of local exchange, local private line, wire maintenance, voice messaging and value-added services. Value-added services are a family of services that expand the utilization of the network, including products such as Caller ID, Call Waiting and Return Call.

The provision of local exchange services not only includes retail revenues but also includes local wholesale revenues from UNEs, interconnection revenues from CLECs and wireless carriers, and some data transport revenues.

The decline in local service revenues of $817 million, or 4.0% in 2003 and $1,167 million, or 5.4% in 2002 was mainly due to lower demand and usage of our basic local exchange and accompanying services, as reflected by a decline in switched access lines in service of 4.2% in 2003 and a decline of 3.7% in 2002. These revenue declines were mainly driven by the effects of competition, regulatory pricing rules for UNEs and technology substitution. Regulatory pricing rules for UNEs, which mandate lower prices from other carriers that use our facilities to provide local exchange services, are putting downward pressure on our revenues by shifting the mix of access lines from retail to wholesale. We added UNE platform lines of approximately 1.8 million in 2003 and 1.0 million in 2002, bringing total UNE platform provisioned lines to 5.0 million at December 31, 2003 and 3.2 million at December 31, 2002. Technology substitution also affected local service revenue growth in both years, as indicated by declining demand for residential access lines of 3.7% in 2003 and 2.8% in 2002, as more customers substituted wireless services for traditional landline services. At the same time, basic business access lines have declined 5.0% in 2003 and 5.1% in 2002, primarily reflecting a shift to high-speed, high-volume special access lines.

We continue to seek opportunities to retain and win-back customers. The launch of our Freedom plans in 2003 offers local services with various combinations of long distance, wireless and Internet access services in a discounted bundle available on one bill. Currently, we have introduced our Freedom service plans in 17 key markets, which cover approximately 85% of consumer access lines. For small businesses, we have also rolled out Verizon Freedom for Business in eight markets, covering approximately 70% of business access lines. As of year-end 2003, approximately 48% of Verizon's residential customers have purchased local services in combination with either Verizon long distance or Verizon DSL, or both.

Network Access Services

Network access services revenues are earned from end-user customers and long distance and other competing carriers who use our local exchange facilities to provide usage services to their customers. Switched access revenues are derived from fixed and usage-based charges paid by carriers for access to our local network. Special access revenues originate from carriers and end-users that buy dedicated local exchange capacity to support their private networks. End-user access revenues are earned from our customers and from resellers who purchase dial-tone services. Further, network access revenues include our DSL services.

In 2003, our network access revenues declined by $708 million, or 5.3% principally due to decreasing switched MOUs and access lines, as well as price reductions associated with federal and state price cap filings and other regulatory decisions. Switched MOUs declined in 2003 by 7.2% from a year ago, reflecting the impact of access line loss and wireless substitution. Total revenues for high-capacity and data services were $7,262 million for the year ended December 31, 2003, down slightly from a year ago. Voice-grade equivalents (switched access lines and data circuits) increased to 140.3 million at December 31, 2003, up 3.4%, compared to a year ago, as more customers chose high-speed, digital services. However, increased demand for high-speed services was offset by reduced demand for lower-speed services and price reductions. Further, our special access revenues in 2003 were negatively impacted by a reduction in rates for modem aggregation services provided to MCI under Verizon's CyberPOP tariff. Under the CyberPOP agreement, we provided access circuits for MCI's managed modem business. This rate reduction was necessary in order to avoid rejection and termination of the CyberPOP agreement by MCI in its bankruptcy case and the total loss of revenues that would have resulted. These decreases were partially offset by increased demand for our DSL services. At December 31, 2003, approximately 80% of our total access lines qualified for DSL service. In 2003, we added net new DSL lines of 649,000, for a total of 2.3 million lines in service at December 31, 2003, an increase of 38.9% year-over-year.

In 2002, our network access revenues increased $435 million, or 3.3% principally due to higher customer demand for high-capacity and data services, which increased 7.6% in 2002, compared to the prior year. Voice-grade equivalents increased 4.5% and DSL lines increased approximately 50% compared to the prior year. In addition to volume-related growth, network access revenues in the fourth quarter of 2002 also included the favorable effect of a state regulatory decision in Michigan. These factors were partially offset by price reductions associated with federal and state price cap filings and other regulatory decisions and a decline in switched MOUs of 8.4% from the prior year.

The FCC regulates the rates that we charge long distance carriers and end-user customers for interstate access services. We are required to file new access rates with the FCC each year. See "Other Factors That May Affect Future Results – Regulatory and Competitive Trends" for additional information on FCC rulemakings concerning federal access rates, universal service and unbundling of network elements.

Long Distance Services

Long distance service revenues include both intraLATA toll services and interLATA long distance voice and data services.

Long distance service revenues increased $618 million, or 19.5% in 2003 and $57 million, or 1.8% in 2002, principally as a result of customer growth from our interLATA long distance services. In 2003, long distance revenues were stimulated by the introduction of our Freedom plans. In the first quarter of 2003, we received final FCC approval to offer long distance services in our remaining three jurisdictions: Maryland, West Virginia and the District of Columbia. We now offer long distance services throughout the United States, capping a seven-year effort. Our authority in Alaska is limited to interstate and international services. In 2003, we added 4.2 million long distance lines, for a total of 16.6 million long distance lines nationwide, representing a 33.3% increase from a year ago. This growth resulted from 41% of our local wireline residential customers having chosen Verizon as their long distance carrier as of December 31, 2003. In 2002, we added 3.9 million long distance lines, representing an increase of 44.8% over 2001.

Other Services

Our other services include such services as billing and collections for long distance carriers, public (coin) telephone and customer premises equipment and supply sales. Other services revenues also include services provided by our non-regulated subsidiaries such as data solutions and systems integration businesses.

Revenues from other services declined by $330 million, or 8.3% in 2003 and by $634 million, or 13.8% in 2002. These declines were substantially due to lower sales of supplies to some major customers as a result of the termination of contracts and lower volumes at some of our non-regulated businesses due to declines in customer demand. Customers substituting wireless communications for pay telephone services and customers taking back billing and collections services were also factors that contributed to the reduction in other service revenues in both years. In 2003, these revenue decreases were partially offset by increased sales of voice and data customer premises equipment services.

Operating Expenses		(dollars in millions)	
Years Ended December 31,	**2003**	2002	2001
Cost of services and sales	**$ 14,708**	$ 13,390	$ 14,313
Selling, general and administrative expense	**8,517**	9,048	9,402
Depreciation and amortization expense	**9,217**	9,456	9,260
	$ 32,442	$ 31,894	$ 32,975

Cost of Services and Sales

Cost of services and sales includes the following costs directly attributable to a service or product: salaries and wages, benefits, materials and supplies, contracted services, network access and transport costs, customer provisioning costs, computer systems support and costs of products sold. Aggregate customer care costs, which include billing and service provisioning, are allocated between cost of services and sales and selling, general and administrative expense.

In 2003, our cost of services and sales increased by $1,318 million, or 9.8% principally driven by lower income provided by pension income net of other postretirement benefit expense. As of December 31, 2002, Verizon changed key employee benefit plan assumptions in response to conditions in the securities markets at that time and medical and prescription drug cost trends, as previously described (see "Consolidated Operating Expenses"). The overall impact of these assumption changes, combined with the impact of lower than expected actual asset returns over the past three years, reduced pension income, net of postretirement benefit expenses, by $1,193 million in 2003 (primarily in cost of services and sales), compared to 2002. In addition, costs of removal in excess of salvage for outside plant assets, resulting from the adoption of SFAS No. 143 effective January 1, 2003, were approximately $165 million in 2003. Under SFAS No. 143, we began expensing the costs of removal in excess of salvage for outside plant assets as incurred. Previously, we had included costs of removal for these assets in our depreciation rates. Higher costs associated with our growth businesses such as long distance and data services, as well as the impact of annual wage increases, additional overtime pay due to higher weather-related repair volumes and contingency costs to maintain operational readiness during recent labor negotiations further contributed to cost increases in 2003.

Cost increases in 2003 were partially offset by lower access and transport costs, including a favorable adjustment of approximately $80 million recorded in the first quarter of 2003. As part of our ongoing review of local interconnection expense charged by CLECs, we determined that selected charges from CLECs, previously recorded as expense but not paid, were no longer required and accordingly, we adjusted our first quarter 2003 operating expenses. In addition, effective in 2003, we recognize as local interconnection expense no more than the amount payable under the April 27, 2001 FCC order addressing intercarrier compensation for dial-up connections for Internet-bound traffic. The effects of workforce reductions and disciplined expense controls also offset services and sales cost increases in 2003. At December 31, 2003, our Domestic Telecom workforce was approximately 137,700, compared to 160,300 at December 31, 2002, a 14.1% reduction from a year ago.

In 2002, our cost of services and sales decreased by $923 million, or 6.4% principally due to lower costs at our domestic telephone operations, business integration activities and achievement of merger synergies. These reductions were mainly attributable to reduced spending for materials and contracted services, driven by lower capital expenditures and strong cost control management. Lower overtime for installation and maintenance activity principally as a result of reduced volumes at our dispatch and call centers and lower employee costs associated with declining workforce levels also contributed to the decline in operating costs. At December 31, 2002, we reduced our full-time headcount by approximately 18,000 employees, or 10.1%, from the prior year. At year-end 2002, we had reduced the installation and repair overtime hours per employee per week by 23.8% from 2001. Lower cost of sales at our customer premises equipment and supply business driven by declining business volumes also contributed to the cost reductions in 2002. Favorable adjustments in 2002 included updates to ongoing expense estimates as a result of specific regulatory decisions by the FCC and state regulatory commissions in New York and other states. These cost reductions were partially offset by higher costs associated with our growth businesses such as data and long distance services. Salary and wage increases for employees and increased health care costs further offset cost reductions in 2002.

We recorded insurance recoveries related to the terrorist attacks on September 11, 2001 of $270 million in 2003, $200 million in 2002 and $400 million in 2001, primarily offsetting fixed asset losses and expenses incurred in the current and prior years. Of the amounts recorded, approximately $130 million in 2003, $112 million in 2002 and $124 million in 2001 relates to operating expenses (primarily cost of services and sales). In 2001, we recorded costs of $285 million (net of the $400 million insurance recovery) related to the terrorist attacks. The costs and estimated insurance recoveries were recorded in accordance with Emerging Issues Task Force Issue No. 01-10, "Accounting for the Impact of the Terrorist Attacks of September 11, 2001."

See "Other Factors That May Affect Future Results – Regulatory and Competitive Trends – Intercarrier Compensation" for additional information on FCC rulemakings and other court decisions addressing intercarrier compensation for dial-up connections for Internet-bound traffic.

Selling, General and Administrative Expense

Selling, general and administrative expense includes salaries and wages and benefits not directly attributable to a service or product, bad debt charges, taxes other than income, advertising and sales commission costs, customer billing, call center and information technology costs, professional service fees and rent for administrative space.

In 2003, our selling, general and administrative expense declined by $531 million, or 5.9% primarily as a result of lower bad debt expense due to a reduction in uncollectible accounts receivable (primarily CLECs), improved collections and additional customer deposit requirements. In addition, advertising costs were lower in 2003 compared to a year ago. These cost reductions were partially offset by higher employee benefit costs and by higher general costs associated with our non-regulated growth businesses.

Our selling, general and administrative expense declined in 2002 by $354 million, or 3.8% principally driven by strong cost control management and the effects of business integration activities and achievement of merger synergies, resulting in reduced spending for general and administrative services and lower salary and wage costs. These cost reductions were partially offset by higher costs associated with uncollectible accounts receivable for CLECs and other wholesale customers and by higher costs for pension and other employee benefits.

Depreciation and Amortization Expense

In 2003, the decline in depreciation and amortization expense of $239 million, or 2.5% was principally attributable to lower rates of depreciation on telephone plant, as well as the favorable impact on depreciation expense of adopting SFAS No. 143, effective January 1, 2003. These expense reductions were partially offset by higher software amortization costs.

In 2002, the increase in depreciation and amortization expense of $196 million, or 2.1% was due to growth in depreciable telephone plant and increased software amortization costs. These factors were offset, in part, by the effect of lower rates of depreciation on telephone plant.

Segment Income			(dollars in millions)
Years Ended December 31,	**2003**	2002	2001
Segment Income	**$ 3,335**	$ 4,364	$ 4,509

Segment income decreased by $1,029 million, or 23.6% in 2003 and $145 million, or 3.2% in 2002 primarily as a result of the after-tax impact of operating revenues and operating expenses described above. Special and non-recurring charges of $1,099 million, $236 million, and $1,188 million, after-tax, affected the Domestic Telecom segment in 2003, 2002 and 2001, respectively. Special and non-recurring items in 2003 primarily include the costs associated with severance activity, including retirement enhancement costs, and pension settlements for employees that received lump-sum distributions under voluntary separation plans, partially offset by the favorable impact of adopting SFAS No. 143. Special and non-recurring items in 2002 primarily relate to gains on sales of assets, net, offset by employee severance and termination benefit costs, merger-related costs, our financial statement exposure to MCI, the settlement of a litigation matter and the adoption of SFAS No. 142. Special and non-recurring items in 2001 primarily relate to merger-related costs and severance and retirement enhancement costs. Special and non-recurring items in 2002 and 2001 also include the results of operations of the access lines sold.

Domestic Wireless

Our Domestic Wireless segment provides wireless voice and data services and equipment sales across the United States. This segment primarily represents the operations of the Verizon Wireless joint venture with Vodafone. Verizon owns a 55% interest in the joint venture and Vodafone owns the remaining 45%. All financial results included in the tables below reflect the consolidated results of Verizon Wireless.

Operating Revenues			(dollars in millions)
Years Ended December 31,	**2003**	2002	2001
Wireless sales and services	**$ 22,489**	$ 19,473	$ 17,560

Domestic Wireless's total revenues of $22,489 million were $3,016 million, or 15.5% higher in 2003 compared to 2002. Service revenues of $20,336 million were $2,589 million, or 14.6% higher than 2002. This revenue growth was largely attributable to customer additions and higher revenue per customer per month.

Our Domestic Wireless segment ended 2003 with 37.5 million customers, an increase of 5.0 million net new customers, or 15.5%. Retail net additions accounted for 4.6 million, or 92.0% of the total net additions. Approximately 35.1 million, or 94% of Domestic Wireless's customers now subscribe to digital services, compared to 88% at year-end 2002 and generate almost 99% of our busy-hour usage. The overall composition of our Domestic Wireless customer base as of December 31, 2003 was 91% retail postpaid, 5% retail prepaid and 4% resellers. The average monthly churn rate, the rate at which customers disconnect service, decreased to 1.8% for 2003, compared to 2.3% for 2002.

Average revenue per customer per month was $48.85, or 1.0% higher in 2003 compared to 2002, primarily due to a larger number of customers on higher access price plan offerings as well as an increase in data revenues per subscriber. This increase was partially offset by decreased roaming revenue as a result of rate reductions with third-party carriers and decreased long distance revenue due to bundled pricing. Average MOUs per customer increased to 457, or 30.9% in 2003 compared to 2002.

Domestic Wireless's revenues of $19,473 million were $1,913 million, or 10.9% higher in 2002 compared to 2001. Service revenues of $17,747 million were $1,736 million, or 10.8% higher than 2001. This revenue growth was largely attributable to customer additions and higher revenue per customer per month. At year-end 2002, customers totaled approximately 32.5 million, an increase of 10.5% over year-end 2001, which included 485,000 customers added as a result of acquisitions during 2002, primarily from the acquisition of the wireless operations of Price Communications Corp. (Price) in Alabama, Florida, Georgia and South Carolina. Total churn decreased to 2.3% in 2002, compared to 2.5% in 2001. Average revenue per customer per month increased by 1.1% to $48.35 in 2002, compared to 2001 primarily due to higher access revenue per customer.

Operating Expenses (dollars in millions)			
Years Ended December 31,	**2003**	2002	2001
Cost of services and sales	**$ 6,460**	$ 5,456	$ 5,085
Selling, general and administrative expense	**8,057**	7,084	6,461
Depreciation and amortization expense	**3,888**	3,293	3,709
	$ 18,405	$ 15,833	$ 15,255

Cost of Services and Sales

Cost of services and sales, which are costs to operate the wireless network as well as the cost of roaming, long distance and equipment sales, increased by $1,004 million, or 18.4% in 2003. Cost of services increased primarily due to higher direct wireless network charges resulting from increased MOUs in 2003 compared to 2002, partially offset by lower roaming, local interconnection and long distance rates. Cost of equipment sales was higher by 24.2% in 2003, due primarily to an increase in handsets sold, driven by growth in customer additions and an increase in equipment upgrades in 2003 compared to 2002.

Cost of services and sales increased by $371 million, or 7.3% in 2002 compared to 2001. This increase was due primarily to increased network costs resulting from increased MOUs, and an increase in cost of equipment sales driven by growth in new customer additions.

Selling, General and Administrative Expense

Selling, general and administrative expense increased by $973 million, or 13.7% in 2003. This increase was primarily due to an increase in salary and wage expense of $338 million, caused by an increase in the employee base, primarily in the customer care and sales channels, as well as an increase in employee benefits expense. Also contributing to the increase was higher sales commissions in our direct and indirect channels of $233 million, primarily related to an increase in customer additions and renewals during the year. Costs associated with regulatory fees, primarily the universal service fund, increased by $159 million in 2003, compared to 2002 due to an April 2003 FCC order requiring a change in the methodology for billing these fees from a flat rate to a percentage rate.

Selling, general and administrative expense increased by $623 million, or 9.6% in 2002 compared to 2001. This increase was due primarily to higher sales commissions related to the growth in customer additions and increased salary and wage expense.

Depreciation and Amortization Expense

Depreciation and amortization expense increased by $595 million, or 18.1% in 2003 compared to 2002. This increase was primarily due to increased depreciation expense related to the increase in depreciable assets.

Depreciation and amortization expense decreased by $416 million, or 11.2% in 2002 compared to 2001. This decrease was mainly attributable to a reduction of amortization expense from the adoption of SFAS No. 142, effective January 1, 2002, which required that goodwill and indefinite-lived intangible assets no longer be amortized, partially offset by increased depreciation expense related to the increase in depreciable assets.

Segment Income (dollars in millions)			
Years Ended December 31,	**2003**	2002	2001
Segment Income	**$ 1,083**	$ 966	$ 537

Segment income increased by $117 million, or 12.1% in 2003 and by $429 million, or 79.9% in 2002, primarily as a result of the after-tax impact of operating revenues and operating expenses described above, partially offset by higher minority interest. Special and nonrecurring charges of $57 million and $107 million, after-tax, affected the Domestic Wireless segment in 2002 and 2001, respectively, and were primarily merger-related costs and employee severance costs. There were no special items affecting this segment in 2003.

Increases in minority interest in 2003 and 2002 were principally due to the increased income of the wireless joint venture and the significant minority interest attributable to Vodafone.

Information Services

Our Information Services segment consists of our domestic and international publishing businesses, including print SuperPages® and our Internet directory, SuperPages.com™, and electronic commerce services. This segment has operations principally in North America and Latin America.

During 2003, Information Services changed its method of recognizing revenue and expenses from the publication-date method to the amortization method effective January 1, 2003. Under the amortization method, revenue and direct expenses are recognized over the life of the directory, which is usually 12 months.

Operating Revenues (dollars in millions)			
Years Ended December 31,	**2003**	2002	2001
Operating Revenues	**$ 4,114**	$ 4,287	$ 4,313

Operating revenues from our Information Services segment decreased $173 million, or 4.0% in 2003. The decrease was due primarily to the impact of the accounting change from the publication-date method to the amortization method and the elimination of revenue related to the sales of businesses (directories no longer published by Information Services). Revenues from ongoing operations remained relatively flat for the year. Verizon's domestic Internet directory service, SuperPages.com™, continues to achieve strong domestic growth as demonstrated by a 32.7% increase in revenue over 2002.

Operating revenues from our Information Services segment decreased $26 million, or 0.6% in 2002. The decrease was due primarily to the elimination of directory revenues related to wireline property sales as well as reduced extension of publications and affiliate revenues. The decrease was partially offset by sales performance growth and increased revenue from the August 2001 acquisition of TELUS' advertising services business in Canada. SuperPages.com™ revenue increased 63.7% compared to 2001.

Operating Expenses			(dollars in millions)
Years Ended December 31,	**2003**	2002	2001
Cost of services and sales	**$ 641**	$ 688	$ 743
Selling, general and administrative expense	**1,505**	1,411	1,218
Depreciation and amortization expense	**89**	74	79
Sales of businesses, net	**(141)**	–	–
	$ 2,094	$ 2,173	$ 2,040

Cost of Services and Sales

Cost of services and sales decreased $47 million, or 6.8% in 2003. The decrease was due primarily to operational cost savings, cost reductions recognized due to the sales of businesses, and the change in accounting from the publication-date method to the amortization method.

Cost of services and sales decreased $55 million, or 7.4% in 2002. The decrease was due primarily to the execution of cost reduction initiatives and merger synergies.

Selling, General and Administrative Expense

Selling, general and administrative expense increased $94 million, or 6.7% in 2003. The increase was due primarily to higher pension and benefit costs and increased bad debt expense partially offset by operational cost savings, costs reductions recognized due to the sales of businesses, and the change in accounting from the publication-date method to the amortization method.

Selling, general and administrative expense increased $193 million, or 15.8% in 2002. The increase was due primarily to increased selling costs, higher bad debt expense and a small asset gain recorded in 2001.

Sales of Businesses, Net

In 2003, Information Services completed the sale of its directory businesses in Europe, which consisted of publishing operations in Austria, the Czech Republic, Gibraltar, Hungary, Poland and Slovakia. We recorded a pretax net gain of $141 million.

Segment Income			(dollars in millions)
Years Ended December 31,	**2003**	2002	2001
Segment Income	**$ 1,206**	$ 1,281	$ 1,352

Segment income decreased $75 million, or 5.9% in 2003 and $71 million, or 5.3% in 2002 as a result of the after-tax impact of operating revenues and expense issues described above. Special and non-recurring charges of $1,738 million, $92 million and $81 million, after-tax, affected the Information Services segment in 2003, 2002 and 2001, respectively. Special items in 2003 were primarily related to the change in accounting from the publication-date method to the amortization method and severance charges. Special items in 2002 included merger-related costs, costs associated with Domestic Telecom access line sales and severance costs. Special items in 2001 pertained to merger-related costs.

International

Our International segment includes international wireline and wireless telecommunication operations and investments primarily in the Americas and Europe. Our consolidated international investments as of December 31, 2003 included Verizon's operations in the Dominican Republic, TELPRI in Puerto Rico and Micronesian Telecommunications Corporation in the Northern Mariana Islands. Either the cost or the equity method is applied to those investments in which we have less than a controlling interest.

On June 13, 2003, we announced our decision to sell our 39.4% consolidated interest in Iusacell. We reclassified our investment and the results of operations of Iusacell in the current and prior years as discontinued operations in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." We subsequently sold our shares in Iusacell on July 29, 2003. Discontinued operations are excluded from International's segment income.

On January 25, 2002, we exercised our option to purchase an additional 12% of TELPRI common stock from the government of Puerto Rico. We now hold 52% of TELPRI stock, up from 40% held at December 31, 2001. As a result of gaining control over TELPRI, we changed the accounting for this investment from the equity method to consolidation, effective January 1, 2002. Accordingly, TELPRI's net results of operations are reported as a component of Equity in Earnings (Loss) of Unconsolidated Businesses for the year ended December 31, 2001, while 2002 and 2003 results of operations are included in consolidated revenues and expenses in the tables below.

On March 28, 2002, we transferred 5.5 million of our shares in CTI to an indirectly wholly owned subsidiary of Verizon and subsequently transferred ownership of that subsidiary to a newly created trust for CTI employees. This decreased our ownership percentage in CTI from 65% to 48%. We also reduced our representation on CTI's board of directors from five of nine members to four of nine (subsequently reduced to one of five members). As a result of these actions that surrendered control of CTI, we changed our method of accounting for this investment from consolidation to the equity method. On June 3, 2002, as a result of an option exercised by Telfone (BVI) Limited (Telfone), a CTI shareholder, Verizon acquired approximately 5.3 million additional CTI shares. Also on June 3, 2002, we transferred ownership of a wholly owned subsidiary of Verizon that held 5.4 million CTI shares to a second independent trust leaving us with an approximately 48% non-controlling interest in CTI. In addition, during the first quarter of 2002, we wrote our remaining investment in CTI, including those shares we were contractually committed to purchase under the Telfone option, down to zero (see "Special Items"). Since we had no other future commitments or plans to fund CTI's operations and had written our investment down to zero, in accordance with the accounting rules for equity method investments, we ceased recording operating income or losses related to CTI's operations beginning in 2002. On October 16, 2003 we sold our entire remaining interest in CTI. Accordingly, CTI's results of operations are reported in revenues and expenses for the year ended December 31, 2001, while 2002 and 2003 revenues and expenses are not included in the tables below.

Operating Revenues			(dollars in millions)
Years Ended December 31,	**2003**	2002	2001
Operating Revenues	**$ 1,949**	$ 2,219	$ 1,581

Revenues generated by our international businesses decreased $270 million, or 12.2% in 2003 and increased $638 million, or 40.4% in 2002. The 2003 decrease was primarily due to declining foreign exchange rates in the Dominican Republic, reduced software sales as well as an adjustment to carrier access revenues at TELPRI. The 2002 growth is primarily due to the consolidation of TELPRI partially offset by the deconsolidation of CTI in 2002. Adjusting 2001 to be

comparable with 2002, revenues generated by our international businesses declined by $197 million, or 8.2%. The 2002 decrease in comparable revenues was due to the weak economies and increased competition in our Latin America markets, as well as reduced software sales.

Operating Expenses (dollars in millions)

Years Ended December 31,	2003	2002	2001
Cost of services and sales	$ 574	$ 586	$ 398
Selling, general and administrative expense	691	610	610
Depreciation and amortization expense	346	376	278
	$ 1,611	$ 1,572	$ 1,286

Cost of Services and Sales

Cost of services and sales decreased $12 million, or 2.0% in 2003 and increased $188 million, or 47.2%, in 2002. The 2003 decrease reflects declining foreign exchange rates in the Dominican Republic partially offset by higher operating costs. The 2002 increase was primarily due to the consolidation of TELPRI, partially offset by the deconsolidation of CTI in 2002. Adjusting 2001 to be comparable with 2002, cost of services and sales decreased $55 million, or 8.6%. The 2002 decrease in comparable cost of services and sales reflects lower variable costs associated with reduced sales volumes.

Selling, General and Administrative Expense

Selling, general and administrative expense increased $81 million, or 13.3% in 2003 and did not change in 2002. The 2003 increase was due to a charge recorded by TELPRI in 2003 as a result of an adverse Puerto Rico Circuit Court of Appeals ruling regarding access rates for intra-island long distance service and a contract settlement in 2002, offset by the replacement of a revenue-based operating tax in the Dominican Republic with an income tax and declining foreign exchange rates in the Dominican Republic. Adjusting 2001 to reflect the 2002 TELPRI consolidation and CTI deconsolidation for comparability with 2002, selling, general and administrative expense decreased $148 million, or 19.5%. The 2002 decrease in comparable selling, general and administrative expense was due to the contract settlement and declining foreign exchange rates in the Dominican Republic.

Depreciation and Amortization Expense

Depreciation and amortization expense decreased $30 million, or 8.0% in 2003 and increased $98 million, or 35.3% in 2002. The 2003 decrease was due to declining foreign exchange rates in the Dominican Republic and the adoption of SFAS No. 143, offset in part by increased depreciation generated from ongoing network capital expenditures. The 2002 growth was primarily due to the consolidation of TELPRI partially offset by the deconsolidation of CTI in 2002. Adjusting 2001 to be comparable with 2002, depreciation and amortization expense decreased $15 million, or 3.8%. The 2002 decrease was driven by a reduction of amortization expense from the adoption of SFAS No. 142, effective January 1, 2002, which required that goodwill and indefinite-lived intangible assets no longer be amortized, offset by ongoing network capital expenditures.

Segment Income (dollars in millions)

Years Ended December 31,	2003	2002	2001
Segment Income	$ 1,392	$ 1,152	$ 1,014

Segment income increased by $240 million, or 20.8% in 2003 and by $138 million, or 13.6% in 2002. The increase in 2003 was largely driven by the changes in earnings from unconsolidated businesses. The 2002 increase was primarily the after-tax impact of operating revenues and operating expenses described above.

Equity in earnings of unconsolidated businesses increased $447 million, or 69.4% in 2003. This increase was driven by tax benefits arising from a reorganization at Omnitel, a contribution tax reversal as a result of a favorable European Court of Justice ruling benefiting Omnitel, favorable foreign exchange rates and continued operational growth of Verizon's equity investments, partially offset by lower gains on sales of investments in 2003. Income from other unconsolidated businesses decreased $49 million, or 22.5% in 2003. The decrease was due to income realized in 2002 from investments that have been sold.

Equity in earnings of unconsolidated businesses decreased $179 million, or 21.7% in 2002 and income from other unconsolidated businesses increased $120 million, or 122.4% in 2002. Adjusting 2001 for the consolidation of TELPRI and the deconsolidation of CTI, equity in earnings of unconsolidated businesses decreased $14 million, or 2.1%. This decrease was primarily the result of ceasing recording CTI's operating losses in 2002, more than offset by the unfavorable impact of Venezuelan bolivar fluctuations on the results of CANTV in 2002 and lower operating results of TELUS. Higher income from other unconsolidated businesses was primarily due to a gain on the sale of a portion of our interest in Taiwan Cellular Corporation (TCC).

Special and non-recurring charges of $791 million, $2,426 million and $2,966 million, after-tax, affected the International segment in 2003, 2002 and 2001, respectively. Special and non-recurring items in 2003 were primarily related to the impairment of our investment in Iusacell, partially offset by the Eurotel Praha gain on sale. Special and non-recurring items in 2002 included losses on CANTV, TELUS, CTI and other investments and the cumulative effect of adopting SFAS No. 142, partially offset by the gain on a sale of nearly all of our interest in TCNZ. Special and non-recurring items in 2001 primarily related to losses on investments in securities and a loss at CTI in connection with the deteriorating Argentinean economy and devaluation of the Argentinean peso.

SPECIAL ITEMS

Discontinued Operations

During 2003, we announced our decision to sell our 39.4% consolidated interest in Iusacell into the tender offer launched by Movil Access, a Mexican company. Verizon tendered its shares shortly after the tender offer commenced, and the tender offer closed on July 29, 2003. In accordance with SFAS No. 144, we have classified the results of operations of Iusacell as discontinued operations. In connection with the decision to sell our interest in Iusacell and a comparison of expected net sale proceeds to the net book value of our investment in Iusacell (including the foreign currency translation balance), we recorded a pretax loss of $957 million ($931 million after-tax, or $.33 per diluted share).

Sales of Businesses and Investments, Net

Sales of Businesses, Net

Wireline Property Sales

During the third quarter of 2002, we completed the sales of all 675,000 of our switched access lines in Alabama and Missouri to CenturyTel Inc. and 600,000 of our switched access lines in Kentucky to ALLTEL Corporation for $4,059 million in cash proceeds ($191 million of which was received in 2001). We recorded a pretax gain of $2,527 million ($1,550 million after-tax, or $.56 per diluted share). The operating revenues of the access lines sold were $623 million and $997 million for the years 2002 and 2001, respectively. Operating expenses of the access lines sold were $241 million and $413 million for the years 2002 and 2001, respectively.

Wireless Overlap Property Sales

During 2001, we recorded a pretax gain of $80 million ($48 million after-tax, or $.02 per diluted share) on the sale of the Cincinnati wireless market and a pretax loss of $172 million ($108 million after-tax, or $.04 per diluted share) related to the sale of the Chicago wireless market.

Other Transactions

During 2002, we recorded a net pretax gain of $220 million ($116 million after-tax, or $.04 per diluted share), primarily resulting from a pretax gain on the sale of TSI of $466 million ($275 million after-tax, or $.10 per diluted share), partially offset by an impairment charge in connection with our exit from the video business and other charges of $246 million ($159 million after-tax, or $.06 per diluted share).

During 2001, we recorded charges totaling $258 million ($166 million after-tax, or $.06 per diluted share) related to exiting several businesses, including our video business and some leasing activities.

Sales of Investments, Net

During 2003, we recorded a pretax gain of $348 million on the sale of our interest in Eurotel Praha. Also during 2003, we recorded a net pretax gain of $176 million as a result of a payment received in connection with the liquidation of Genuity. In connection with these sales transactions, Verizon recorded contributions of $150 million for each of the transactions to Verizon Foundation to fund its charitable activities and increase its self-sufficiency. Consequently, we recorded a net gain of $44 million after taxes, or $.02 per diluted share related to these transactions and the accrual of the Verizon Foundation contributions.

During 2002, we sold nearly all of our investment in TCNZ for net cash proceeds of $769 million, which resulted in a pretax gain of $383 million ($229 million after-tax, or $.08 per diluted share).

Investment-Related Charges and Related Tax Benefits

We continually evaluate our investments in unconsolidated businesses and other long-lived assets for impairment. That evaluation includes, in addition to persistent, declining stock prices, general economic and company-specific evaluations. In the event of a determination that a decline in market value is other than temporary, a charge to earnings is recorded for the loss and a new cost basis in the investment is established. As of December 31, 2003, no impairments were determined to exist.

In 2002, we recorded total net investment-related pretax losses of $6,202 million ($5,652 million after-tax, or $2.06 per diluted share) in Equity in Earnings (Loss) of Unconsolidated Businesses, Income (Loss) from Other Unconsolidated Businesses and Selling, General and Administrative Expense. These losses are comprised of the following:

- A loss of $2,898 million ($2,735 million after-tax, or $1.00 per diluted share) related to our investment in Genuity. This loss includes a write-down of our investments and loans of $2,624 million ($2,560 million after-tax, or $.93 per diluted share). We also recorded a pretax charge of $274 million ($175 million after-tax, or $.07 per diluted share) related to the remaining financial exposure to our assets, including receivables, as a result of Genuity's bankruptcy.
- During 2002, we also recorded a pretax loss of $1,400 million ($1,400 million after-tax, or $.51 per diluted share) due to the other than temporary decline in the market value of our investment in CANTV. As a result of the political and economic instability in Venezuela, including the devaluation of the Venezuelan bolivar, and the related impact on CANTV's future economic prospects, we no longer expected that the future undiscounted cash flows applicable to CANTV would be sufficient to recover our investment. Accordingly, we wrote our investment down to market value as of March 31, 2002.
- In 2002, we also recorded an other than temporary loss related to several investments, including a loss of $580 million ($430 million after-tax, or $.16 per diluted share) to the market value of our investment in TELUS, a net loss of $347 million ($230 million after-tax, or $.08 per diluted share) primarily related to the market value of our investment in C&W and losses totaling $231 million ($231 million after-tax, or $.08 per diluted share) relating to several other investments.
- In 2002, we recorded a pretax loss of $516 million ($436 million after-tax, or $.16 per diluted share) to market value of MFN primarily due to the other than temporary decline in the market value of our investment in MFN. During 2001, we wrote down our investment in MFN due to the declining market value of its stock. We wrote off our remaining investment and other financial statement exposure related to MFN in 2002 primarily as a result of its deteriorating financial condition and related defaults.
- In addition, in 2002 we recorded a pretax loss of $230 million ($190 million after-tax, or $.07 per diluted share) to fair value due to the other than temporary decline in the fair value of our remaining investment in CTI. In 2001, we recorded an estimated loss of $637 million ($637 million after-tax, or $.23 per diluted share) to reflect the impact of the deteriorating Argentinean economy and devaluation of the Argentinean peso on CTI's financial position. As a result of these charges, our financial exposure related to our equity investment in CTI was eliminated.

As a result of capital gains and other income on access line sales and investment sales in 2002, as well as assessments and transactions related to several of the impaired investments during the third and fourth quarters of 2002, we recorded tax benefits of $2,104 million ($.77 per diluted share) in 2002 pertaining to current and prior year investment impairments. The investment impairments primarily related to debt and equity investments in MFN and in Genuity.

Prior to the second quarter of 2001, we considered the declines in the market values of our investments in securities to be temporary, due principally to the overall weakness in the securities markets as well as telecommunications sector share prices. However, included in our results for 2001 is the recognition of pretax losses recorded in June 2001 and December 2001 totaling $4,686 million ($3,607 million after-tax, or $1.32 per diluted share) primarily relating to our investments in C&W, NTL and MFN. We determined, through the evaluation described above, that market value declines in these investments were considered other than temporary.

During 2001, we also recorded a pretax charge of $1,251 million ($1,251 million after-tax, or $.46 per diluted share) related to our cost investment in Genuity. The charge was necessary because we determined that the decline in the estimated fair value of Genuity was other than temporary. Our investment in Genuity was not considered a marketable security given its unique characteristics and the associated contingent conversion right. However, we estimated fair value based on the number of shares of Genuity we would own, assuming the exercise of the contingent conversion right, and the market value of Genuity common stock.

Other Strategic Actions and Completion of Merger

Severance, Pension and Benefit Charges

Total pension, benefit and other costs related to severance activities were $5,524 million ($3,399 million after-tax, or $1.22 per diluted share) in 2003, primarily in connection with the voluntary separation of more than 25,000 employees, as follows:

- In the fourth quarter of 2003, we recorded a pretax charge of $4,695 million ($2,882 million after-tax, or $1.03 per diluted share) primarily associated with costs incurred in connection with a voluntary separation plan under which more than 21,000 employees accepted the separation offer. This pretax voluntary separation plan charge included $2,716 million recorded in accordance with SFAS No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits" and SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" for pension and postretirement benefit enhancements and a net curtailment gain for a significant reduction of the expected years of future service resulting from early retirements. In addition, we recorded a pretax charge of $76 million for pension settlement losses related to lump-sum settlements of some existing pension obligations. SFAS No. 88 requires that settlement losses be recorded once prescribed payment thresholds have been reached. The fourth quarter pretax charge also included severance costs of $1,720 million and costs related to other severance-related activities of $183 million.
- We also recorded a special charge in 2003 of $235 million ($150 million after-tax, or $.05 per diluted share) primarily associated with employee severance costs and severance-related activities in connection with the voluntary separation of approximately 4,000 employees. In addition, we recorded pretax pension settlement losses of $131 million ($81 million after-tax, or $.03 per diluted share) in 2003 related to employees that received lump-sum distributions during the year in connection with previously announced employee separations.
- Further, in 2003 we recorded a special charge of $463 million ($286 million after-tax, or $.10 per diluted share) in connection with enhanced pension benefits granted to employees retiring in the first half of 2003, estimated costs associated with the July 10, 2003 Verizon-New York arbitration ruling and pension settlement losses related to lump-sum pay-outs in 2003. On July 10, 2003, an arbitrator ruled that Verizon-New York's termination of 2,300 employees in 2002 was not permitted under a union contract; similar cases were pending impacting an additional 1,100 employees. Verizon offered to reinstate all 3,400 impacted employees, and accordingly, recorded a charge in the second quarter of 2003 representing estimated payments to employees and other related company-paid costs.

Total pension, benefit and other costs related to severances were $2,010 million ($1,264 million after taxes and minority interest, or $.46 per diluted share) in 2002, primarily in connection with the separation of approximately 8,000 employees and pension and other postretirement benefit charges associated with 2002 and 2001 severance activity, as follows:

- In the fourth quarter of 2002, we recorded a pretax charge of $981 million ($604 million after taxes and minority interest, or $.22 per diluted share) primarily associated with pension and benefit costs related to severances in 2002 and 2001. This pretax charge included $910 million recorded in accordance with SFAS No. 88 and SFAS No. 106 for curtailment losses related to a significant reduction of the expected years of future service resulting from early retirements once the prescribed threshold was reached, pension settlement losses related to lump-sum settlements of some existing pension obligations and pension and postretirement benefit enhancements. The fourth quarter charge also included severance costs of $71 million.
- We also recorded a pretax charge in 2002 of $295 million ($185 million after-tax, or $.07 per diluted share) related to settlement losses incurred in connection with previously announced employee separations.
- In addition, we recorded a charge of $734 million ($475 million after taxes and minority interest, or $.17 per diluted share) in 2002 primarily associated with employee severance costs and severance-related activities in connection with the voluntary and involuntary separation of approximately 8,000 employees.

During 2001, we recorded a special charge of $1,613 million ($1,001 million after-tax, or $.37 per diluted share) primarily associated with employee severance costs and related pension enhancements. The pretax charge included severance and related benefits of $765 million for the voluntary and involuntary separation of approximately 10,000 employees. We also recorded a pretax charge of $848 million primarily associated with related pension enhancements.

Other Charges and Special Items

During 2003, we recorded other special pretax charges of $557 million ($419 million after-tax, or $.15 per diluted share). These charges included $240 million ($156 million after-tax, or $.06 per diluted share) primarily in connection with environmental remediation efforts relating to several discontinued businesses, including a former facility that processed nuclear fuel rods in Hicksville, New York (see "Other Factors That May Affect Future Results") and a pretax impairment charge of $184 million ($184 million after-tax, or $.07 per diluted

share) pertaining to our leasing operations for airplanes leased to airlines experiencing financial difficulties and for power generating facilities. These 2003 charges also include pretax charges of $61 million ($38 million after-tax, or $.01 per diluted share) related to the early retirement of debt and other pretax charges of $72 million ($41 million after-tax, or $.01 per diluted share).

During 2002, we recorded pretax charges of $626 million ($469 million after-tax, or $.17 per diluted share). These charges related to losses in connection with our financial statement exposure to MCI due to its July 2002 bankruptcy of $300 million ($183 million after-tax, or $.07 per diluted share), an impairment charge of $117 million ($136 million after-tax, or $.05 per diluted share) pertaining to our leasing operations for airplanes leased to airlines experiencing financial difficulties and other charges of $209 million ($150 million after-tax, or $.05 per diluted share). In addition, we recorded a charge of $175 million ($114 million after-tax, or $.04 per diluted share) related to a settlement of a litigation matter that arose from our decision to terminate an agreement with NorthPoint Communications Group, Inc. to combine the two companies' DSL businesses.

Other charges and special items recorded during 2001 include an asset impairment charge of $151 million ($95 million after-tax, or $.03 per diluted share) related to property sales and facility consolidation, a charge of $182 million ($179 million after taxes and minority interest, or $.07 per diluted share) in connection with mark-to-market adjustments related to some of our financial instruments and a charge of $29 million ($19 million after-tax, or $.01 per diluted share) resulting from the early retirement of debt. In 2001, we also recorded a loss of $35 million ($26 million after-tax, or $.01 per diluted share) related to international losses.

Merger Transition Costs

We announced at the time of the Bell Atlantic–GTE merger in 2000 that we expected to incur a total of approximately $2 billion of transition costs related to the merger and the formation of the wireless joint venture. These costs were incurred to establish the Verizon brand, integrate systems, consolidate real estate and relocate employees. Transition activities were complete at December 31, 2002 and totaled $2,243 million. For 2002 and 2001, transition costs were $510 million ($288 million after taxes and minority interest, or $.10 per diluted share) and $1,039 million ($578 million after taxes and minority interest, or $.21 per diluted share), respectively.

CONSOLIDATED FINANCIAL CONDITION

		(dollars in millions)	
Years Ended December 31,	**2003**	2002	2001
Cash Flows Provided By (Used In)			
Operating activities	**$ 22,482**	$ 22,099	$ 19,526
Investing activities	**(12,246)**	(6,800)	(21,324)
Financing activities	**(10,959)**	(14,809)	1,973
Increase (Decrease) In Cash and Cash Equivalents	**$ (723)**	$ 490	$ 175

We use the net cash generated from our operations to fund network expansion and modernization, repay external financing, pay dividends and invest in new businesses. Additional external financing is utilized when necessary. While our current liabilities typically exceed current assets, our sources of funds, primarily from operations and, to the extent necessary, from readily available external financing arrangements, are sufficient to meet ongoing operating and investing requirements. We expect that capital spending requirements will continue to be financed primarily through internally generated funds. Additional debt or equity financing may be needed to fund additional development activities or to maintain our capital structure to ensure our financial flexibility.

Cash Flows Provided By Operating Activities

Our primary source of funds continues to be cash generated from operations. In 2003, the increase in cash from operations was primarily driven by a decrease in working capital requirements, net of a lower provision for uncollectible accounts. The decrease in working capital requirements was driven by an increase in payables and higher accrued income taxes related to tax payments not yet due.

In 2002, the increase in cash from operations compared to 2001 primarily reflects improved results of operations before gains or losses on asset sales.

Cash Flows Used In Investing Activities

Capital expenditures continue to be our primary use of capital resources and facilitate the introduction of new products and services, enhance responsiveness to competitive challenges and increase the operating efficiency and productivity of our networks. Including capitalized software, we invested $6,820 million in our Domestic Telecom business in 2003, compared to $8,004 million and $12,731 million in 2002 and 2001, respectively. We also invested $4,590 million in our Domestic Wireless business in 2003, compared to $4,414 million and $5,080 million in 2002 and 2001, respectively. The decrease in capital spending in 2003 and 2002, particularly by Domestic Telecom, is primarily due to a decrease in demand for local network expansion, partially offset by investments in high growth areas such as long distance and DSL.

Capital spending, including capitalized software, is expected to be approximately $12 billion to $13 billion in 2004. This range includes $6.5 billion to $7.0 billion for Domestic Telecom, $5.0 billion to $5.5 billion for Domestic Wireless and a total of $.5 billion for Information Services, International and Corporate and Other businesses.

We invested $1,162 million in acquisitions and investments in businesses during 2003, including $762 million to acquire 50 wireless licenses and related network assets from Northcoast Communications LLC and $157 million for other wireless properties. In 2002, we invested $1,088 million in acquisitions and investments in businesses, including $556 million to acquire some of the cellular properties of Dobson Communications Corporation and $242 million for other wireless properties. We also received a $1,740 million refund from the FCC in connection with a wireless auction payment. In 2001, we invested $3,072 million in acquisitions and investments in businesses, including $1,691 million related to wireless licenses purchased in connection with an FCC auction, $410 million for additional wireless spectrum purchased from another telecommunications carrier and $194 million in wireless properties. In addition, we invested $497 million in 2001 to acquire the directory business of TELUS.

In 2003, we received cash proceeds of $229 million, from the sale of our directory publication operations in Austria, the Czech Republic, Gibraltar, Hungary, Poland and Slovakia. In 2002, we received cash

proceeds of $4,638 million, including $3,868 million from the sale of non-strategic access lines and $770 million in connection with the sale of TSI. In 2001, we received cash proceeds of $200 million and $215 million in connection with sales of our Cincinnati and Chicago wireless overlap properties, respectively.

Our short-term investments include principally cash equivalents held in trust accounts for payment of employee benefits. In 2003, 2002 and 2001, we invested $1,887 million, $2,073 million and $1,928 million, respectively, in short-term investments, primarily to pre-fund active employees' health and welfare benefits. Proceeds from the sales of all short-term investments, principally for the payment of these benefits, were $1,767 million, $1,857 million and $1,546 million in the years 2003, 2002 and 2001, respectively.

Other, net investing activities for 2003 include net cash proceeds of $415 million in connection with sales of our interests in various investments, primarily TCC and Crown Castle International Corp. and $195 million in connection with the sale of our interest in Eurotel Praha, representing a portion of the total proceeds of $525 million. Other, net investing activities for 2002 include total cash proceeds of $1,453 million in connection with share sales of various investments, including net cash proceeds of $769 million in connection with a sale of nearly all of our investment in TCNZ and $281 million related to the sale of our investment in C&W, and purchases of investments of $425 million. Other, net investing activities for 2001 included loans to Genuity of $1,150 million. In addition, in 2001 we received a deposit of $191 million related to the sale of non-strategic access lines, $167 million in connection with CANTV's share repurchase program and proceeds of $515 million related to prior year wireless asset sales.

Under the terms of an investment agreement relating to our wireless joint venture, Vodafone may require Verizon Wireless to purchase up to an aggregate of $20 billion worth of Vodafone's interest in Verizon Wireless at designated times between 2003 and 2007 at its then fair market value. In the event Vodafone exercises its put rights, we have the right, exercisable at our sole discretion, to purchase up to $12.5 billion of Vodafone's interest instead of Verizon Wireless for cash or Verizon stock at our option. Vodafone may require the purchase of up to $10 billion during a 61-day period opening on June 10 and closing on August 9 in 2004, and the remainder, which may not exceed $10 billion in any one year, during a 61-day period opening on June 10 and closing on August 9 in 2005 through 2007. Vodafone also may require that Verizon Wireless pay for up to $7.5 billion of the required repurchase through the assumption or incurrence of debt. Vodafone did not exercise its put rights during the 61-day period that ended on August 9, 2003.

Cash Flows Provided By (Used In) Financing Activities

Cash of $7,436 million was used to reduce our total debt during 2003. We repaid $5,646 million of Verizon Global Funding Corp., $2,190 million of Domestic Telecom, $1,582 million of Domestic Wireless and $1,239 million of other corporate long-term debt, and reduced our short-term borrowings by $1,330 million with cash from operations and the issuance of Verizon Global Funding, Domestic Telecom and Domestic Wireless long-term debt. Verizon Global Funding, Domestic Telecom and Domestic Wireless issued long-term debt with principal amounts of $1,500 million, $1,653 million and $1,525 million, respectively, resulting in total cash proceeds of $4,591 million, net of discounts, costs and a payment related to a hedge on the interest rate for an anticipated financing.

Cash of $11,595 million was used to reduce our total debt during 2002. We repaid $4,083 million of Verizon Global Funding, $2,454 million of Domestic Telecom and $1,022 million of Domestic Wireless long-term debt (including $585 million of net debt assumed in connection with the Price transaction), and reduced our short-term borrowings by $11,024 million primarily with cash and the issuance of Domestic Telecom and Verizon Global Funding long-term debt. Domestic Telecom and Verizon Global Funding issued $3,779 million and $3,816 million of long-term debt, respectively.

The net cash proceeds from increases in our total debt during 2001 of $6,031 million was primarily due to the issuance of $7,002 million of long-term debt by Verizon Global Funding, partially offset by repayments of $980 million of maturities of corporate long-term debt. In addition, Verizon Wireless issued $4,555 million of long-term debt and repaid $4,690 million of revolving loans, while Domestic Telecom incurred $2,303 million of long-term debt, repaid $573 million of net short-term debt and retired $1,430 million of long-term debt.

Our ratio of debt to debt combined with shareowners' equity was 57.6% at December 31, 2003, compared to 62.0% at December 31, 2002.

As of December 31, 2003, we had $143 million in bank borrowings outstanding. In addition, we had approximately $5.9 billion of unused bank lines of credit and our telephone and financing subsidiaries had shelf registrations for the issuance of up to $12.5 billion of unsecured debt securities. The debt securities of our telephone and financing subsidiaries continue to be accorded high ratings by primary rating agencies. In February 2003, Standard & Poor's upgraded our credit rating outlook from negative to stable, citing debt reduction efforts over the past year. We have adopted a debt portfolio strategy that continues our overall debt reduction efforts through the remainder of the year.

Verizon and its consolidated subsidiaries are in compliance with all of their debt covenants.

As in prior years, dividend payments were a significant use of capital resources. We determine the appropriateness of the level of our dividend payments on a periodic basis by considering such factors as long-term growth opportunities, internal cash requirements and the expectations of our shareowners. In 2003, 2002 and 2001, we declared quarterly cash dividends of $.385 per share.

Common stock has generally been issued to satisfy funding requirements of employee benefit plans. On January 22, 2004, the Board of Directors authorized the repurchase of up to 80 million common shares terminating no later than the close of business on February 28, 2006. The Board of Directors also determined that no additional common shares may be purchased under the previous program.

Increase (Decrease) In Cash and Cash Equivalents

Our cash and cash equivalents at December 31, 2003 totaled $699 million, a $723 million decrease compared to cash and cash equivalents at December 31, 2002 of $1,422 million. The decrease in cash and cash equivalents was primarily driven by significant reduction in our outstanding borrowings, and capital expenditures and dividends

paid. Our cash and cash equivalents at December 31, 2002 was $490 million higher compared to December 31, 2001. The increase was driven by favorable results of operations, proceeds from non-strategic access line sales and other sales, partially offset by capital expenditures and a significant reduction in borrowings in 2002.

Additional Minimum Pension Liability and Employee Benefit Plan Contributions

We evaluate each pension plan to determine whether any additional minimum liability is required. In 2002, we recorded an additional minimum pension liability of $1,342 million for the amount of excess unfunded accumulated benefit liability over our accrued liability, as required by SFAS No. 87, "Employers' Accounting for Pensions." As a result of lower interest rates and lower than expected 2002 investment returns, an additional minimum pension liability was required for a small number of plans. In 2003, we recorded a net benefit of $513 million, primarily in Other Assets in the consolidated balance sheets, largely as a result of a higher return on plan assets in 2003. The increases in the asset and liability are recorded in Accumulated Other Comprehensive Loss, net of a tax benefit, in shareowners' investment in the consolidated balance sheets.

We operate numerous qualified and nonqualified pension plans and other postretirement benefit plans. These plans primarily relate to our domestic business units and TELPRI. The majority of Verizon's pension plans are adequately funded. We contributed $126 million and $69 million in 2003 and 2002, respectively, to our qualified pension trusts, primarily for TELPRI. We also contributed $159 million and $88 million to our nonqualified pension plans in 2003 and 2002, respectively. Consistent with these historical contributions and based on the funded status of the plans at December 31, 2003, we anticipate making required qualified pension trust contributions of $266 million (excluding nonqualified contributions of $161 million) in 2004, including $138 million related to TELPRI. As a result of pending federal legislation pertaining to required pension funding, our assessment of the amount and timing of the required qualified pension trust contributions for 2005 are less clear, but have been estimated to be approximately $350 million, including $136 million for TELPRI. Contributions to our other postretirement benefit plans generally relate to payments for benefits primarily on an as-incurred basis since the other postretirement benefit plans do not have similar funding requirements as the pension plans. Consequently, we contributed $1,014 million and $919 million to our other postretirement benefit plans in 2003 and 2002, respectively. Consistent with these historical contributions and based on the funded status of the plans at December 31, 2003, we anticipate making required contributions to our other postretirement benefit plans of $1,149 million and $1,183 million in 2004 and 2005, respectively.

Leasing Arrangements

We are the lessor in leveraged and direct financing lease agreements under which commercial aircraft and power generating facilities, which comprise the majority of the portfolio, along with industrial equipment, real estate property, telecommunications and other equipment are leased for remaining terms of less than 1 year to 45 years as of December 31, 2003. Minimum lease payments receivable represent unpaid rentals, less principal and interest on third-party nonrecourse debt relating to leveraged lease transactions. Since we have no general liability for this debt, which holds a senior security interest in the leased equipment and rentals, the related principal and interest have been offset against the minimum lease payments receivable in accordance with GAAP. All recourse debt is reflected in our consolidated balance sheets.

Off Balance Sheet Arrangements and Contractual Obligations

Contractual Obligations and Commercial Commitments

The following table provides a summary of our contractual obligations and commercial commitments at December 31, 2003. Additional detail about these items is included in the notes to the consolidated financial statements.

(dollars in millions)

	Payments Due By Period				
Contractual Obligations	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-term debt (see Note 11)	$ 44,353	$ 5,097	$ 9,354	$ 4,927	$ 24,975
Capital lease obligations (see Note 10)	240	83	52	29	76
Total long-term debt	44,593	5,180	9,406	4,956	25,051
Interest on long-term debt (see Note 11)	29,997	2,507	4,521	3,689	19,280
Operating leases (see Note 10)	4,653	909	1,699	918	1,127
Purchase obligations (see Note 22)	630	413	217	–	–
Other long-term liabilities (see Notes 5 and 15)	3,201	1,542	1,614	30	15
Total contractual obligations	$ 83,074	$ 10,551	$ 17,457	$ 9,593	$ 45,473

Genuity

Prior to the merger of Bell Atlantic and GTE in 2000, we owned and consolidated Genuity, which was deconsolidated in June 2000 as a condition of the merger in connection with an initial public offering. Our remaining ownership interest in Genuity contained a contingent conversion feature that gave us the option to regain control of Genuity and was dependent on obtaining approvals to provide long distance service in the former Bell Atlantic region and satisfaction of other regulatory and legal requirements. On July 24, 2002, we converted all but one of our shares of Class B common stock of Genuity into shares of Class A common stock of Genuity and relinquished our right to convert our current ownership into a controlling interest in Genuity. On December 18, 2002, we sold all of our Class A common stock of Genuity.

Our commercial relationship continues with Level 3 Communications LLC (Level 3), the purchaser of substantially all of Genuity's domestic assets and the assignee of Genuity's principal contract with us. We have a multi-year purchase commitment expiring on December 31, 2005 for services such as dedicated Internet access, managed web hosting, Internet security and some transport services. Under this purchase commitment, Verizon has agreed to pay Level 3 a minimum of $250 million between February 4, 2003 and December 31, 2005. Through December 31, 2003, $71 million of that purchase commitment had been met by Verizon.

MARKET RISK

We are exposed to various types of market risk in the normal course of business, including the impact of interest rate changes, foreign currency exchange rate fluctuations, changes in equity investment prices and changes in corporate tax rates. We employ risk management strategies using a variety of derivatives, including interest rate swap agreements, interest rate locks, foreign currency forwards, equity options and basis swap agreements. We do not hold derivatives for trading purposes.

It is our general policy to enter into interest rate, foreign currency and other derivative transactions only to the extent necessary to achieve our desired objectives in limiting our exposures to the various market risks. Our objectives include maintaining a mix of fixed and variable rate debt to lower borrowing costs within reasonable risk parameters and to protect against earnings and cash flow volatility resulting from changes in market conditions. We do not hedge our market risk exposure in a manner that would completely eliminate the effect of changes in interest rates, equity prices and foreign exchange rates on our earnings. We do not expect that our net income, liquidity and cash flows will be materially affected by these risk management strategies.

Exchangeable Notes

In 1998, Verizon Global Funding issued notes exchangeable into shares of TCNZ and into shares of Cable & Wireless Communications plc (subsequently C&W shares and a combination of shares and warrants in the reorganized NTL entities) as described in Note 11 to the consolidated financial statements. These financial instruments exposed us to market risk, including (i) equity price risk, because the notes were exchangeable into shares that are traded on the open market and routinely fluctuate in value, (ii) foreign exchange rate risk, because the notes were exchangeable into shares that are denominated in a foreign currency, and (iii) interest rate risk, because the notes carried fixed interest rates.

On April 1, 2003, all of the outstanding $2,455 million principal amount of the 5.75% notes that were exchangeable into shares of TCNZ were redeemed at maturity. On March 15, 2003, Verizon Global Funding redeemed all of the outstanding 4.25% notes. The cash redemption price for the 4.25% notes was $1,048.29 for each $1,000 principal amount of the notes. The principal amount of the 4.25% notes outstanding, before unamortized discount, at the time of redemption, was $2,839 million.

Interest Rate Risk

The table that follows summarizes the fair values of our long-term debt, interest rate derivatives and exchangeable notes as of December 31, 2003 and 2002. The table also provides a sensitivity analysis of the estimated fair values of these financial instruments assuming 100-basis-point upward and downward parallel shifts in the yield curve. Our sensitivity analysis did not include the fair values of our commercial paper and bank loans because they are not significantly affected by changes in market interest rates.

(dollars in millions)

At December 31, 2003	Fair Value	Fair Value assuming +100 basis point shift	Fair Value assuming -100 basis point shift
Long-term debt and interest rate derivatives	**$ 47,725**	**$ 45,255**	**$ 50,399**
At December 31, 2002			
Long-term debt and interest rate derivatives	$ 49,157	$ 46,625	$ 51,931
Exchangeable notes	5,239	5,162	5,317
Total	$ 54,396	$ 51,787	$ 57,248

Foreign Currency Translation

The functional currency for nearly all of our foreign operations is the local currency. The translation of income statement and balance sheet amounts of these entities into U.S. dollars are recorded as cumulative translation adjustments, which are included in Accumulated Other Comprehensive Loss in our consolidated balance sheets. At December 31, 2003, our primary translation exposure was to the Venezuelan bolivar, Dominican Republic peso, Canadian dollar and the euro. We have not hedged our accounting translation exposure to foreign currency fluctuations relative to the carrying value of these investments.

Through June 30, 2003, and during 2002 and 2001, our earnings were affected by foreign currency gains or losses associated with the unhedged portion of U. S. dollar denominated debt at Iusacell (see "Consolidated Results of Operations – Other Consolidated Results – Discontinued Operations").

SIGNIFICANT ACCOUNTING POLICIES

A summary of the significant accounting policies used in preparing our financial statements are as follows:

- Special and non-recurring items generally represent revenues and gains as well as expenses and losses that are non-operational and/or non-recurring in nature. Several of these special and non-recurring items include impairment losses. These impairment losses were determined in accordance with our policy of comparing the fair value of the asset with its carrying value. The fair value is determined by quoted market prices or by estimates of future cash flows. There is inherent subjectivity involved in estimating future cash flows, which can have a significant impact on the amount of any impairment.
- We continually evaluate our investments in securities for impairment due to declines in market value considered to be other than

temporary. That evaluation includes, in addition to persistent, declining stock prices, general economic and company-specific evaluations. In the event of a determination that a decline in market value is other than temporary, a charge to earnings is recorded for the loss and a new cost basis in the investment is established. Given our significant investments in securities, other than temporary declines in market values can have a material impact on our results of operations and financial condition.

- We maintain benefit plans for most of our employees, including pension and other postretirement benefit plans. In the aggregate, the fair value of pension plan assets exceeds benefit obligations, which contributes to pension plan income. Other postretirement benefit plans have larger benefit obligations than plan assets, resulting in expense. Significant benefit plan assumptions, including the discount rate used, the long-term rate of return on plan assets and rate of future increases in compensation are periodically updated and impact the amount of benefit plan income, expense, assets and obligations (see "Consolidated Results of Operations – Consolidated Operating Expenses – Pension and Other Postretirement Benefits").
- Our accounting policy concerning the method of accounting applied to investments (consolidation, equity or cost) involves an evaluation of all significant terms of the investments that explicitly grant or suggest evidence of control or influence over the operations of the entity in which we have invested. Where control is determined, we consolidate the investment. If we determine that we have significant influence over the operating and financial policies of an entity in which we have invested, we apply the equity method. We apply the cost method in situations where we determine that we do not have significant influence.
- Our current and deferred income taxes, and associated valuation allowances, are impacted by events and transactions arising in the normal course of business as well as in connection with special and non-recurring items. Assessment of the appropriate amount and classification of income taxes is dependent on several factors, including estimates of the timing and realization of deferred income tax assets and the timing of income tax payments. Actual collections and payments may materially differ from these estimates as a result of changes in tax laws as well as unanticipated future transactions impacting related income tax balances.
- Intangible assets are a significant component of our consolidated assets. Wireless licenses of $40,907 million represent the largest component of our intangible assets. Our wireless licenses are indefinite-lived intangible assets, and as required by SFAS No. 142, are no longer amortized but are periodically evaluated for impairment. Any impairment loss would be determined by comparing the fair value of the wireless licenses with their carrying value. The fair value is determined by estimating future cash flows of the wireless business. The fair value of the wireless business is then subjected to a reasonableness analysis using public information of comparable wireless carriers. There is inherent subjectivity involved in estimating future cash flows, which can have a material impact on the amount of any impairment.

OTHER FACTORS THAT MAY AFFECT FUTURE RESULTS

Recent Developments

Telephone Access Lines

As we have stated in the past, Verizon continually evaluates its assets and properties for strategic fit and financial performance. In connection with this analysis, discussions have taken place regarding the possible sale of telephone access lines in Hawaii and upstate New York. However, no sale is pending at this time.

Environmental Matters

During 2003, under a government-approved plan, remediation of the site of a former facility in Hicksville, New York that processed nuclear fuel rods in the 1950s and 1960s commenced. Remediation beyond original expectations proved to be necessary and a reassessment of the anticipated remediation costs was conducted. In addition, a reassessment of costs related to remediation efforts at several other former facilities was undertaken. As a result, an additional environmental remediation expense of $240 million was recorded in Selling, General and Administrative Expense in the consolidated statements of income in the fourth quarter of 2003.

New York Recovery Funding

In August 2002, President Bush signed the Supplemental Appropriations bill which included $5.5 billion in New York recovery funding. Of that amount, approximately $750 million has been allocated to cover the uninsured losses of businesses (including the restoration of utility infrastructure) as a result of the September 11th terrorist attacks. These funds will be distributed through the Lower Manhattan Development Corporation following an application process.

On October 31, 2003, Verizon applied for reimbursement of $33 million. We received $11 million in December 2003. We are awaiting an audit for the remaining funds. Once the audit is complete, we will apply for additional funds.

Regulatory and Competitive Trends

Competition and the Telecommunications Act of 1996

We face increasing competition in all areas of our business. The Telecommunications Act of 1996 (1996 Act), regulatory and judicial actions and the development of new technologies, products and services have created opportunities for alternative telecommunication service providers, many of which are subject to fewer regulatory constraints. Current and potential competitors in telecommunications services include long distance companies, other local telephone companies, cable companies, wireless service providers, foreign telecommunications providers, electric utilities, Internet service providers and other companies that offer network services. Many of these companies have a strong market presence, brand recognition and existing customer relationships, all of which contribute to intensifying competition and may affect our future revenue growth.

We are unable to predict definitively the impact that the ongoing changes in the telecommunications industry will ultimately have on our business, results of operations or financial condition. The financial impact will depend on several factors, including the timing, extent and success of competition in our markets, the timing and outcome of various regulatory proceedings and any appeals, and the timing,

extent and success of our pursuit of new opportunities resulting from the 1996 Act and technological advances.

In-Region Long Distance

Under the 1996 Act, our ability to offer in-region long distance services in the regions where the former Bell Atlantic telephone subsidiaries operate as local exchange carriers was largely dependent on satisfying specified requirements. These requirements included a 14-point "competitive checklist" of steps which we must take to help competitors offer local services through resale, through purchase of UNEs, or by interconnecting their own networks to ours. We were required to demonstrate to the FCC that our entry into the in-region long distance market would be in the public interest.

We now have authority from the FCC to offer in-region long distance service in all 14 of the former Bell Atlantic jurisdictions. The United States Court of Appeals for the District of Columbia remanded the Massachusetts order to the FCC for further explanation on one issue, but left our long distance authority in effect. The FCC's orders for the remaining jurisdictions were upheld on appeal or no appeal was filed.

FCC Regulation and Interstate Rates

Our telephone operations are subject to the jurisdiction of the FCC with respect to interstate services and related matters.

Access Charges and Universal Service

On May 31, 2000, the FCC adopted the Coalition for Affordable Local and Long Distance Services (CALLS) plan as a comprehensive five-year plan for regulation of interstate access charges. The CALLS plan has three main components. First, it establishes a portable interstate access universal service support of $650 million for the industry. This explicit support replaces implicit support embedded in interstate access charges. Second, the plan simplifies the patchwork of common line charges into one subscriber line charge (SLC) and provides for de-averaging of the SLC by zones and class of customers in a manner that will not undermine comparable and affordable universal service. Third, the plan sets into place a mechanism to transition to a set target of $.0055 per minute for switched access services. Once that target rate is reached, local exchange carriers are no longer required to make further annual price cap reductions to their switched access prices. The annual reductions leading to the target rate, as well as annual reductions for the subset of special access services that remain subject to price cap regulation was set at 6.5% per year.

As a result of tariff adjustments which became effective in July 2003, virtually all of our switched access lines reached the $.0055 benchmark.

The FCC has adopted rules for special access services that provide for pricing flexibility and ultimately the removal of services from price regulation when prescribed competitive thresholds are met. Approximately 55% of special access revenues are now removed from price regulation.

In November 1999, the FCC adopted a new mechanism for providing universal service support to high-cost areas served by large local telephone companies. This funding mechanism provides additional support for local telephone services in several states served by our telephone operations. This system has been supplemented by the new FCC access charge plan described above. On October 16, 2003, in response to a previous court decision, the FCC announced a decision providing additional justification for its non-rural high-cost universal support mechanism and modifying it in part. The FCC also has proceedings underway to evaluate possible changes to its current rules for assessing contributions to the universal service fund. Any change in the current assessment mechanism could result in a change in the contribution that local telephone companies must make and that would have to be collected from customers.

Unbundling of Network Elements

On February 20, 2003, the FCC announced a decision adopting new rules defining the obligations of incumbent local exchange carriers to provide competing carriers with access to UNEs. The decision was the culmination of an FCC rulemaking referred to as its triennial review of its UNE rules, and also was in response to a decision by the U.S. Court of Appeals for the D.C. Circuit. The U.S. Court of Appeals for the D.C. Circuit had overturned the FCC's previous unbundling rules on the grounds that the FCC did not adequately consider the limitations of the "necessary and impair" standards of the 1996 Act when it chose national rules for unbundling and that it failed to consider the relevance of competition from other types of service providers, including cable and satellite.

The text of the order and accompanying rules was released on August 21, 2003. With respect to broadband facilities, such as mass market fiber to the premises loops and packet switching, that order generally removed unbundling obligations under Section 251 of the 1996 Act. With respect to narrowband services, the order generally left unbundling obligations in place, with certain limited exceptions, and delegated to state regulatory proceedings a further review. The order also provided a new set of criteria relating to when carriers may purchase a combination of unbundled loops and transport elements known as enhanced extended loops (EELs).

The FCC's order significantly increases arbitrage opportunities by making it easier for carriers to use EELs for non-local service at regulated prices set using the pricing formula that applies to UNEs rather than competitive special access prices. In addition, the FCC's order eliminates important safeguards that protected against this kind of arbitrage, including the FCC's previous rule against co-mingling unbundled elements and other services. As a result, we estimate the impact on earnings related to this portion of the FCC's order to be potentially 4 cents to 6 cents per diluted share in 2004.

Multiple parties, including Verizon, appealed various aspects of the decision. Multiple parties also have asked the FCC to clarify or reconsider various aspects of its order, and Verizon has petitioned the FCC to make clear that any broadband facilities that do not have to be unbundled under Section 251 of the 1996 Act also do not have to be unbundled under another provision of the 1996 Act. On March 2, 2004, the U.S. Court of Appeals for the D.C. Circuit issued an order upholding the FCC in part, and overturning its order in part. The court upheld the FCC with respect to broadband facilities. On the narrowband unbundling requirements and on the EELs rules, the court reversed key aspects of the FCC decision. The court's reversal of the FCC will not go into effect for 60 days following the ruling or until a petition for rehearing is denied or granted.

Intercarrier Compensation

On April 27, 2001, the FCC released an order addressing intercarrier compensation for dial-up connections for Internet-bound traffic. The FCC found that Internet-bound traffic is interstate and subject to the

FCC's jurisdiction. Moreover, the FCC again found that Internet-bound traffic is not subject to reciprocal compensation under Section 251(b)(5) of the 1996 Act. Instead, the FCC established federal rates per minute for this traffic that decline from $.0015 to $.0007 over a three-year period. The FCC order also sets caps on the total minutes of this traffic that may be subject to any intercarrier compensation and requires that incumbent local exchange carriers must offer to both bill and pay reciprocal compensation for local traffic at the same rate as they are required to pay on Internet-bound traffic. On May 3, 2002, the U.S. Court of Appeals for the D.C. Circuit rejected part of the FCC's rationale for its April 27, 2001 order, but declined to vacate the order while it is on remand. As a result, pending further action by the FCC, the FCC's underlying order remains in effect.

More generally, the FCC has an ongoing rulemaking that could fundamentally restructure the regulatory regime for intercarrier compensation, including, but not limited to, access charges, compensation for Internet traffic, and reciprocal compensation for local traffic. The FCC also is considering multiple petitions asking it to declare whether, and under what circumstances, services that employ Internet protocol are subject to access charges under current law, or asking it to forbear from any requirement to pay access charges on some such services. The FCC also has announced that it intends to initiate a rulemaking proceeding to address the regulation of voice over Internet protocol services generally.

Broadband Services

The FCC has several ongoing rulemakings considering the regulatory treatment of broadband services. Among the questions at issue are whether to require local telephone companies like Verizon to offer such services as a common carrier or whether such services may be offered under a potentially less regulated private carriage arrangement, and whether to declare broadband services offered by local telephone companies as non-dominant and what the effect should be of any such classification.

CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS

In this Management's Discussion and Analysis of Results of Operations and Financial Condition, and elsewhere in this Annual Report, we have made forward-looking statements. These statements are based on our estimates and assumptions and are subject to risks and uncertainties. Forward-looking statements include the information concerning our possible or assumed future results of operations. Forward-looking statements also include those preceded or followed by the words "anticipates," "believes," "estimates," "hopes" or similar expressions. For those statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

The following important factors, along with those discussed elsewhere in this Annual Report, could affect future results and could cause those results to differ materially from those expressed in the forward-looking statements:

- the duration and extent of the current economic downturn;
- materially adverse changes in economic and industry conditions and labor matters, including workforce levels and labor negotiations, and any resulting financial and/or operational impact, in the markets served by us or by companies in which we have substantial investments;
- material changes in available technology;
- technology substitution;
- an adverse change in the ratings afforded our debt securities by nationally accredited ratings organizations;
- the final results of federal and state regulatory proceedings concerning our provision of retail and wholesale services and judicial review of those results;
- the effects of competition in our markets;
- our ability to satisfy regulatory merger conditions;
- the ability of Verizon Wireless to continue to obtain sufficient spectrum resources; and
- changes in our accounting assumptions that regulatory agencies, including the SEC, may require or that result from changes in the accounting rules or their application, which could result in an impact on earnings.

report of management

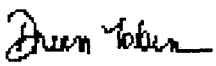
We, the management of Verizon Communications Inc., are responsible for the consolidated financial statements and the information and representations contained in this report. The financial statements have been prepared in conformity with generally accepted accounting principles and include amounts based on management's best estimates and judgments. Financial information elsewhere in this report is consistent with that in the financial statements.

Management has established and maintained a system of internal control which is designed to provide reasonable assurance that errors or irregularities that could be material to the financial statements are prevented or would be detected within a timely period. The system of internal control includes widely communicated statements of policies and business practices, which are designed to require all employees to maintain high ethical standards in the conduct of our business. The internal controls are augmented by organizational arrangements that provide for appropriate delegation of authority and division of responsibility and by a program of internal audits.

The company's financial statements have been audited by Ernst & Young LLP, independent auditors. Their audits were conducted in accordance with generally accepted auditing standards and included an evaluation of our internal control structure and selective tests of transactions. The Report of Independent Auditors follows this report.

The Audit Committee of the Board of Directors, which is composed solely of outside directors, meets periodically with the independent auditors, management and internal auditors to review accounting, auditing, internal controls, litigation and financial reporting matters. Both the internal auditors and the independent auditors have free access to the Audit Committee without management present.

Ivan G. Seidenberg
Chairman and Chief Executive Officer



Doreen A. Toben
Executive Vice President and Chief Financial Officer

David H. Benson
Senior Vice President and Controller

report of independent auditors

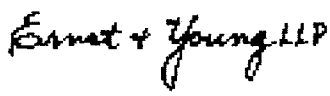
To the Board of Directors and Shareowners of Verizon Communications Inc.:

We have audited the accompanying consolidated balance sheets of Verizon Communications Inc. and subsidiaries (Verizon) as of December 31, 2003 and 2002, and the related consolidated statements of income, cash flows and changes in shareowners' investment for each of the three years in the period ended December 31, 2003. These financial statements are the responsibility of Verizon'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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as 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 at December 31, 2003 and 2002, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 2 to the consolidated financial statements, Verizon changed its methods of accounting for directory revenues and expenses, stock-based compensation and asset retirement obligations effective January 1, 2003; as discussed in Note 2 to the consolidated financial statements, Verizon changed its method of accounting for goodwill and other intangible assets effective January 1, 2002; and as discussed in Note 2 to the consolidated financial statements, Verizon changed its method of accounting for derivative instruments effective January 1, 2001.



Ernst & Young LLP
New York, New York

January 29, 2004

consolidated statements of income

(dollars in millions, except per share amounts)

Years Ended December 31,	2003	2002	2001
Operating Revenues	**$ 67,752**	$ 67,304	$ 66,713
Operating Expenses			
Cost of services and sales (exclusive of items shown below)	**21,783**	19,911	20,538
Selling, general & administrative expense	**24,999**	21,846	20,829
Depreciation and amortization expense	**13,617**	13,290	13,523
Sales of businesses, net	**(141)**	(2,747)	350
Total Operating Expenses	**60,258**	52,300	55,240
Operating Income	**7,494**	15,004	11,473
Equity in earnings (loss) of unconsolidated businesses	**1,278**	(1,547)	446
Income (loss) from other unconsolidated businesses	**331**	(2,857)	(5,486)
Other income and (expense), net	**38**	192	199
Interest expense	**(2,797)**	(3,130)	(3,276)
Minority interest	**(1,583)**	(1,404)	(625)
Income before provision for income taxes, discontinued operations and cumulative effect of accounting change	**4,761**	6,258	2,731
Provision for income taxes	**(1,252)**	(1,597)	(2,147)
Income Before Discontinued Operations and Cumulative Effect of Accounting Change	**3,509**	4,661	584
Discontinued Operations			
Income (loss) from operations of Iusacell	**(957)**	(74)	6
Income tax benefit (provision)	**22**	(12)	(19)
Loss on discontinued operations, net of tax	**(935)**	(86)	(13)
Cumulative Effect of Accounting Change, Net of Tax	**503**	(496)	(182)
Net Income	**$ 3,077**	$ 4,079	$ 389
Basic Earnings Per Common Share:			
Income before discontinued operations and cumulative effect of accounting change	**$ 1.27**	$ 1.71	$ .22
Loss on discontinued operations, net of tax	**(.34)**	(.03)	–
Cumulative effect of accounting change, net of tax	**.18**	(.18)	(.07)
Net Income[1]	**$ 1.12**	$ 1.49	$ .14
Weighted-average shares outstanding (in millions)	**2,756**	2,729	2,710
Diluted Earnings Per Common Share:			
Income before discontinued operations and cumulative effect of accounting change	**$ 1.27**	$ 1.70	$ .21
Loss on discontinued operations, net of tax	**(.34)**	(.03)	–
Cumulative effect of accounting change, net of tax	**.18**	(.18)	(.07)
Net Income[1]	**$ 1.11**	$ 1.49	$ .14
Weighted-average shares outstanding (in millions)	**2,789**	2,745	2,730

(1) Total per share amounts may not add due to rounding.

See Notes to Consolidated Financial Statements.

consolidated balance sheets

At December 31,	2003	2002
	(dollars in millions, except per share amounts)	
Assets		
Current assets		
Cash and cash equivalents	**$ 699**	$ 1,422
Short-term investments	**2,172**	2,042
Accounts receivable, net of allowances of $2,387 and $2,771	**9,905**	12,496
Inventories	**1,283**	1,497
Assets of discontinued operations	**–**	1,305
Prepaid expenses and other	**4,234**	3,331
Total current assets	**18,293**	22,093
Plant, property and equipment	**180,975**	176,838
Less accumulated depreciation	**105,659**	103,080
	75,316	73,758
Investments in unconsolidated businesses	**5,789**	4,986
Wireless licenses	**40,907**	40,038
Goodwill	**1,389**	1,339
Other intangible assets, net	**4,733**	4,962
Other assets	**19,541**	20,292
Total assets	**$ 165,968**	$ 167,468
Liabilities and Shareowners' Investment		
Current liabilities		
Debt maturing within one year	**$ 5,967**	$ 9,267
Accounts payable and accrued liabilities	**14,699**	12,642
Liabilities of discontinued operations	**–**	1,007
Other	**5,904**	5,013
Total current liabilities	**26,570**	27,929
Long-term debt	**39,413**	44,003
Employee benefit obligations	**16,759**	15,389
Deferred income taxes	**21,708**	19,467
Other liabilities	**3,704**	4,007
Minority interest	**24,348**	24,057
Shareowners' investment		
Series preferred stock ($.10 par value; none issued)	**–**	–
Common stock ($.10 par value; 2,772,313,619 shares and 2,751,650,484 shares issued)	**277**	275
Contributed capital	**25,363**	24,685
Reinvested earnings	**9,409**	10,536
Accumulated other comprehensive loss	**(1,250)**	(2,110)
	33,799	33,386
Less common stock in treasury, at cost	**115**	218
Less deferred compensation-employee stock ownership plans and other	**218**	552
Total shareowners' investment	**33,466**	32,616
Total liabilities and shareowners' investment	**$ 165,968**	$ 167,468

See Notes to Consolidated Financial Statements.

consolidated statements of cash flows

(dollars in millions)

Years Ended December 31,	2003	2002	2001
Cash Flows from Operating Activities			
Income before discontinued operations and cumulative effect of accounting change	**$ 3,509**	$ 4,661	$ 584
Adjustments to reconcile income before discontinued operations and cumulative effect of accounting change to net cash provided by operating activities:			
Depreciation and amortization expense	**13,617**	13,290	13,523
Sales of businesses, net	**(141)**	(2,747)	350
Employee retirement benefits	**3,048**	(501)	(1,327)
Deferred income taxes	**826**	1,704	1,084
Provision for uncollectible accounts	**1,803**	2,899	1,940
(Income) loss from unconsolidated businesses	**(1,609)**	4,404	5,040
Changes in current assets and liabilities, net of effects from acquisition/disposition of businesses:			
Accounts receivable	**(844)**	(1,001)	(2,414)
Inventories	**(65)**	450	(59)
Other assets	**(8)**	405	(767)
Accounts payable and accrued liabilities	**2,643**	(1,435)	573
Other, net	**(297)**	(30)	999
Net cash provided by operating activities	**22,482**	22,099	19,526
Cash Flows from Investing Activities			
Capital expenditures (including capitalized software)	**(11,884)**	(13,061)	(18,369)
Acquisitions, net of cash acquired, and investments	**(1,162)**	(1,088)	(3,072)
Proceeds from disposition of businesses	**229**	4,638	415
Proceeds from spectrum payment refund	**–**	1,740	–
Purchases of short-term investments	**(1,887)**	(2,073)	(1,928)
Proceeds from sale of short-term investments	**1,767**	1,857	1,546
Other, net	**691**	1,187	84
Net cash used in investing activities	**(12,246)**	(6,800)	(21,324)
Cash Flows from Financing Activities			
Proceeds from long-term borrowings	**4,653**	7,820	13,870
Repayments of long-term borrowings and capital lease obligations	**(10,759)**	(8,391)	(7,293)
Decrease in short-term obligations, excluding current maturities	**(1,330)**	(11,024)	(546)
Dividends paid	**(4,239)**	(4,200)	(4,168)
Proceeds from sale of common stock	**839**	915	501
Other, net	**(123)**	71	(391)
Net cash provided by (used in) financing activities	**(10,959)**	(14,809)	1,973
Increase (decrease) in cash and cash equivalents	**(723)**	490	175
Cash and cash equivalents, beginning of year	**1,422**	932	757
Cash and cash equivalents, end of year	**$ 699**	$ 1,422	$ 932

See Notes to Consolidated Financial Statements.

consolidated statements of changes in shareowners' investment

(dollars in millions, except per share amounts, and shares in thousands)

Years Ended December 31,	2003		2002		2001	
	Shares	Amount	Shares	Amount	Shares	Amount
Common Stock						
Balance at beginning of year	2,751,650	$ 275	2,751,650	$ 275	2,751,650	$ 275
Shares issued-employee and shareowner plans	20,664	2	–	–	–	–
Shares retired	–	–	–	–	–	–
Balance at end of year	2,772,314	277	2,751,650	275	2,751,650	275
Contributed Capital						
Balance at beginning of year		24,685		24,676		24,555
Shares issued-employee and shareowner plans		725		–		–
Tax benefit from exercise of stock options		12		46		101
Other		(59)		(37)		20
Balance at end of year		25,363		24,685		24,676
Reinvested Earnings						
Balance at beginning of year		10,536		10,704		14,667
Net income		3,077		4,079		389
Dividends declared ($1.54 per share)		(4,250)		(4,208)		(4,176)
Shares issued-employee and shareowner plans		39		(48)		(188)
Other		7		9		12
Balance at end of year		9,409		10,536		10,704
Accumulated Other Comprehensive Loss						
Balance at beginning of year		(2,110)		(1,187)		(2,176)
Foreign currency translation adjustment		568		220		(40)
Unrealized gains (losses) on marketable securities		1		(304)		1,061
Unrealized derivative gains (losses) on cash flow hedges		(21)		12		(45)
Minimum pension liability adjustment		312		(851)		13
Other comprehensive income (loss)		860		(923)		989
Balance at end of year		(1,250)		(2,110)		(1,187)
Treasury Stock						
Balance at beginning of year	8,624	218	35,173	1,182	49,215	1,861
Shares purchased	–	–	–	–	395	18
Shares distributed						
Employee plans	(4,047)	(102)	(26,531)	(963)	(14,376)	(694)
Shareowner plans	(23)	(1)	(18)	(1)	(61)	(3)
Balance at end of year	4,554	115	8,624	218	35,173	1,182
Deferred Compensation – ESOPs and Other						
Balance at beginning of year		552		747		882
Amortization		(312)		(150)		(155)
Other		(22)		(45)		20
Balance at end of year		218		552		747
Total Shareowners' Investment		$ 33,466		$ 32,616		$ 32,539
Comprehensive Income						
Net income		$ 3,077		$ 4,079		$ 389
Other comprehensive income (loss) per above		860		(923)		989
Total Comprehensive Income		$ 3,937		$ 3,156		$ 1,378

See Notes to Consolidated Financial Statements.

NOTE 1

DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business

Verizon Communications Inc. (Verizon) is one of the world's leading providers of communications services. Verizon companies are the largest providers of wireline and wireless communications in the United States. Verizon is also the largest directory publisher in the world, as measured by directory titles and circulation. Verizon's international presence includes wireline and wireless communications operations and investments, primarily in the Americas and Europe. We have four reportable segments, which we operate and manage as strategic business units: Domestic Telecom, Domestic Wireless, Information Services and International. For further information concerning our business segments, see Note 17.

Consolidation

The method of accounting applied to investments, whether consolidated, equity or cost, involves an evaluation of all significant terms of the investments that explicitly grant or suggest evidence of control or influence over the operations of the investee. The consolidated financial statements include our controlled subsidiaries. Investments in businesses which we do not control, but have the ability to exercise significant influence over operating and financial policies, are accounted for using the equity method. Investments in which we do not have the ability to exercise significant influence over operating and financial policies are accounted for under the cost method. Equity and cost method investments are included in Investments in Unconsolidated Businesses in our consolidated balance sheets. Certain of our cost method investments are classified as available-for-sale securities and adjusted to fair value pursuant to Statement of Financial Accounting Standards (SFAS) No. 115, "Accounting for Certain Investments in Debt and Equity Securities."

All significant intercompany accounts and transactions have been eliminated.

We have reclassified prior year amounts to conform to the current year presentation.

Discontinued Operations and Sales of Businesses and Investments

We classify as discontinued operations any component of our business that we hold for sale or dispose of that has operations and cash flows that are clearly distinguishable operationally and for financial reporting purposes from the rest of Verizon. For those components, Verizon has no significant continuing involvement after disposal and their operations and cash flows are eliminated from Verizon's ongoing operations. Sales not classified as discontinued operations are reported as either Sales of Businesses, Net, Equity in Earnings (Loss) of Unconsolidated Businesses or Income (Loss) From Other Unconsolidated Businesses in our consolidated statements of income.

Use of Estimates

We prepare our financial statements using generally accepted accounting principles (GAAP), 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 intangibles and other long-lived assets, valuation allowances on tax assets and pension and postretirement benefit assumptions.

Revenue Recognition

Domestic Telecom

Our Domestic Telecom segment earns revenue based upon usage of our network and facilities and contract fees. In general, fixed fees for local telephone, long distance and certain other services are billed one month in advance and recognized the following month when earned. Revenue from other products that are not fixed fee or that exceed contracted amounts is recognized when such services are provided.

We recognize equipment revenue for services, in which we bundle the equipment with maintenance and monitoring services, 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.

Domestic Wireless

Our Domestic Wireless segment earns revenue by providing access to and usage of our network, which includes roaming and long distance revenue. In general, access revenue is billed one month in advance and recognized when earned. Airtime and usage revenue, roaming revenue and long distance revenue are recognized when the service is rendered. Equipment sales revenue associated with the sale of wireless handsets and accessories is recognized when the products are delivered to and accepted by the customer, as this is considered to be a separate earnings process from the sale of wireless services. Customer activation fees are considered additional consideration when handsets are sold to the customers at a discount and are recorded as equipment sales revenue.

Information Services

Information Services earns revenues primarily from print and online directory publishing. Revenues from our online directory, SuperPages.com™, is amortized over the term of the advertising contracts that generally last one year.

During 2002 and 2001 we recognized revenues for our print directory publishing under the publication-date method. Under that method, we recorded revenues and direct expenses when the directories were published.

During the second quarter of 2003, we changed our method for recognizing revenues and expenses in our print directory business from the publication-date method to the amortization method. The publication-date method recognizes revenues and direct expenses when directories are published. Under the amortization method, which is increasingly becoming the industry standard, revenues and direct expenses, primarily printing and distribution costs, are recognized

over the life of the directory, which is usually 12 months. This accounting change affects the timing of the recognition of revenues and expenses. As required by GAAP, the directory accounting change was recorded retroactively to January 1, 2003, and resulted in an impact on previously reported first-quarter financial results, including a cumulative effect of the accounting change (see Note 2).

International

The consolidated wireline and wireless businesses that comprise our International segment recognize revenue in a similar manner as our other segments. In addition, this segment holds several investments that are either accounted for under the equity or cost method of accounting. For additional detail on our accounting policy related to these investments, see "Consolidation" above.

Maintenance and Repairs

We charge the cost of maintenance and repairs, including the cost of replacing minor items not constituting substantial betterments, principally to Cost of Services and Sales as these costs are incurred.

Earnings Per Common Share

Basic earnings per common share are based on the weighted-average number of shares outstanding during the year. Diluted earnings per common share include the dilutive effect of shares issuable under our stock-based compensation plans and an exchangeable equity interest (see Note 13), which represent the only potentially dilutive common shares.

Cash and Cash Equivalents

We consider all highly liquid investments with a maturity of 90 days or less when purchased to be cash equivalents, except cash equivalents held as short-term investments. Cash equivalents are stated at cost, which approximates market value.

Short-Term Investments

Our short-term investments consist primarily of cash equivalents held in trust to pay for certain employee benefits. Short-term investments are stated at cost, which approximates market value.

Marketable Securities

We continually evaluate our investments in marketable securities for impairment due to declines in market value considered to be other than temporary. That evaluation includes, in addition to persistent, declining stock prices, general economic and company-specific evaluations. In the event of a determination that a decline in market value is other than temporary, a charge to earnings is recorded for the loss, and a new cost basis in the investment is established. These investments are included in the accompanying consolidated balance sheets in Investments in Unconsolidated Businesses or Other Assets.

Inventories

We include in inventory new and reusable supplies and network equipment of our telephone operations, which are stated principally at average original cost, except that specific costs are used in the case of large individual items. Inventories of our other subsidiaries are stated at the lower of cost (determined principally on either an average cost or first-in, first-out basis) or market.

Plant and Depreciation

We record plant, property and equipment at cost. Our telephone operations' 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, 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 telephone operations are presented in the following table:

Average Lives (in years)	
Buildings	25–42
Central office equipment	5–12
Outside communications plant	15–50
Furniture, vehicles and other	5–15

When we replace or retire depreciable plant used in our wireline network, we deduct the carrying amount of such plant from the respective accounts and charge it to accumulated depreciation (see Note 2 for additional information on the adoption of SFAS No. 143 "Accounting for Asset Retirement Obligations.")

Plant, property and equipment of our other subsidiaries is generally depreciated on a straight-line basis over the following estimated useful lives: buildings, 8 to 40 years; wireless plant equipment, 3 to 15 years; and other equipment, 1 to 20 years.

When the depreciable assets of our other subsidiaries are retired or otherwise disposed of, the related cost and accumulated depreciation are deducted from the plant accounts, and any gains or losses on disposition are recognized in income.

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

Computer Software Costs

We capitalize the cost of internal-use network and non-network software which has a useful life in excess of one year in accordance with Statement of Position (SOP) No. 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." Subsequent additions, modifications or upgrades to internal-use network and non-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 non-network internal-use software. Capitalized non-network internal-use software costs are amortized using the straight-line method over a period of 3 to 7 years and are included in Other Intangible Assets, Net in our consolidated balance sheets. For a discussion of our impairment policy for capitalized software costs under SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," see "Goodwill and Other Intangibles" below. Also, see Note 7 for additional detail of non-network internal-use software reflected in our consolidated balance sheets.

Goodwill and Other Intangible Assets

Accounting Policy – 2001

During 2001, we generally amortized goodwill, wireless licenses and other identifiable intangibles on a straight-line basis over their estimated useful life, not exceeding 40 years. We assessed the impairment of other identifiable intangibles and goodwill related to our consolidated subsidiaries under SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," whenever events or changes in circumstances indicated that the carrying value may not have been recoverable. A determination of impairment (if any) was made based on estimates of future cash flows. In instances where goodwill was recorded for assets that were subject to an impairment loss, the carrying amount of the goodwill was eliminated before any reduction was made to the carrying amounts of impaired long-lived assets and identifiable intangibles. On a quarterly basis, we assessed the impairment of enterprise level goodwill under Accounting Principles Board (APB) Opinion No. 17, "Intangible Assets." A determination of impairment (if any) was made based primarily on estimates of market value.

Accounting Policy – Effective January 1, 2002

Effective January 1, 2002, we adopted SFAS No. 142, "Goodwill and Other Intangible Assets." As required under SFAS No. 142, we no longer amortize goodwill (including goodwill recorded on our equity method investments), acquired workforce intangible assets and wireless licenses, which we have determined have an indefinite life (see Note 2 for additional information on the impact of adopting SFAS No. 142).

Goodwill

Goodwill is the excess of the acquisition cost of businesses over the fair value of the identifiable net assets acquired. Impairment testing for goodwill is performed at least annually unless indicators of impairment exist. The impairment test for goodwill uses a two-step approach, which is performed at the reporting unit level. Reporting units may be operating segments or one level below an operating segment, referred to as a component. Businesses for which discrete financial information is available are generally considered to be components of an operating segment. Components that are economically similar and managed by the same segment management group are aggregated and considered a reporting unit under SFAS No. 142. Step one compares the fair value of the reporting unit (calculated using a discounted cash flow method) to its carrying value. If the carrying value exceeds the fair value, there is a potential impairment and step two must be performed. Step two compares the carrying value of the reporting unit's goodwill to its implied fair value (i.e., fair value of reporting unit less the fair value of the unit's assets and liabilities, including identifiable intangible assets). If the carrying value of goodwill exceeds its implied fair value, the excess is required to be recorded as an impairment.

Intangible Assets Not Subject to Amortization

A significant portion of our intangible assets are Domestic Wireless licenses, including licenses associated with equity method investments, that provide our wireless operations with the exclusive right to utilize designated radio frequency spectrum to provide cellular communication services. While licenses are issued for only a fixed time, generally ten years, such licenses are subject to renewal by the Federal Communications Commission (FCC). Renewals of licenses have occurred routinely and at nominal cost. Moreover, we have determined that there are currently no legal, regulatory, contractual, competitive, economic or other factors that limit the useful life of our wireless licenses. As a result, we treat the wireless licenses as an indefinite-lived intangible asset under the provisions of SFAS No. 142. We reevaluate the useful life determination for wireless licenses each reporting period to determine whether events and circumstances continue to support an indefinite useful life.

Similar to goodwill, we are required by SFAS No. 142 to test our Domestic Wireless licenses for impairment as least annually unless indicators of impairment exist. In performing these tests, we determine the fair value of the wireless business by estimating future cash flows of the wireless operations. The fair value of aggregate wireless licenses is determined by subtracting from the fair value of the wireless business the fair value of all of the other net tangible and intangible (primarily recognized and unrecognized customer relationship intangible assets) assets of our wireless operations. We determine the fair value of our customer relationship intangible assets based on our average customer acquisition costs. In addition, our calculation of the fair value of the wireless business is then subjected to a reasonableness analysis using public information of comparable wireless carriers. If the fair value of the aggregated wireless licenses as determined above is less than the aggregated carrying amount of the licenses, an impairment will be recognized.

Intangible Assets Subject to Amortization

Our intangible assets that do not have indefinite lives (primarily customer lists and non-network internal-use software) are amortized over their useful lives and reviewed for impairment in accordance with SFAS No. 144, which only requires testing whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. If any indicators 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. We reevaluate the useful life determination for these intangible assets each reporting period to determine whether events and circumstances warrant a revision in their remaining useful life.

For information related to the carrying amount of goodwill by segment as well as the major components and average useful lives of our other acquired intangible assets, see Note 7.

Sale of Stock By Subsidiary

We recognize in consolidation changes in our ownership percentage in a subsidiary caused by issuances of the subsidiary's stock as adjustments to Contributed Capital.

Income Taxes

Verizon and its domestic subsidiaries file a consolidated federal income tax return.

Our telephone operations use the deferral method of accounting for investment tax credits earned prior to the repeal of investment tax credits by the Tax Reform Act of 1986. We also defer certain transitional credits earned after the repeal. We amortize these credits over the estimated service lives of the related assets as a reduction to the Provision for Income Taxes.

Stock-Based Compensation
Prior to 2003, we accounted for stock-based employee compensation under APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations, and followed the disclosure-only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation."

Effective January 1, 2003, we adopted the fair value recognition provisions of SFAS No. 123, using the prospective method (as permitted under SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure") to all new awards granted, modified or settled after January 1, 2003. Under the prospective method, employee compensation expense in the first year will be recognized for new awards granted, modified, or settled. The options generally vest over a term of three years, therefore the expenses related to stock-based employee compensation included in the determination of net income for 2003 are less than what would have been recorded if the fair value method was also applied to previously issued awards (see Note 2 for additional information on the impact of adopting SFAS No. 123).

Foreign Currency Translation
The functional currency for nearly all of our foreign operations is the local currency. For these foreign entities, we translate income statement amounts at average exchange rates for the period, and we translate assets and liabilities at end-of-period exchange rates. We record these translation adjustments in Accumulated Other Comprehensive Loss, a separate component of Shareowners' Investment, in our consolidated balance sheets. We report exchange gains and losses on intercompany foreign currency transactions of a long-term nature in Accumulated Other Comprehensive Loss. Other exchange gains and losses are reported in income.

When a foreign entity operates in a highly inflationary economy, it is our policy to use the U.S. dollar as the functional currency rather than the local currency. We translate nonmonetary assets and liabilities and related expenses into U.S. dollars at historical exchange rates. We translate all other income statement amounts using average exchange rates for the period. Monetary assets and liabilities denominated in other than U.S. dollars are translated at end-of-period exchange rates, and any gains or losses are reported in income.

Employee Benefit Plans
Pension and postretirement health care and life insurance benefits earned during the year as well as interest on projected benefit obligations are accrued currently. Prior service costs and credits resulting from changes in plan benefits are amortized over the average remaining service period of the employees expected to receive benefits.

Derivative Instruments
We have entered into derivative transactions to manage our exposure to fluctuations in foreign currency exchange rates, interest rates and equity prices. We employ risk management strategies using a variety of derivatives including foreign currency forwards, equity options, interest rate swap agreements, interest rate locks and basis swap agreements. We do not hold derivatives for trading purposes.

In accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" and related amendments and interpretations, we measure all derivatives, including derivatives embedded in other financial instruments, at fair value and recognize them as either assets or liabilities on our consolidated balance sheets. Changes in the fair values of derivative instruments not qualifying as hedges or any ineffective portion of hedges are recognized in earnings in the current period. Changes in the fair values of derivative instruments used effectively as fair value hedges are recognized in earnings, along with changes in the fair value of the hedged item. Changes in the fair value of the effective portions of cash flow hedges are reported in other comprehensive income (loss), and recognized in earnings when the hedged item is recognized in earnings.

NOTE 2

ACCOUNTING CHANGE

Directory Accounting
As discussed in Note 1, we changed our method for recognizing revenues and expenses in our directory business from the publication-date method to the amortization method. The cumulative effect of this accounting change resulted in a charge of $2,697 million ($1,647 million after-tax), recorded as of January 1, 2003.

The following table presents our 2002 and 2001 results of operations for comparison to the current period, assuming we had applied the amortization method in all periods:

(dollars in millions, except per share amounts)

	Year Ended December 31, 2002		Year Ended December 31, 2001	
	Before Directory Accounting Change	After Directory Accounting Change	Before Directory Accounting Change	After Directory Accounting Change
Operating revenues	$ 67,304	$ 67,226	$ 66,713	$ 66,449
Operating expenses	52,300	52,277	55,240	55,314
Income before discontinued operations and cumulative effect of accounting change	4,661	4,624	584	382
Per common share – diluted	1.70	1.69	.21	.14
Income before cumulative effect of accounting change	4,575	4,538	571	369
Per common share – diluted	1.67	1.66	.21	.14
Net income	4,079	4,042	389	187
Per common share – diluted	1.49	1.48	.14	.07

Stock-Based Compensation

As discussed in Note 1, we adopted the fair value recognition provisions of SFAS No. 123 using the prospective method as permitted under SFAS No. 148. The following table illustrates the effect on reported net income and earnings per share if the fair value method had been applied to all outstanding and unvested options in each period.

Years Ended December 31,	2003	2002	2001
	(dollars in millions)		
Net Income, As Reported	**$ 3,077**	$ 4,079	$ 389
Add: Stock option-related employee compensation expense included in reported net income, net of related tax effects	**44**	–	–
Deduct: Total stock option-related employee compensation expense determined under fair value based method for all awards, net of related tax effects	**(215)**	(467)	(498)
Pro Forma Net Income (Loss)	**$ 2,906**	$ 3,612	$ (109)
Earnings (Loss) Per Share			
Basic – as reported	**$ 1.12**	$ 1.49	$ .14
Basic – pro forma	**1.05**	1.32	(.04)
Diluted – as reported	**1.11**	1.49	.14
Diluted – pro forma	**1.05**	1.32	(.04)

After-tax compensation expense for other stock-based compensation included in net income as reported for the years ended December 31, 2003, 2002 and 2001 was $80 million, $15 million and $31 million, respectively.

For additional information on assumptions used to determine the pro forma amounts as well as other information related to our stock-based compensation plans, see Note 14.

Asset Retirement Obligations

Effective January 1, 2003, we adopted SFAS No. 143 which provides the accounting for the cost of legal obligations associated with the retirement of long-lived assets. SFAS No. 143 requires that companies recognize the fair value of a liability for asset retirement obligations in the period in which the obligations are incurred and capitalize that amount as part of the book value of the long-lived asset. We have determined that Verizon does not have a material legal obligation to remove long-lived assets as described by this statement. However, prior to the adoption of SFAS No. 143, we included estimated removal costs in our group depreciation models. These costs have increased depreciation expense and accumulated depreciation for future removal costs for existing assets. These removal costs were recorded as a reduction to accumulated depreciation when the assets were retired and removal costs were incurred.

For some assets, such as telephone poles, the removal costs exceeded salvage value. Under the provisions of SFAS No. 143, we are required to exclude costs of removal from our depreciation rates for assets for which the removal costs exceed salvage. Accordingly, in connection with the initial adoption of this standard on January 1, 2003, we have reversed accrued costs of removal in excess of salvage from our accumulated depreciation accounts for these assets. The adjustment was recorded as a cumulative effect of an accounting change, resulting in the recognition of a gain of $3,499 million ($2,150 million after-tax). Effective January 1, 2003, we began expensing costs of removal in excess of salvage for these assets as incurred. The impact of this change in accounting results in a decrease in depreciation expense and an increase in cost of services and sales.

Goodwill and Other Intangible Assets

The initial impact of adopting SFAS No. 142 on our consolidated financial statements was recorded as a cumulative effect of an accounting change as of January 1, 2002, resulting in a charge of $496 million, net of tax. This charge was comprised of $204 million ($203 million after-tax) for goodwill and $294 million ($293 million after-tax) for wireless licenses and goodwill of equity method investments and for other intangible assets. The following tables present the impact of SFAS No. 142 on reported income before discontinued operations and cumulative effect of accounting change, reported net income and earnings per share had SFAS No. 142 been in effect for the year ended December 31, 2001:

Year Ended December 31, 2001	(dollars in millions)
Reported income before discontinued operations and cumulative effect of accounting change	$ 584
Goodwill amortization	32
Wireless licenses amortization	334
Adjusted income before discontinued operations and cumulative effect of accounting change	$ 950

Year Ended December 31, 2001	Basic	Diluted
Earnings per common share	$ .22	$ .21
Goodwill amortization	.01	.01
Wireless licenses amortization	.12	.12
Adjusted earnings per common share[1]	$ .35	$ .35

Year Ended December 31, 2001	(dollars in millions)
Reported net income	$ 389
Goodwill amortization	49
Wireless licenses amortization	334
Adjusted net income	$ 772

Year Ended December 31, 2001	Basic	Diluted
Earnings per common share	$ .14	$ .14
Goodwill amortization	.02	.02
Wireless licenses amortization	.12	.12
Adjusted earnings per common share[1]	$ .28	$ .28

(1) Total per share amounts may not add due to rounding.

The preceding tables exclude $115 million ($.04 per share) for the year ended 2001, related to amortization of goodwill and other intangible assets with indefinite lives of equity method investments.

Derivatives

We adopted the provisions of SFAS No. 133 effective January 1, 2001. The initial impact of adoption of SFAS No. 133 on our consolidated financial statements was recorded as a cumulative effect of an accounting change resulting in a charge of $182 million to current earnings and income of $110 million to other comprehensive income (loss). The recognition of assets and liabilities was immaterial to our financial position.

NOTE 3

DISCONTINUED OPERATIONS AND SALES OF BUSINESSES, NET

Discontinued Operations

Grupo Iusacell, S.A. de C.V. (Iusacell) is a wireless telecommunications company in Mexico. Prior to June 2003 we consolidated Iusacell, since we appointed a majority of the members of its board of directors. In June 2003, we announced our decision to sell our 39.4% consolidated interest in Iusacell into the tender offer launched by Movil Access, a Mexican company. Verizon tendered its shares shortly after the tender offer commenced, and the tender offer closed on July 29, 2003. In accordance with SFAS No. 144, we have classified the results of operations of Iusacell as discontinued operations. In connection with the decision to sell our interest in Iusacell and a comparison of expected net sale proceeds to the net book value of our investment in Iusacell (including the foreign currency translation balance), we recorded a pretax loss of $957 million ($931 million after-tax). This loss included $317 million of goodwill. In addition, the assets and liabilities of Iusacell are summarized and disclosed as current assets and current liabilities in the consolidated balance sheet at December 31, 2002. Additional detail related to the assets and liabilities of Iusacell, which was part of our International segment, follows:

At December 31, 2002	(dollars in millions)
Current assets	$ 133
Plant, property and equipment, net	738
Other non-current assets	434
Total assets	$ 1,305
Current liabilities	$ 125
Long-term debt	788
Other non-current liabilities	94
Total liabilities	$ 1,007

Summarized results of operations for Iusacell are as follows:

Years Ended December 31,	2003	2002	2001
		(dollars in millions)	
Income (loss) from operations of Iusacell before income taxes	$ –	$ (74)	$ 6
Investment loss	(957)	–	–
Income tax benefit (provision)	22	(12)	(19)
Loss on discontinued operations, net of tax	$ (935)	$ (86)	$ (13)

Included in income (loss) from operations of Iusacell before income taxes in the preceding table are operating revenues of $181 million, $540 million and $644 million for the years ended December 31, 2003, 2002 and 2001, respectively.

Sales of Businesses, Net

During 2003 and 2002, we recognized net gains in operations related to sales of businesses and other charges. During 2001, we recognized net losses in operations related to sales of businesses, impairments of assets held for sale and other charges. These net gains and losses are summarized as follows:

Years Ended December 31,	2003		2002		2001	
	Pretax	After-tax	Pretax	After-tax	Pretax	After-tax
					(dollars in millions)	
Wireline property sales	$ –	$ –	$2,527	$1,550	$ –	$ –
Wireless overlap property sales	–	–	–	–	(92)	(60)
Other, net	141	88	220	116	(258)	(166)
	$ 141	$ 88	$2,747	$1,666	$ (350)	$ (226)

Wireline Property Sales

During the third quarter of 2002, we completed the sales of all 675,000 of our switched access lines in Alabama and Missouri to CenturyTel Inc. and 600,000 of our switched access lines in Kentucky to ALLTEL Corporation for $4,059 million in cash proceeds ($191 million of which was received in 2001). We recorded a pretax gain of $2,527 million ($1,550 million after-tax). The operating revenues of the access lines sold were $623 million and $997 million for the years 2002 and 2001, respectively. Operating expenses of the access lines sold were $241 million and $413 million for the years 2002 and 2001, respectively.

Wireless Overlap Property Sales

During 2001, we recorded a pretax gain of $80 million ($48 million after-tax) on the sale of the Cincinnati wireless market and a pretax loss of $172 million ($108 million after-tax) related to the sale of the Chicago wireless market.

Other Transactions

During 2003, we recorded a net pretax gain of $141 million ($88 million after-tax) primarily related to the sale of our directory publication operations in Austria, the Czech Republic, Gibraltar, Hungary, Poland and Slovakia.

During 2002, we recorded a net pretax gain of $220 million ($116 million after-tax), primarily resulting from a pretax gain on the sale of TSI Telecommunication Services Inc. of $466 million ($275 million after-tax), partially offset by an impairment charge in connection with our exit from the video business and other charges of $246 million ($159 million after-tax).

During 2001, we recorded charges totaling $258 million ($166 million after-tax) related to exiting several businesses, including our video business and some leasing activities.

NOTE 4

OTHER STRATEGIC ACTIONS AND COMPLETION OF MERGER

Severance, Pension and Benefit Charges

Total pension, benefit and other costs related to severance activities were $5,524 million ($3,399 million after-tax) in 2003, primarily in connection with the voluntary separation of more than 25,000 employees, as follows:

- In the fourth quarter of 2003, we recorded a pretax charge of $4,695 million ($2,882 million after-tax) primarily associated with costs incurred in connection with a voluntary separation plan under which more than 21,000 employees accepted the separation offer. This pretax voluntary separation plan charge included $2,716 million recorded in accordance with SFAS No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits" and SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" for pension and postretirement benefit enhancements and a net curtailment gain for a significant reduction of the expected years of future service resulting from early retirements. In addition, we recorded a pretax charge of $76 million for pension settlement losses related to lump-sum settlements of some existing pension obligations. SFAS No. 88 requires that settlement losses be recorded once prescribed payment thresholds have been reached. The fourth quarter pretax charge also included severance costs of $1,720 million, included primarily in Selling, General & Administrative Expense, and costs related to other severance-related activities of $183 million.
- We also recorded a special charge in 2003 of $235 million ($150 million after-tax) primarily associated with employee severance costs and severance-related activities in connection with the voluntary separation of approximately 4,000 employees. In addition, we recorded pretax pension settlement losses of $131 million ($81 million after-tax) in 2003 related to employees that received lump-sum distributions during the year in connection with previously announced employee separations.
- Further, in 2003 we recorded a special charge of $463 million ($286 million after-tax) in connection with enhanced pension benefits granted to employees retiring in the first half of 2003, estimated costs associated with the July 10, 2003 Verizon-New York arbitration ruling and pension settlement losses related to lump-sum pay-outs in 2003. On July 10, 2003, an arbitrator ruled that Verizon-New York's termination of 2,300 employees in 2002 was not permitted under a union contract; similar cases were pending impacting an additional 1,100 employees. Verizon offered to reinstate all 3,400 impacted employees, and accordingly, recorded a charge in the second quarter of 2003 representing estimated payments to employees and other related company-paid costs.

Total pension, benefit and other costs related to severances were $2,010 million ($1,264 million after taxes and minority interest) in 2002, primarily in connection with the separation of approximately 8,000 employees and pension and other postretirement benefit charges associated with 2002 and 2001 severance activity, as follows:

- In the fourth quarter of 2002, we recorded a pretax charge of $981 million ($604 million after taxes and minority interest) primarily associated with pension and benefit costs related to severances in 2002 and 2001. This pretax charge included $910 million recorded in accordance with SFAS No. 88 and SFAS No. 106 for curtailment losses related to a significant reduction of the expected years of future service resulting from early retirements once the prescribed threshold was reached, pension settlement losses related to lump-sum settlements of some existing pension obligations and pension and postretirement benefit enhancements. The fourth quarter charge also included severance costs of $71 million.
- We also recorded a pretax charge in 2002 of $295 million ($185 million after-tax) related to settlement losses incurred in connection with previously announced employee separations.
- In addition, we recorded a charge of $734 million ($475 million after taxes and minority interest) in 2002 primarily associated with employee severance costs and severance-related activities in connection with the voluntary and involuntary separation of approximately 8,000 employees.

During 2001, we recorded a special charge of $1,613 million ($1,001 million after-tax) primarily associated with employee severance costs and related pension enhancements. The pretax charge included severance and related benefits of $765 million for the voluntary and involuntary separation of approximately 10,000 employees. We also recorded a pretax charge of $848 million primarily associated with related pension enhancements.

We expect to complete the severance activities within a year of when the respective charges are recorded.

Other Charges and Special Items

During 2003, we recorded other special pretax charges of $557 million ($419 million after-tax). These charges included $240 million ($156 million after-tax) primarily in connection with environmental remediation efforts relating to several discontinued businesses including a former facility that processed nuclear fuel rods in Hicksville, New York (see Note 22) and a pretax impairment charge of $184 million ($184 million after-tax) pertaining to our leasing operations for airplanes leased to airlines experiencing financial difficulties and for power generating facilities. These 2003 charges also include pretax charges of $61 million ($38 million after-tax) related to the early retirement of debt and other pretax charges of $72 million ($41 million after-tax).

During 2002, we recorded pretax charges of $626 million ($469 million after-tax). These charges related to an impairment charge in connection with our financial statement exposure to MCI due to its July 2002 bankruptcy of $300 million ($183 million after-tax), an impairment charge of $117 million ($136 million after-tax) pertaining to our leasing operations for airplanes leased to airlines experiencing financial difficulties and other charges of $209 million ($150 million after-tax). In addition, we recorded a charge of $175 million ($114 million after-tax) related to a settlement of a litigation matter that arose from our decision to terminate an agreement with NorthPoint Communications Group, Inc. (NorthPoint) to combine the two companies' digital subscriber line (DSL) businesses.

Other charges and special items recorded during 2001 include an asset impairment charge of $151 million ($95 million after-tax) related to property sales and facility consolidation, a charge of $182 million ($179 million after taxes and minority interest) in connection with mark-to-market adjustments related to some of our financial instruments and a charge of $29 million ($19 million after-tax) resulting from the early retirement of debt. In 2001, we also recorded a loss of $35 million ($26 million after-tax) related to international losses.

Merger Transition Costs

We announced at the time of the Bell Atlantic–GTE merger in 2000 that we expected to incur a total of approximately $2 billion of transition costs related to the merger and the formation of the wireless joint venture. These costs were incurred to establish the Verizon brand, integrate systems, consolidate real estate and relocate employees. Transition activities were complete at December 31, 2002 and totaled $2,243 million. For 2002 and 2001, transition costs were $510 million ($288 million after taxes and minority interest) and $1,039 million ($578 million after taxes and minority interest), respectively.

NOTE 5

MARKETABLE SECURITIES AND OTHER SECURITIES

We have investments in marketable securities which are considered "available-for-sale" under SFAS No. 115. These investments have been included in our consolidated balance sheets in Investments in Unconsolidated Businesses and Other Assets.

Under SFAS No. 115, available-for-sale securities are required to be carried at their fair value, with unrealized gains and losses (net of income taxes) that are considered temporary in nature recorded in Accumulated Other Comprehensive Loss. The fair values of our investments in marketable securities are determined based on market quotations. We continually evaluate our investments in marketable securities for impairment due to declines in market value considered to be other than temporary. That evaluation includes, in addition to persistent, declining stock prices, general economic and company-specific evaluations. In the event of a determination that a decline in market value is other than temporary, a charge to earnings is recorded in Income (Loss) From Other Unconsolidated Businesses in the consolidated statements of income for all or a portion of the unrealized loss, and a new cost basis in the investment is established.

The following table shows certain summarized information related to our investments in marketable securities:

(dollars in millions)

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
At December 31, 2003				
Investments in unconsolidated businesses	$ 160	$ –	$ (10)	$ 150
Other assets	194	41	–	235
	$ 354	$ 41	$ (10)	$ 385
At December 31, 2002				
Investments in unconsolidated businesses	$ 115	$ 5	$ (20)	$ 100
Other assets	196	46	–	242
	$ 311	$ 51	$ (20)	$ 342

Our investments in marketable securities are primarily bonds and mutual funds.

During 2002, we recognized a net loss of $347 million ($230 million after-tax) primarily related to the market value of our investment in Cable & Wireless plc (C&W) and losses totaling $231 million ($231 million after-tax) relating to several other investments in marketable securities. We determined that market value declines in these investments during 2002 were considered other than temporary.

During 2002, we sold nearly all of our investment in Telecom Corporation of New Zealand Limited (TCNZ) for net cash proceeds of $769 million, which resulted in a pretax gain of $383 million ($229 million after-tax).

During 2002, we also recorded a pretax loss of $516 million ($436 million after-tax) to market value due primarily to the other than temporary decline in the market value of our investment in Metromedia Fiber Network, Inc. (MFN). We wrote off our remaining investment and other financial statement exposure related to MFN primarily as a result of its deteriorating financial condition and related defaults.

During 2001, we recognized a pretax loss of $4,686 million ($3,607 million after-tax) primarily relating to our investments in C&W, NTL Incorporated (NTL) and MFN. We determined that market value declines in these investments during 2001 were considered other than temporary.

Certain other investments in securities that we hold are not adjusted to market values because those values are not readily determinable and/or the securities are not marketable. We have, however, adjusted the carrying values of these securities in situations where we believe declines in value below cost were other than temporary. During 2002 and 2001, we recognized pretax losses of $2,898 million ($2,735 million after-tax) and $1,251 million ($1,251 million after-tax), respectively, primarily in Income (Loss) From Other Unconsolidated Businesses in the consolidated statements of income relating to our investment in Genuity Inc. (Genuity). The 2002 loss includes a write-down of our investments and loans of $2,624 million ($2,560 million after-tax). We also recorded a pretax charge of $274 million ($175 million after-tax) related to the remaining financial exposure to our assets, including receivables, as a result of Genuity's bankruptcy. During 2003, we recorded a net pretax gain of $176 million as a result of a payment received in connection with the liquidation of Genuity. In connection with this payment, Verizon recorded a contribution of $150 million to Verizon Foundation to fund its charitable activities and increase its self-sufficiency. Consequently, we recorded a net gain of $17 million after taxes related to this transaction and the accrual of the Verizon Foundation contribution. The carrying values for investments not adjusted to market value were $24 million at December 31, 2003 and $103 million at December 31, 2002.

As a result of capital gains and other income from access line sales and investment sales in 2002, as well as assessments and transactions related to several of the impaired investments during the third and fourth quarters of 2002, we recorded tax benefits of $2,104 million in 2002 pertaining to current and prior year investment impairments. The investment impairments primarily related to debt and equity investments in MFN and in Genuity.

NOTE 6

PLANT, PROPERTY AND EQUIPMENT

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

At December 31,	2003	2002
	(dollars in millions)	
Land	$ 812	$ 915
Buildings and equipment	15,677	14,572
Network equipment	142,296	137,353
Furniture, office and data processing equipment	16,352	17,396
Work in progress	1,137	1,476
Leasehold improvements	1,575	1,573
Other	3,126	3,553
	180,975	176,838
Accumulated depreciation	(105,659)	(103,080)
Total	$ 75,316	$ 73,758

NOTE 7

GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill

Changes in the carrying amount of goodwill for the year ended December 31, 2003 are as follows:

	Domestic Telecom	Domestic Wireless	Information Services	International	Corporate & Other	Total
						(dollars in millions)
Balance as of December 31, 2002	$ 314	$ –	$ 579	$ 446	$ –	$ 1,339
Goodwill reclassifications and other	–	–	52	(2)	–	50
Balance as of December 31, 2003	$ 314	$ –	$ 631	$ 444	$ –	$ 1,389

Other Intangible Assets

	As of December 31, 2003		As of December 31, 2002	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
				(dollars in millions)
Amortized intangible assets:				
Customer lists (4 to 7 years)	$ 3,441	$ 2,362	$ 3,440	$ 1,846
Non-network internal-use software (3 to 7 years)	5,799	2,208	4,700	1,399
Other (2 to 30 years)	86	23	81	14
Total	$ 9,326	$ 4,593	$ 8,221	$ 3,259
Unamortized intangible assets:				
Wireless licenses	$ 40,907		$ 40,038	

Intangible asset amortization expense was $1,402 million, $1,154 million and $2,161 million for years ended December 31, 2003, 2002 and 2001, respectively. It is estimated to be $1,382 million in 2004, $1,236 million in 2005, $703 million in 2006, $409 million in 2007 and $290 million in 2008, primarily related to customer lists and non-network internal-use software.

NOTE 8

INVESTMENTS IN UNCONSOLIDATED BUSINESSES

Our investments in unconsolidated businesses are comprised of the following:

(dollars in millions)

	2003		2002	
At December 31,	**Ownership**	**Investment**	Ownership	Investment
Equity Investees				
CANTV	**28.5%**	**$ 219**	28.5%	$ 475
Omnitel	**23.1**	**3,639**	23.1	2,226
TELUS	**20.9**	**574**	21.3	463
Other	**Various**	**1,183**	Various	1,620
Total equity investees		**5,615**		4,784
Cost Investees	**Various**	**174**	Various	202
Total investments in unconsolidated businesses		**$ 5,789**		$ 4,986

Dividends received from investees amounted to $198 million in 2003, $182 million in 2002 and $244 million in 2001, respectively.

Equity Investees

CANTV

Compañia Anónima Nacional Teléfonos de Venezuela (CANTV) is Venezuela's largest full-service telecommunications provider. CANTV offers local services, national and international long distance, Internet access and wireless services in Venezuela as well as public telephone, private network, data transmission, directory and other value-added services.

In October 2001, shareholders of CANTV approved an extraordinary dividend of approximately $550 million, paid in two installments in December 2001 and March 2002, and a share repurchase program of up to 15% of CANTV's shares. During December 2001, we received approximately $167 million from the repurchase program and $85 million in extraordinary dividends. In 2002, we received $67 million in extraordinary dividends.

During 2002, we recorded a pretax loss of $1,400 million ($1,400 million after-tax) due to the other than temporary decline in the market value of our investment in CANTV. As a result of the political and economic instability in Venezuela, including the devaluation of the Venezuelan bolivar, and the related impact on CANTV's future economic prospects, we no longer expected that the future undiscounted cash flows applicable to CANTV were sufficient to recover our investment. Accordingly, we wrote our investment down to market value as of March 31, 2002.

Vodafone Omnitel

Vodafone Omnitel N.V. (Omnitel) is an Italian digital cellular telecommunications company. It is the second largest wireless provider in Italy. At December 31, 2003 and 2002, our investment in Omnitel included goodwill of $996 million and $830 million, respectively.

TELUS

TELUS Corporation (TELUS) is the largest telecommunications company in Western Canada and the second largest in Canada. The company is a full-service telecommunications provider and provides subscribers with a full range of telecommunications products and services including data, voice and wireless services across Canada.

In 2002, we recorded a pretax loss of $580 million ($430 million after-tax) to the market value of our investment in TELUS. We determined that the market value decline in this investment was considered other than temporary.

Other Equity Investees

Verizon has limited partnership investments in entities that invest in affordable housing projects, for which Verizon provides funding as a limited partner and receives tax deductions and tax credits based on its partnership interests. At December 31, 2003 and 2002, Verizon had equity investments in these partnerships of $863 million and $954 million, respectively. Verizon currently adjusts the carrying value of these investments for any losses incurred by the limited partnerships through earnings.

CTI Holdings, S.A. (CTI) provides wireless services in Argentina. During 2002, we recorded a pretax loss of $230 million ($190 million after-tax) to fair value due to the other than temporary decline in the fair value of our remaining investment in CTI as a result of the impact of the deterioration of the Argentinean economy and the devaluation of the Argentinean peso on CTI's financial position. As a result of this 2002 charge and a $637 million ($637 million after-tax) charge recorded in 2001, our financial exposure related to our equity investment in CTI was eliminated as of year-end 2002. On March 28, 2002, Verizon transferred 5.5 million of its shares in CTI to an indirectly wholly owned subsidiary of Verizon and subsequently transferred ownership of that subsidiary to a newly created trust for CTI employees. This decreased Verizon's ownership percentage in CTI from 65% to 48%. We also reduced our representation on CTI's board of directors from five of nine members to four of nine (subsequently reduced to one of five members). As a result of these actions that surrender control of CTI, we changed our method of accounting for this investment from consolidation to the equity method. On June 3, 2002, as a result of an option exercised by Telfone (BVI) Limited (Telfone), a CTI shareholder, Verizon acquired approximately 5.3 million additional CTI shares. Also on June 3, 2002, we transferred ownership of a wholly owned subsidiary of Verizon that held 5.4 million CTI shares to a second independent trust leaving us with an approximately 48% non-controlling interest in CTI. Since we had no other future commitments or plans to fund CTI's operations and had written our investment down to zero, in accordance with the accounting rules for equity method investments, we ceased recording operating income or losses related to CTI's operations beginning in 2002. On October 16, 2003, we sold our entire remaining interest in CTI.

We also have an international wireless investment in Slovakia. This investment is a joint venture to build and operate a cellular network in that country. The remaining investments include wireless partnerships in the U.S., real estate partnerships, publishing joint ventures, and several other domestic and international joint ventures.

During 2003, we recorded a pretax gain of $348 million on the sale of our interest in Eurotel Praha, spol. s r.o. In connection with this sale transaction, Verizon recorded a contribution of $150 million to Verizon Foundation to fund its charitable activities and increase its self-sufficiency. Consequently, we recorded a net gain of $27 million after taxes related to this transaction and the accrual of the Verizon Foundation contribution.

Cost Investees

Some of our cost investments are carried at their current market value. Other cost investments are carried at their original cost, except in cases where we have determined that a decline in the estimated market value of an investment is other than temporary as described in Note 5.

Genuity

Prior to the merger of Bell Atlantic and GTE in 2000, we owned and consolidated Genuity, which was deconsolidated in June 2000 as a condition of the merger in connection with an initial public offering. Our remaining ownership interest in Genuity contained a contingent conversion feature that gave us the option to regain control of Genuity and was dependent on obtaining approvals to provide long distance service in the former Bell Atlantic region and satisfaction of other regulatory and legal requirements. On July 24, 2002, we converted all but one of our shares of Class B common stock of Genuity into shares of Class A common stock of Genuity and relinquished our right to convert our current ownership into a controlling interest in Genuity. On December 18, 2002, we sold all of our Class A common stock of Genuity. (See Note 5 for additional information.)

Other Cost Investees

TCNZ is the principal provider of telecommunications services in New Zealand. During 2002, we sold nearly all of our investment in TCNZ (see Note 5 for additional information). As of December 31, 2003, we hold an insignificant interest in TCNZ.

Other cost investments include a variety of domestic and international investments primarily involved in providing telecommunication services.

Summarized Financial Information

Summarized financial information for our equity investees is as follows:

Balance Sheet

At December 31,	2003	(dollars in millions) 2002
Current assets	$ 9,527	$ 4,778
Noncurrent assets	23,804	21,425
Total assets	$ 33,331	$ 26,203
Current liabilities	$ 5,377	$ 5,187
Noncurrent liabilities	8,044	7,345
Equity	19,910	13,671
Total liabilities and equity	$ 33,331	$ 26,203

Income Statement

Years Ended December 31,	2003	2002	(dollars in millions) 2001
Revenue	$ 15,364	$ 12,740	$ 12,658
Operating income	4,918	2,799	3,163
Net income	4,172	1,628	2,323

NOTE 9

MINORITY INTEREST

Minority interests in equity of subsidiaries were as follows:

At December 31,	2003	(dollars in millions) 2002
Minority interests in consolidated subsidiaries*:		
Wireless joint venture (55%)	$ 22,383	$ 22,018
Cellular partnerships and other (various)	1,549	1,544
TELPRI (52%)	316	276
Preferred securities issued by subsidiaries	100	219
	$ 24,348	$ 24,057

*Indicated ownership percentages are Verizon's consolidated interests.

Wireless Joint Venture

The wireless joint venture was formed in April 2000 in connection with the combination of the U.S. wireless operations and interests of Verizon and Vodafone Group Plc (Vodafone). The wireless joint venture operates as Verizon Wireless. Verizon owns a controlling 55% interest in Verizon Wireless and Vodafone owns the remaining 45%.

Under the terms of an investment agreement, Vodafone may require Verizon Wireless to purchase up to an aggregate of $20 billion worth of Vodafone's interest in Verizon Wireless at designated times between 2003 and 2007 at its then fair market value. In the event Vodafone exercises its put rights, we have the right, exercisable at our sole discretion, to purchase up to $12.5 billion of Vodafone's interest instead of Verizon Wireless for cash or Verizon stock at our option. Vodafone may require the purchase of up to $10 billion during a 61-day period opening on June 10 and closing on August 9 in 2004, and the remainder, which may not exceed $10 billion in any one year, during a 61-day period opening on June 10 and closing on August 9 in 2005 through 2007. Vodafone also may require that Verizon Wireless pay for up to $7.5 billion of the required repurchase through the assumption or incurrence of debt. Vodafone did not exercise its put rights during the 61-day period that ended on August 9, 2003.

Cellular Partnerships and Other

In August 2002, Verizon Wireless and Price Communications Corp. (Price) combined Price's wireless business with a portion of Verizon Wireless in a transaction valued at approximately $1.7 billion, including $550 million of net debt. The resulting limited partnership is controlled and managed by Verizon Wireless. In exchange for its contributed assets, Price received a limited partnership interest in the new partnership which is exchangeable into common stock of Verizon Wireless if an initial public offering of that stock occurs, or into the common stock of Verizon on the fourth anniversary of the asset contribution date if the initial public offering of Verizon Wireless common stock does not occur prior to then. The price of the Verizon common stock used in determining the number of Verizon common shares received in an exchange is also subject to a maximum and minimum amount.

TELPRI

Telecomunicaciones de Puerto Rico, Inc. (TELPRI) provides local, wireless, long distance, paging and Internet-access services in Puerto Rico. During 2002, we exercised our option to purchase additional equity in TELPRI, which increased our ownership percentage to 52%. As a result, Verizon changed the accounting for TELPRI from the equity method to consolidation, effective January 1, 2002.

NOTE 10

LEASING ARRANGEMENTS

As Lessor

We are the lessor in leveraged and direct financing lease agreements under which commercial aircraft and power generating facilities, which comprise the majority of the portfolio, along with industrial equipment, real estate property, telecommunications and other equipment are leased for remaining terms of less than 1 year to 45 years as of December 31, 2003. Minimum lease payments receivable represent unpaid rentals, less principal and interest on third-party nonrecourse debt relating to leveraged lease transactions. Since we have no general liability for this debt, which holds a senior security interest in the leased equipment and rentals, the related principal and interest have been offset against the minimum lease payments receivable in accordance with GAAP. All recourse debt is reflected in our consolidated balance sheets. See Note 4 for a discussion of lease impairment charges.

Finance lease receivables, which are included in Prepaid Expenses and Other and Other Assets in our consolidated balance sheets are comprised of the following:

(dollars in millions)

At December 31,	2003			2002		
	Leveraged Leases	Direct Finance Leases	Total	Leveraged Leases	Direct Finance Leases	Total
Minimum lease payments receivable	$ 4,381	$ 254	$ 4,635	$ 3,881	$ 260	$ 4,141
Estimated residual value	2,432	31	2,463	2,556	35	2,591
Unearned income	(2,782)	(56)	(2,838)	(2,426)	(41)	(2,467)
	$ 4,031	$ 229	4,260	$ 4,011	$ 254	4,265
Allowance for doubtful accounts			(423)			(214)
Finance lease receivables, net			$ 3,837			$ 4,051
Current			$ 51			$ 49
Noncurrent			$ 3,786			$ 4,002

Accumulated deferred taxes arising from leveraged leases, which are included in Deferred Income Taxes, amounted to $3,297 million at December 31, 2003 and $3,282 million at December 31, 2002.

The following table is a summary of the components of income from leveraged leases:

Years Ended December 31,	2003	2002	2001
		(dollars in millions)	
Pretax lease income	$ 108	$ 110	$ 64
Income tax expense/(benefit)	11	17	(32)
Investment tax credits	3	3	3

The future minimum lease payments to be received from noncancelable leases, net of nonrecourse loan payments related to leveraged and direct financing leases in excess of debt service requirements, for the periods shown at December 31, 2003, are as follows:

Years	Capital Leases	Operating Leases
	(dollars in millions)	
2004	$ 159	$ 35
2005	155	28
2006	106	26
2007	124	20
2008	168	14
Thereafter	3,923	39
Total	$ 4,635	$ 162

As Lessee

We lease certain facilities and equipment for use in our operations under both capital and operating leases. Total rent expense from continuing operations under operating leases amounted to $1,339 million in 2003, $1,259 million in 2002 and $1,258 million in 2001.

Capital lease amounts included in plant, property and equipment are as follows:

At December 31,	2003	2002
		(dollars in millions)
Capital leases	$ 558	$ 544
Accumulated amortization	(354)	(368)
Total	$ 204	$ 176

The aggregate minimum rental commitments under noncancelable leases for the periods shown at December 31, 2003, are as follows:

Years	Capital Leases	Operating Leases
		(dollars in millions)
2004	$ 103	$ 909
2005	37	822
2006	29	877
2007	22	521
2008	16	397
Thereafter	97	1,127
Total minimum rental commitments	304	$ 4,653
Less interest and executory costs	(64)	
Present value of minimum lease payments	240	
Less current installments	(83)	
Long-term obligation at December 31, 2003	$ 157	

As of December 31, 2003, the total minimum sublease rentals to be received in the future under noncancelable operating and capital subleases were $50 million and $4 million, respectively.

NOTE 11

DEBT

Debt Maturing Within One Year

Debt maturing within one year is as follows:

At December 31,	2003	2002
		(dollars in millions)
Notes payable		
Commercial paper	$ 767	$ 2,057
Bank loans	20	40
Short-term notes	–	4
Long-term debt maturing within one year	5,180	7,166
Total debt maturing within one year	$ 5,967	$ 9,267
Weighted-average interest rates for notes payable outstanding at year-end	1.9%	1.4%

The weighted average interest rates for our domestic notes payable at year-end were 1.1% and 1.4% at December 31, 2003 and 2002, respectively.

Capital expenditures (primarily construction of telephone plant) are partially financed, pending long-term financing, through bank loans and the issuance of commercial paper payable within 12 months.

At December 31, 2003, we had approximately $5.9 billion of unused bank lines of credit. Certain of these lines of credit contain requirements for the payment of commitment fees.

Long-Term Debt

Outstanding long-term debt obligations are as follows:

At December 31,	Interest Rates %	Maturities	2003	(dollars in millions) 2002
Notes payable	1.24 – 10.05	2004 – 2032	**$ 17,364**	$ 16,974
Telephone subsidiaries – debentures and first/refunding mortgage bonds	2.00 – 7.00	2004 – 2042	**13,417**	13,492
	7.15 – 7.65	2006 – 2032	**3,625**	3,315
	7.85 – 9.67	2010 – 2031	**2,184**	2,288
Other subsidiaries – debentures and other	6.36 – 8.75	2004 – 2028	**3,926**	4,895
Zero-coupon convertible notes, net of unamortized discount of $2,198 and $2,293	3.00% yield	2021	**3,244**	3,149
Employee stock ownership plan loans:				
GTE guaranteed obligations	9.73	2005	**119**	222
NYNEX debentures	9.55	2010	**175**	203
Capital lease obligations (average rate 7.9% and 8.2%) and other lease-related debt (average rate 6.0% and 4.8%)			**521**	1,269
Exchangeable notes, net of unamortized discount of $90			**–**	5,204
Property sale holdbacks held in escrow, vendor financing and other	4.00 – 6.00	2004 – 2005	**99**	241
Unamortized discount, net of premium			**(81)**	(83)
Total long-term debt, including current maturities			**44,593**	51,169
Less: debt maturing within one year			**(5,180)**	(7,166)
Total long-term debt			**$ 39,413**	$ 44,003

Telephone Subsidiaries' Debt

The telephone subsidiaries' debentures outstanding at December 31, 2003 include $825 million that are callable. The call prices range from 100.0% to 103.7% of face value, depending upon the remaining term to maturity of the issue. In addition, our refunding mortgage bond issuance and first mortgage bonds of $305 million are secured by certain telephone operations assets.

See Note 21 for additional information about guarantees of subsidiary debt.

Zero-Coupon Convertible Notes

In May 2001, Verizon Global Funding Corp. (Verizon Global Funding) issued approximately $5.4 billion in principal amount at maturity of zero-coupon convertible notes due 2021, resulting in gross proceeds of approximately $3 billion. The notes are convertible into shares of our common stock at an initial price of $69.50 per share if the closing price of Verizon common stock on the New York Stock Exchange exceeds specified levels or in other specified circumstances. The conversion price increases by at least 3% a year. The initial conversion price represents a 25% premium over the May 8, 2001 closing price of $55.60 per share. There are no scheduled cash interest payments associated with the notes. The zero-coupon convertible notes are callable by Verizon Global Funding on or after May 15, 2006. In addition, the notes are redeemable at the option of the holders on May 15th in each of the years 2004, 2006, 2011 and 2016. As of December 31, 2003, the zero-coupon notes were classified as long-term debt maturing within one year since they are redeemable on May 15, 2004.

Exchangeable Notes

Previously, Verizon Global Funding issued two series of notes: $2,455 million of 5.75% senior exchangeable notes due on April 1, 2003 that were exchangeable into shares of TCNZ (the 5.75% Notes) and $3,180 million of 4.25% senior exchangeable notes due on September 15, 2005 that, in connection with a restructuring of Cable & Wireless Communications plc in 2000 and the bankruptcy of NTL in 2002, were exchangeable into shares of C&W and a combination of shares and warrants in the reorganized NTL entities (the 4.25% Notes).

On April 1, 2003, all of the outstanding $2,455 million principal amount of the 5.75% Notes were redeemed at maturity. On March 15, 2003, Verizon Global Funding redeemed all of the outstanding 4.25% Notes. The cash redemption price for the 4.25% Notes was $1,048.29 for each $1,000 principal amount of the notes. The principal amount of the 4.25% Notes outstanding, before unamortized discount, at the time of redemption, was $2,839 million.

The 5.75% Notes and the 4.25% Notes were indexed to the fair market value of the exchange property into which they are exchangeable. At December 31, 2002 and 2001, the exchange prices of each of the 5.75% Notes and the 4.25% Notes exceeded the fair market value of the exchange property. Consequently, the notes were recorded at their amortized carrying value with no mark-to-market adjustments.

Support Agreements
All of Verizon Global Funding's debt has the benefit of Support Agreements between us and Verizon Global Funding, which give holders of Verizon Global Funding debt the right to proceed directly against us for payment of interest, premium (if any) and principal outstanding should Verizon Global Funding fail to pay. The holders of Verizon Global Funding debt do not have recourse to the stock or assets of most of our telephone operations; however, they do have recourse to dividends paid to us by any of our consolidated subsidiaries as well as assets not covered by the exclusion. Verizon Global Funding's long-term debt, including current portion, aggregated $15,281 million at December 31, 2003. The carrying value of the available assets reflected in our consolidated balance sheets was approximately $56.8 billion at December 31, 2003.

Debt Covenants
Verizon and its consolidated subsidiaries are in compliance with all of their debt covenants.

Maturities of Long-Term Debt
Maturities of long-term debt outstanding at December 31, 2003 are $5.2 billion in 2004, $5.5 billion in 2005, $3.9 billion in 2006, $2.5 billion in 2007, $2.5 billion in 2008 and $25.1 billion thereafter. These amounts include the debt, redeemable at the option of the holder, at the earliest redemption dates.

NOTE 12

FINANCIAL INSTRUMENTS

Derivatives
The ongoing effect of SFAS No. 133 and related amendments and interpretations on our consolidated financial statements will be determined each quarter by several factors, including the specific hedging instruments in place and their relationships to hedged items, as well as market conditions at the end of each period. For the years ended December 31, 2003, 2002 and 2001, we recorded charges of $11 million, $14 million and $182 million, respectively, and losses of $21 million, gains of $12 million and losses of $43 million to other comprehensive income (loss), respectively.

Interest Rate Risk Management
We have entered into domestic interest rate swaps, to achieve a targeted mix of fixed and variable rate debt, where we principally receive fixed rates and pay variable rates based on LIBOR. These swaps hedge against changes in the fair value of our debt portfolio. We record the interest rate swaps at fair value in our balance sheet as assets and liabilities and adjust debt for the change in its fair value due to changes in interest rates. The ineffective portions of these hedges were immaterial to our operating results in all periods presented.

Foreign Exchange Risk Management
Our foreign exchange risk management includes the use of foreign currency forward contracts and cross currency interest rate swaps with foreign currency forwards. These contracts are typically used to hedge short-term foreign currency transactions and commitments, or to offset foreign exchange gains or losses on the foreign currency obligations and are designated as cash flow hedges. The contracts have maturities ranging from approximately two months to 16 months. We record these contracts at fair value as assets or liabilities and the related gains or losses are deferred in shareowners' investment as a component of other comprehensive income (loss). We have recorded losses of $21 million, gains of $12 million and losses of $43 million in other comprehensive income (loss) for the years ended December 31, 2003, 2002 and 2001, respectively.

Other Derivatives
In 2001 and 2000, we invested a total of $1,025 million in MFN's convertible debt securities. The conversion options on the MFN debt securities had, as their underlying risk, changes in the MFN stock price. This risk was not clearly and closely related to the change in interest rate risk underlying the debt securities. Under the provisions of SFAS No. 133 and related amendments and interpretations, we were required to separate the conversion options, considered embedded derivatives, from the debt securities in order to account for changes in the fair value of the conversion options separately from changes in the fair value of the debt securities. The fair value of the conversion options were recognized as assets in our balance sheet and we recorded the mark-to-market adjustment in earnings. The fair value of the debt securities and the conversion options were recorded in Investments in Unconsolidated Businesses in the consolidated balance sheets. A net charge of $186 million related to the conversion options was included as part of the cumulative effect of the accounting change recorded on January 1, 2001. A net charge of $163 million was recorded as a mark-to-market adjustment for the year ended December 31, 2001. As of December 31, 2001, the value of the conversion options in our consolidated balance sheet was approximately $48 million. During 2002, we wrote-off the value of the conversion options due to the other than temporary decline in market value of our investment in MFN and recorded the charge of $48 million in Income (Loss) from Other Unconsolidated Businesses.

In addition, we previously entered into several other contracts and similar arrangements that require fair value accounting under the provisions of SFAS No. 133 and related amendments and interpretations. A net gain of $4 million was recorded as the cumulative effect of an accounting change on January 1, 2001. We recorded charges of $13 million, $15 million and $19 million as mark-to-market adjustments related to these instruments for the years ended December 31, 2003, 2002 and 2001, respectively.

Concentrations of Credit Risk
Financial instruments that subject us to concentrations of credit risk consist primarily of temporary cash investments, short-term and long-term investments, trade receivables, certain notes receivable including lease receivables, preferred stock and derivative contracts. Our policy is to deposit our temporary cash investments with major financial institutions. Counterparties to our derivative contracts are also major financial institutions and organized exchanges. The financial institutions have all been accorded high ratings by primary rating agencies. We limit the dollar amount of contracts entered into with any one financial institution and monitor our counterparties' credit ratings. We generally do not give or receive collateral on swap agreements due to our credit rating and those of our counterparties. While we may be exposed to credit losses due to the nonperformance of our counterparties, we consider the risk remote and do not expect the settlement of these transactions to have a material effect on our results of operations or financial condition.

Fair Values of Financial Instruments

The tables that follow provide additional information about our significant financial instruments:

Financial Instrument	Valuation Method
Cash and cash equivalents and short-term investments	Carrying amounts
Short- and long-term debt (excluding capital leases and exchangeable notes)	Market quotes for similar terms and maturities or future cash flows discounted at current rates
Exchangeable notes	Market quotes
Cost investments in unconsolidated businesses and notes receivable	Future cash flows discounted at current rates, market quotes for similar instruments or other valuation models

(dollars in millions)

At December 31,	2003		2002	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Short- and long-term debt	**$ 45,140**	**$ 48,685**	$ 47,825	$ 51,395
Exchangeable notes	**–**	**–**	5,204	5,239
Cost investments in unconsolidated businesses	**174**	**174**	202	202
Notes receivable, net	**129**	**129**	175	175

In 2003, all of the exchangeable notes were redeemed (see Note 11).

NOTE 13

EARNINGS PER SHARE AND SHAREOWNERS' INVESTMENT

Earnings Per Share

The following table is a reconciliation of the numerators and denominators used in computing earnings per share:

(dollars and shares in millions, except per share amounts)

Years Ended December 31,	2003	2002	2001
Net Income Used For Basic Earnings Per Common Share			
Income before discontinued operations and cumulative effect of accounting change	**$ 3,509**	$ 4,661	$ 584
Loss on discontinued operations, net of tax	**(935)**	(86)	(13)
Cumulative effect of accounting change, net of tax	**503**	(496)	(182)
Net income	**$ 3,077**	$ 4,079	$ 389
Net Income Used For Diluted Earnings Per Common Share			
Income before discontinued operations and cumulative effect of accounting change	**$ 3,509**	$ 4,661	$ 584
After-tax minority interest expense related to exchangeable equity interest	**21**	7	–
Income before discontinued operations and cumulative effect of accounting change – after assumed conversion of dilutive securities	**3,530**	4,668	584
Loss on discontinued operations, net of tax	**(935)**	(86)	(13)
Cumulative effect of accounting change, net of tax	**503**	(496)	(182)
Net income – after assumed conversion of dilutive securities	**$ 3,098**	$ 4,086	$ 389
Basic Earnings Per Common Share[1]			
Weighted-average shares outstanding – basic	**2,756**	2,729	2,710
Income before discontinued operations and cumulative effect of accounting change	**$ 1.27**	$ 1.71	$ .22
Loss on discontinued operations, net of tax	**(.34)**	(.03)	–
Cumulative effect of accounting change, net of tax	**.18**	(.18)	(.07)
Net income	**$ 1.12**	$ 1.49	$ .14
Diluted Earnings Per Common Share[1]			
Weighted-average shares outstanding	**2,756**	2,729	2,710
Effect of dilutive securities:			
Stock options	**5**	6	20
Exchangeable equity interest	**28**	10	–
Weighted-average shares – diluted	**2,789**	2,745	2,730
Income before discontinued operations and cumulative effect of accounting change	**$ 1.27**	$ 1.70	$ .21
Loss on discontinued operations, net of tax	**(.34)**	(.03)	–
Cumulative effect of accounting change, net of tax	**.18**	(.18)	(.07)
Net income	**$ 1.11**	$ 1.49	$ .14

(1) Total per share amounts may not add due to rounding.

Certain outstanding options to purchase shares were not included in the computation of diluted earnings per common share because to do so would have been anti-dilutive for the period, including approximately 248 million shares during 2003, 228 million shares during 2002 and 116 million shares during 2001.

The diluted earnings per share calculation considers the assumed conversion of an exchangeable equity interest (see Note 9).

Shareowners' Investment

Our certificate of incorporation provides authority for the issuance of up to 250 million shares of Series Preferred Stock, $.10 par value, in one or more series, with such designations, preferences, rights, qualifications, limitations and restrictions as the Board of Directors may determine.

We are authorized to issue up to 4.25 billion shares of common stock.

On March 1, 2000, our Board of Directors authorized a two-year share buyback program for the repurchase of up to 80 million shares of common stock in the open market. On January 24, 2002, our Board of Directors approved the extension of the stock repurchase program to the earlier of the date on which the aggregate number of shares purchased under the program reached 80 million shares, or the close of business on February 29, 2004. Through December 31, 2003, we repurchased 36 million Verizon common shares, principally under this program.

On January 22, 2004, the Board of Directors authorized the repurchase of up to 80 million common shares terminating no later than the close of business on February 28, 2006. The Board of Directors also determined that no additional common shares may be purchased under the previous program.

NOTE 14

STOCK INCENTIVE PLANS

We determined stock-option related employee compensation expense for 2003 and the pro forma amounts for prior years (see Note 2) using the Black-Scholes option-pricing model based on the following weighted-average assumptions:

	2003	2002	2001
Dividend yield	**4.0%**	3.2%	2.7%
Expected volatility	**30.9**	28.5	29.1
Risk-free interest rate	**3.4**	4.6	4.8
Expected lives (in years)	**6**	6	6

The weighted-average value of options granted during 2003, 2002 and 2001 was $8.41, $12.11 and $15.24, respectively.

Our stock incentive plans are described below:

Fixed Stock Option Plans

We have fixed stock option plans for substantially all employees. Options to purchase common stock were granted at a price equal to the market price of the stock at the date of grant. The options generally vest over three years and have a maximum term of ten years.

This table summarizes our fixed stock option plans:

	Stock Options (in thousands)	**Weighted-Average Exercise Price**
Outstanding, January 1, 2001	232,568	$ 45.58
Granted	34,217	55.93
Exercised	(15,358)	35.64
Canceled/forfeited	(6,219)	47.82
Outstanding, December 31, 2001	245,208	47.60
Granted	31,206	48.57
Exercised	(7,417)	28.15
Canceled/forfeited	(7,560)	43.62
Outstanding, December 31, 2002	261,437	48.32
Granted	22,207	38.94
Exercised	(4,634)	31.29
Canceled/forfeited	(7,917)	47.87
Outstanding, December 31, 2003	271,093	47.86
Options exercisable, December 31,		
2001	131,924	45.29
2002	162,620	48.37
2003	233,374	48.27

The following table summarizes information about fixed stock options outstanding as of December 31, 2003:

Range of Exercise Prices	Stock Options Outstanding: Shares (in thousands)	Weighted-Average Remaining Life	Weighted-Average Exercise Price	Stock Options Exercisable: Shares (in thousands)	Weighted-Average Exercise Price
$ 20.00 – 29.99	6,756	.85 years	$ 25.88	6,729	$ 25.88
30.00 – 39.99	46,633	5.62	36.55	29,520	35.42
40.00 – 49.99	105,625	6.52	45.33	91,616	44.82
50.00 – 59.99	110,163	6.04	56.16	103,593	56.16
60.00 – 69.99	1,916	5.77	62.44	1,916	62.44
Total	271,093	6.02	47.86	233,374	48.27

Performance-Based Shares

In 2003, stock compensation awards consisted of stock options and performance-based stock units that vest over a period of three years. This was the first grant of performance based shares since 2000, when certain key Verizon employees were granted restricted stock units that vest over a three to five year period.

The number of shares accrued for the performance-based share programs was 6,707,000, 2,861,000 and 4,507,000 at December 31, 2003, 2002 and 2001, respectively.

NOTE 15

EMPLOYEE BENEFITS

We maintain noncontributory defined benefit pension plans for substantially all 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 the company's share of cost for certain recent and future retirees. We also sponsor 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 the majority of our pension and postretirement health care and life insurance plans.

Pension and Other Postretirement Benefits

Pension and other postretirement benefits for many of our employees are subject to collective bargaining agreements. Modifications in benefits have been bargained from time to time, and we may also periodically amend the benefits in the management plans.

The following tables summarize benefit costs, as well as the benefit obligations, plan assets, funded status and rate assumptions associated with pension and postretirement health care and life insurance benefit plans.

Obligations and Funded Status

(dollars in millions)

At December 31,	Pension 2003	Pension 2002	Health Care and Life 2003	Health Care and Life 2002
Change in Benefit Obligation				
Beginning of year	**$ 37,908**	$ 36,391	**$ 17,431**	$ 14,310
Service cost	**788**	718	**176**	126
Interest cost	**2,439**	2,488	**1,204**	1,066
Plan amendments	**854**	114	**3,543**	–
Actuarial loss, net	**1,214**	2,560	**3,024**	2,253
Benefits paid	**(3,925)**	(3,356)	**(1,316)**	(1,183)
Termination benefits	**2,588**	286	**508**	21
Acquisitions and divestitures, net	**23**	885	**–**	404
Settlements and curtailments	**(900)**	(2,256)	**–**	434
Other	**54**	78	**22**	–
End of year	**41,043**	37,908	**24,592**	17,431
Change in Plan Assets				
Beginning of year	**38,676**	48,558	**3,992**	4,720
Actual return on plan assets	**8,671**	(4,678)	**777**	(464)
Company contributions	**285**	157	**1,014**	919
Benefits paid	**(3,925)**	(3,356)	**(1,316)**	(1,183)
Settlements	**(900)**	(2,536)	**–**	–
Acquisitions and divestitures, net	**34**	531	**–**	–
End of year	**42,841**	38,676	**4,467**	3,992
Funded Status				
End of year	**1,798**	768	**(20,125)**	(13,439)
Unrecognized				
Actuarial loss, net	**5,079**	8,295	**6,964**	4,412
Prior service (benefit) cost	**1,512**	752	**2,797**	(892)
Transition asset	**(3)**	(44)	**20**	23
Net amount recognized	**$ 8,386**	$ 9,771	**$ (10,344)**	$ (9,896)
Amounts recognized on the balance sheet				
Prepaid pension cost (in Other Assets)	**$ 12,332**	$ 12,794	**$ –**	$ –
Employee benefit obligation	**(5,397)**	(4,540)	**(10,344)**	(9,896)
Other assets	**511**	72	**–**	–
Minority interest	**79**	71	**–**	–
Accumulated other comprehensive loss	**861**	1,374	**–**	–
Net amount recognized	**$ 8,386**	$ 9,771	**$ (10,344)**	$ (9,896)

Changes in benefit obligations were caused by factors including changes in actuarial assumptions (see "Assumptions"), special termination benefits, settlements and curtailments. As a result of extending and increasing limits (caps) on company payments toward retiree health care costs in connection with the union contracts ratified in the fourth quarter of 2003, we began recording retiree health care costs as if there were no caps in the fourth quarter of 2003 relative to these union contracts. This increased our postretirement benefits obligation by $5,158 million.

In 2003 and 2002, Verizon reduced its workforce using its employee severance plans (see Note 4). Additionally, in 2003, 2002 and 2001, several of the pension plans' lump-sum pension distributions surpassed the settlement threshold equal to the sum of service cost and interest cost requiring settlement recognition for all cash settlements for each of those years.

The accumulated benefit obligation for all defined benefit pension plans was $39,012 million and $35,999 million at December 31, 2003 and 2002, respectively.

Information for pension plans with an accumulated benefit obligation in excess of plan assets follows:

	(dollars in millions)	
At December 31,	**2003**	2002
Projected benefit obligation	**$ 12,579**	$ 11,743
Accumulated benefit obligation	**12,061**	11,484
Fair value of plan assets	**7,828**	7,409

Net Periodic Cost

						(dollars in millions)
			Pension			Health Care and Life
Years Ended December 31,	**2003**	2002	2001	**2003**	2002	2001
Service cost	**$ 788**	$ 718	$ 665	**$ 176**	$ 126	$ 128
Interest cost	**2,439**	2,488	2,490	**1,204**	1,066	965
Expected return on plan assets	**(4,153)**	(4,883)	(4,811)	**(430)**	(476)	(461)
Amortization of transition asset	**(41)**	(109)	(112)	**2**	2	–
Amortization of prior service cost	**22**	(4)	(44)	**(16)**	(89)	(26)
Actuarial loss (gain), net	**(337)**	(707)	(878)	**137**	70	(78)
Net periodic benefit (income) cost	**(1,282)**	(2,497)	(2,690)	**1,073**	699	528
Termination benefits	**2,588**	286	813	**508**	21	–
Settlement loss	**229**	237	35	**–**	–	–
Curtailment (gain) loss and other, net	**62**	312	(13)	**(130)**	441	–
Subtotal	**2,879**	835	835	**378**	462	–
Total (income) cost	**$ 1,597**	$ (1,662)	$ (1,855)	**$ 1,451**	$ 1,161	$ 528

Additional Information

We evaluate each pension plan to determine whether any additional minimum liability is required. As a result of changes in interest rates and changes in investment returns, an adjustment to the additional minimum pension liability was required for a small number of plans. The adjustment in the liability is recorded as a charge or (credit) to Accumulated Other Comprehensive Loss, net of tax, in shareowners' investment in the consolidated balance sheets.

			(dollars in millions)
Years Ended December 31,	**2003**	2002	2001
Increase (decrease) in minimum liability included in other comprehensive income, before tax	**$ (513)**	$ 1,342	$ (20)

Assumptions

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

	Pension		Health Care and Life	
At December 31,	**2003**	2002	**2003**	2002
Discount rate	**6.25%**	6.75%	**6.25%**	6.75%
Rate of future increases in compensation	**5.00**	5.00	**4.00**	4.00

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

			Pension			Health Care and Life
Years Ended December 31,	**2003**	2002	2001	**2003**	2002	2001
Discount rate	**6.75%**	7.25%	7.75%	**6.75%**	7.25%	7.75%
Expected return on plan assets	**8.50**	9.25	9.25	**8.50**	9.10	9.10
Rate of compensation increase	**5.00**	5.00	5.00	**4.00**	4.00	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 following: observable current market interest rates, consensus earnings expectations, historical long-term performance and value-added, and the use of conventional long-term risk premiums. 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 projected long-term results are then also compared to the investment return earned over the previous 10 years.

The assumed Health Care Cost Trend Rates follows:

	Health Care and Life		
At December 31,	**2003**	2002	2001
Health care cost trend rate assumed for next year	**10.00%**	11.00%	10.00%
Rate to which cost trend rate gradually declines	**5.00**	5.00	5.00
Year the rate reaches level it is assumed to remain thereafter	**2008**	2007	2005

Assumed health care trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in the assumed health care cost trend rate would have the following effects:

	(dollars in millions)	
One-Percentage-Point	**Increase**	**Decrease**
Effect on 2003 total service and interest cost	$ 121	$ (100)
Effect on postretirement benefit obligation as of December 31, 2003	1,780	(1,482)

Medicare Drug Act

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (Medicare Drug Act) was signed into law. The Medicare Drug Act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. We sponsor several postretirement health care plans that provide prescription drug benefits that are deemed actuarially equivalent to the Medicare Part D and have elected to recognize the impact of the federal subsidy on our accumulated postretirement benefit obligation and net postretirement benefit costs for 2003. We anticipate the recognition of the Medicare Drug Act to decrease our accumulated postretirement benefit obligation by $1,256 million and have reduced our net postretirement benefit cost for 2003 by $13 million. In 2004, our net postretirement benefit cost will be reduced by approximately $200 million. Specific authoritative guidance on the accounting for the federal subsidy is pending and that guidance, when issued, could impact our current accounting for the effects of the Medicare Drug Act.

Plan Assets

Pension Plans

The weighted-average asset allocations for the pension plans by asset category follows:

At December 31,	**2003**	2002
Asset Category		
Equity securities	**55.9%**	59.6%
Debt securities	**17.3**	22.4
Real estate	**3.3**	4.5
Other	**23.5**	13.5
Total	**100.0%**	100.0%

Equity securities include Verizon common stock in the amounts of $97 million (less than 1% of total plan assets) and $115 million (less than 1% of total plan assets) at December 31, 2003 and 2002, respectively. Other assets include cash and cash equivalents (primarily used for the payment of benefits), private equity and absolute return strategies. At December 31, 2003, other assets included $4,343 million for 2004 payments related to the fourth quarter 2003 voluntary separation plan.

Health Care and Life Plans

The weighted asset allocations for the other postretirement benefit plans by asset category follows:

At December 31,	**2003**	2002
Asset Category		
Equity securities	**64.5%**	61.4%
Debt securities	**27.2**	29.3
Real estate	**0.1**	0.1
Other	**8.2**	9.2
Total	**100.0%**	100.0%

Equity securities include Verizon common stock in the amounts of $8 million (less than 1% of total plan assets) and $9 million (less than 1% of total plan assets) at December 31, 2003 and 2002, respectively.

The portfolio strategy emphasizes a long-term equity orientation, significant global diversification, the use of both public and private investments and professional financial and operational risk controls. Assets are allocated according to a long-term policy neutral position and held within a relatively narrow and pre-determined range. Both active and passive management approaches are used depending on perceived market efficiencies and various other factors. Derivatives are also used primarily as a means for effectively controlling the portfolio's targeted asset mix.

Cash Flows

In 2004, we expect to contribute $266 million to our qualified pension trusts, including $138 million for TELPRI, $161 million to our other nonqualified pension plans and $1,149 million to our other postretirement benefit plans in 2004. In 2003, we contributed $126 million to our qualified pension trusts, including $122 million for TELPRI, $159 million to our nonqualified pension plans and $1,014 million to our other postretirement benefit plans.

Estimated Future Benefit Payments

The benefit payments to retirees, which reflect expected future service, are expected to be paid as follows:

	(dollars in millions)	
	Pension Benefits	**Health Care and Life**
2004	$ 8,925	$ 1,557
2005	2,564	1,594
2006	2,602	1,537
2007	2,589	1,561
2008	2,613	1,591
2009 – 2013	17,369	8,258

Expected pension benefit payments in 2004 include $6,328 million related to the fourth quarter 2003 voluntary separation plan.

Savings Plan and Employee Stock Ownership Plans

We maintain four leveraged employee stock ownership plans (ESOP). Under these plans, we match a certain percentage of eligible employee contributions to the savings plans with shares of our common stock from these ESOPs. Common stock is allocated from all leveraged ESOP trusts based on the proportion of principal and interest paid on ESOP debt in a year to the remaining principal and interest due over the term of the debt. At December 31, 2003, the

number of unallocated and allocated shares of common stock was 10 million and 71 million, respectively. All leveraged ESOP shares are included in earnings per share computations.

We recognize leveraged ESOP cost based on the modified shares allocated method for two leveraged ESOP trusts which purchased securities before December 15, 1989 and the shares allocated method for the other leveraged ESOP trust which purchased securities after December 15, 1989.

ESOP cost and trust activity consist of the following:

Years Ended December 31,	2003	2002	2001
		(dollars in millions)	
Compensation	$ 148	$ 143	$ 121
Interest incurred	22	30	61
Dividends	(24)	(29)	(36)
Net leveraged ESOP cost	146	144	146
Additional ESOP cost	127	120	90
Total ESOP cost	$ 273	$ 264	$ 236
Dividends received for debt service	$ 76	$ 80	$ 87
Total company contributions to leveraged ESOP trusts	$ 306	$ 280	$ 259

In addition to the ESOPs described above, we maintain savings plans for non-management employees and employees of certain subsidiaries. Compensation expense associated with these savings plans was $220 million in 2003, $212 million in 2002 and $252 million in 2001.

Severance Benefits

The following table provides an analysis of our severance liability recorded in accordance with SFAS Nos. 112 and 146:

Year	Beginning of Year	Charged to Expense	Payments	Other	End of Year
			(dollars in millions)		
2001	$ 319	$ 819	$ (38)	$ –	$ 1,100
2002	1,100	707	(691)	21	1,137
2003	**1,137**	**1,985**	**(857)**	**–**	**2,265**

The remaining severance liability includes future contractual payments to employees separated as of December 31, 2003.

NOTE 16

INCOME TAXES

The components of income tax expense from continuing operations are as follows:

Years Ended December 31,	2003	2002	2001
		(dollars in millions)	
Current			
Federal	$ 87	$ (647)	$ 750
Foreign	72	45	56
State and local	267	495	257
	426	(107)	1,063
Deferred			
Federal	820	1,477	899
Foreign	18	(13)	2
State and local	(2)	255	232
	836	1,719	1,133
Investment tax credits	(10)	(15)	(49)
Total income tax expense	$ 1,252	$ 1,597	$ 2,147

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

Years Ended December 31,	2003	2002	2001
Statutory federal income tax rate	35.0%	35.0%	35.0%
State and local income tax, net of federal tax benefits	3.6	7.8	11.6
Tax benefits from investment losses	(3.0)	(17.2)	40.7
Equity in earnings (loss) from unconsolidated businesses	(10.4)	(3.1)	(11.2)
Other, net	1.1	3.0	2.5
Effective income tax rate	26.3%	25.5%	78.6%

The favorable impact on our 2003 effective income tax rate was primarily driven by increased earnings from our unconsolidated businesses.

The effective income tax rates in 2002 and 2001 were both impacted by losses resulting from the other than temporary decline in market value of our investments during those years. Tax benefits recognized in 2002 favorably impacted our 2002 effective income tax rate. In 2001, tax benefits on those losses were not available and, consequently, had an unfavorable impact on the 2001 effective income tax rate.

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

At December 31,	2003	2002
		(dollars in millions)
Depreciation	$ 9,722	$ 7,314
Employee benefits	(1,578)	(427)
Leasing activity	3,064	3,109
Loss on investments	(1,004)	(388)
Wireless joint venture including wireless licenses	9,977	9,251
Uncollectible accounts receivable	(740)	(704)
Other – net	(1,245)	(425)
	18,196	17,730
Valuation allowance	1,463	661
Net deferred tax liability	$ 19,659	$ 18,391
Net long-term deferred tax liabilities	$ 21,708	$ 19,467
Less net current deferred tax assets (in Prepaid Expenses and Other)	1,905	918
Less deferred investment tax credit	144	158
Net deferred tax liability	$ 19,659	$ 18,391

At December 31, 2003, undistributed earnings of our foreign subsidiaries amounted to approximately $3.4 billion. Deferred income taxes are not provided on these earnings as it is intended that the earnings are indefinitely invested outside of the U.S. It is not practical to estimate the amount of taxes that might be payable upon the remittance of such earnings.

The valuation allowance primarily represents the tax benefits of certain state net operating loss carry forwards and other deferred tax assets which may expire without being utilized. During 2003, the valuation allowance increased $802 million. This increase primarily relates to the sale or write-down of investments for which tax benefits may not be realized.

NOTE 17

SEGMENT INFORMATION

Reportable Segments

We have four reportable segments, which we operate and manage as strategic business units and organize by products and services. We measure and evaluate our reportable segments based on segment income. This segment income excludes unallocated corporate expenses and other adjustments arising during each period. The other adjustments include transactions that the chief operating decision makers exclude in assessing business unit performance due primarily to their non-operational and/or non-recurring nature. Although such transactions are excluded from the business segment results, they are included in reported consolidated earnings. Gains and losses that are not individually significant are included in all segment results, since these items are included in the chief operating decision makers' assessment of unit performance. These are mostly contained in Information Services and International since they actively manage investment portfolios.

Our segments and their principal activities consist of the following:

Domestic Telecom
Domestic wireline communications services, principally representing our telephone operations that provide local telephone services in 29 states and the District of Columbia. These services include voice and data transport, enhanced and custom calling features, network access, directory assistance, private lines and public telephones. This segment also provides long distance services, customer premises equipment distribution, data solutions and systems integration, billing and collections, Internet access services and inventory management services.

Domestic Wireless
Domestic wireless products and services include wireless voice and data services and equipment sales across the United States.

Information Services
Domestic and international publishing businesses, including print SuperPages® and electronic SuperPages.com™ directories, as well as website creation and other electronic commerce services. This segment has operations principally in North America and Latin America.

International
International wireline and wireless communications operations and investments primarily in the Americas, as well as investments in Europe.

The following table provides operating financial information for our four reportable segments:

(dollars in millions)

2003	Domestic Telecom	Domestic Wireless	Information Services	International	Total Segments
External revenues	$ 38,828	$ 22,436	$ 4,114	$ 1,921	$ 67,299
Intersegment revenues	774	53	–	28	855
Total operating revenues	39,602	22,489	4,114	1,949	68,154
Cost of services and sales	14,708	6,460	641	574	22,383
Selling, general & administrative expense	8,517	8,057	1,505	691	18,770
Depreciation & amortization expense	9,217	3,888	89	346	13,540
Sales of businesses, net	–	–	(141)	–	(141)
Total operating expenses	32,442	18,405	2,094	1,611	54,552
Operating income	7,160	4,084	2,020	338	13,602
Equity in earnings (loss) of unconsolidated businesses	–	15	(1)	1,091	1,105
Income (loss) from other unconsolidated businesses	(4)	–	–	169	165
Other income and (expense), net	47	12	7	32	98
Interest expense	(1,682)	(626)	(38)	(160)	(2,506)
Minority interest	–	(1,554)	(8)	(20)	(1,582)
Provision for income taxes	(2,186)	(848)	(774)	(58)	(3,866)
Segment income	$ 3,335	$ 1,083	$ 1,206	$ 1,392	$ 7,016
Assets	$ 82,087	$ 65,166	$ 2,431	$ 11,872	$ 161,556
Investments in unconsolidated businesses	64	288	4	4,555	4,911
Capital expenditures	6,820	4,590	84	358	11,852
2002					
External revenues	$ 40,260	$ 19,424	$ 4,287	$ 2,191	$ 66,162
Intersegment revenues	579	49	–	28	656
Total operating revenues	40,839	19,473	4,287	2,219	66,818
Cost of services and sales	13,390	5,456	688	586	20,120
Selling, general & administrative expense	9,048	7,084	1,411	610	18,153
Depreciation & amortization expense	9,456	3,293	74	376	13,199
Total operating expenses	31,894	15,833	2,173	1,572	51,472
Operating income	8,945	3,640	2,114	647	15,346
Equity in earnings of unconsolidated businesses	–	13	1	644	658
Income from other unconsolidated businesses	–	–	–	218	218
Other income and (expense), net	84	28	11	61	184
Interest expense	(1,745)	(626)	(35)	(238)	(2,644)
Minority interest	–	(1,349)	(16)	(102)	(1,467)
Provision for income taxes	(2,920)	(740)	(794)	(78)	(4,532)
Segment income	$ 4,364	$ 966	$ 1,281	$ 1,152	$ 7,763
Assets	$ 82,257	$ 63,470	$ 4,319	$ 11,955	$ 162,001
Investments in unconsolidated businesses	70	289	9	3,603	3,971
Capital expenditures	8,004	4,414	167	421	13,006

(dollars in millions)

2001	Domestic Telecom	Domestic Wireless	Information Services	International	Total Segments
External revenues	$ 41,670	$ 17,519	$ 4,267	$ 1,572	$ 65,028
Intersegment revenues	478	41	46	9	574
Total operating revenues	42,148	17,560	4,313	1,581	65,602
Cost of services and sales	14,313	5,085	743	398	20,539
Selling, general & administrative expense	9,402	6,461	1,218	610	17,691
Depreciation & amortization expense	9,260	3,709	79	278	13,326
Total operating expenses	32,975	15,255	2,040	1,286	51,556
Operating income	9,173	2,305	2,273	295	14,046
Equity in earnings of unconsolidated businesses	4	5	–	823	832
Income from other unconsolidated businesses	–	–	–	98	98
Other income and (expense), net	157	5	17	92	271
Interest expense	(1,810)	(577)	(39)	(323)	(2,749)
Minority interest	–	(788)	(7)	63	(732)
Provision for income taxes	(3,015)	(413)	(892)	(34)	(4,354)
Segment income	$ 4,509	$ 537	$ 1,352	$ 1,014	$ 7,412
Assets	$ 83,978	$ 60,262	$ 4,160	$ 15,119	$ 163,519
Investments in unconsolidated businesses	69	285	10	7,315	7,679
Capital expenditures	12,731	5,080	156	310	18,277

Reconciliation To Consolidated Financial Information

A reconciliation of the results for the operating segments to the applicable line items in the consolidated financial statements is as follows:

(dollars in millions)

	2003	2002	2001
Operating Revenues			
Total reportable segments	$ 68,154	$ 66,818	$ 65,602
Non-strategic access line sales	–	623	997
Corporate, eliminations and other	(402)	(137)	114
Consolidated operating revenues – reported	$ 67,752	$ 67,304	$ 66,713
Operating Expenses			
Total reportable segments	$ 54,552	$ 51,472	$ 51,556
Non-strategic access line sales	–	241	413
Sales of businesses and investments, net (see Notes 3, 5 and 8)	300	(2,747)	350
Transition costs (see Note 4)	–	510	1,039
Severance, pension and benefit charges (see Note 4)	5,523	1,949	1,597
Investment-related charges (see Notes 5 and 8)	–	732	705
NorthPoint settlement (see Note 4)	–	175	–
MCI exposure, lease impairment and other special items (see Note 4)	496	593	151
International restructuring (see Note 4)	–	–	35
Corporate, eliminations and other	(613)	(625)	(606)
Consolidated operating expenses – reported	$ 60,258	$ 52,300	$ 55,240
Net Income			
Segment income – reportable segments	$ 7,016	$ 7,763	$ 7,412
Sales of businesses and investments, net (see Notes 3, 5 and 8)	44	1,895	(226)
Transition costs (see Note 4)	–	(288)	(578)
Severance, pension and benefit charges (see Note 4)	(3,399)	(1,264)	(1,001)
Investment-related charges (see Notes 5 and 8)	–	(5,652)	(5,495)
NorthPoint settlement (see Note 4)	–	(114)	–
MCI exposure, lease impairment and other special items (see Note 4)	(419)	(469)	(293)
International restructuring (see Note 4)	–	–	(26)
Iusacell charge (see Note 3)	(931)	–	–
Tax benefits (see Note 5)	–	2,104	–
Loss on discontinued operations – Iusacell (see Note 3)	(3)	(83)	(13)
Cumulative effect of accounting change (see Note 2)	503	(496)	(182)
Corporate and other	266	683	791
Consolidated net income – reported	$ 3,077	$ 4,079	$ 389
Assets			
Total reportable segments	$ 161,556	$ 162,001	$ 163,519
Reconciling items	4,412	5,467	7,276
Consolidated assets	$ 165,968	$ 167,468	$ 170,795

Results of operations for Domestic Telecom exclude the effects of the non-strategic access lines sold in the third quarter of 2002. In addition, the transfer of Global Solutions Inc. from International to Domestic Telecom effective January 1, 2003 is reflected in this financial information as if it had occurred for all periods presented. Financial information for International excludes the effects of Iusacell (see Note 3).

Corporate, eliminations and other includes unallocated corporate expenses, intersegment eliminations recorded in consolidation, the results of other businesses such as lease financing, and asset impairments and expenses that are not allocated in assessing segment performance due to their non-recurring nature.

We generally account for intersegment sales of products and services and asset transfers at current market prices. We are not dependent on any single customer.

Geographic Areas

Our foreign investments are located principally in the Americas and Europe. Domestic and foreign operating revenues are based on the location of customers. Long-lived assets consist of plant, property and equipment (net of accumulated depreciation) and investments in unconsolidated businesses. The table below presents financial information by major geographic area:

			(dollars in millions)
Years Ended December 31,	**2003**	2002	2001
Domestic			
Operating revenues	**$ 65,303**	$ 64,576	$ 64,816
Long-lived assets	**74,346**	72,726	74,462
Foreign			
Operating revenues	**2,449**	2,728	1,897
Long-lived assets	**6,759**	6,018	9,295
Consolidated			
Operating revenues	**67,752**	67,304	66,713
Long-lived assets	**81,105**	78,744	83,757

NOTE 18

COMPREHENSIVE INCOME

Comprehensive income consists of net income and other gains and losses affecting shareowners' investment that, under GAAP, are excluded from net income.

Changes in the components of other comprehensive income (loss), net of income tax expense (benefit), are as follows:

			(dollars in millions)
Years Ended December 31,	**2003**	2002	2001
Foreign Currency Translation Adjustments, net of taxes of $–, $28 and $–	**$ 568**	$ 220	$ (40)
Unrealized Gains (Losses) on Marketable Securities			
Unrealized gains (losses), net of taxes of $2, $(129) and $(403)	**5**	(464)	(2,402)
Less reclassification adjustments for gains (losses) realized in net income, net of taxes of $1, $51 and $(1,059)	**4**	(160)	(3,351)
Add reclassification of earnings due to accounting change for derivatives	**–**	–	112
Net unrealized gains (losses) on marketable securities	**1**	(304)	1,061
Unrealized Derivative Gains (Losses) on Cash Flow Hedges			
Cumulative effect of accounting change	**–**	–	(2)
Unrealized gains (losses)	**29**	70	(68)
Less reclassification adjustments for gains (losses) realized in net income	**50**	58	(25)
Net unrealized derivative gains (losses) on cash flow hedges	**(21)**	12	(45)
Minimum Pension Liability Adjustment, net of taxes of $201, $(491) and $7	**312**	(851)	13
Other Comprehensive Income (Loss)	**$ 860**	$ (923)	$ 989

The reclassification adjustments for the net gains and losses realized in net income on marketable securities in 2003, 2002 and 2001 primarily relate to the other than temporary decline in market value of certain of our investments in marketable securities in 2002 and 2001. The net realized losses for 2002 are partially offset by realized gains on the sales of TCNZ and C&W. The unrealized derivative gains and losses primarily result from our hedges of foreign exchange risk in 2002 and 2001 (see Note 12). The changes in the minimum pension liability in 2003 and 2002 were required by accounting rules for certain pension plans based on their funded status (see Note 15). The foreign currency translation adjustment in 2003 is primarily driven by the impact of the euro on our investment in Omnitel and a reclassification of the foreign currency translation loss of Iusacell of $577 million in connection with the sale of Iusacell (see Note 3), partially offset by unrealized foreign currency translation losses at Verizon's operations in the Dominican Republic and CANTV.

The components of Accumulated Other Comprehensive Loss are as follows:

		(dollars in millions)
At December 31,	**2003**	2002
Foreign currency translation adjustments	**$ (660)**	$ (1,228)
Unrealized gains on marketable securities	**24**	23
Unrealized derivative losses on cash flow hedges	**(54)**	(33)
Minimum pension liability adjustment	**(560)**	(872)
Accumulated other comprehensive loss	**$ (1,250)**	$ (2,110)

NOTE 19

ACCOUNTING FOR THE IMPACT OF THE SEPTEMBER 11, 2001 TERRORIST ATTACKS

The primary financial statement impact of the September 11, 2001 terrorist attacks pertains to Verizon's plant, equipment and administrative office space located either in, or adjacent to the World Trade Center complex, and the associated service restoration efforts. During the year ended December 31, 2001, we recorded an estimate of equipment losses and costs incurred associated with service disruption and restoration of $685 million. In addition, we accrued an insurance recovery of $400 million, resulting in a net impact of $285 million ($172 million after-tax) recorded in operating expenses (primarily cost of services and sales) in the consolidated statements of income, and also reported by our Domestic Telecom segment. The costs and estimated insurance recovery were recorded in accordance with Emerging Issues Task Force Issue No. 01-10, "Accounting for the Impact of the Terrorist Attacks of September 11, 2001." In 2003 and 2002, we recorded additional insurance recoveries of $270 million and $200 million, respectively. Of the amounts recorded, approximately $130 million and $112 million were related to operating expenses (primarily cost of services and sales) in 2003 and 2002, respectively. As of December 31, 2003, we received insurance proceeds of $825 million.

NOTE 20

ADDITIONAL FINANCIAL INFORMATION

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

Income Statement Information

(dollars in millions)			
Years Ended December 31,	**2003**	2002	2001
Depreciation expense	**$ 12,215**	$ 12,136	$ 11,362
Interest expense incurred	**2,941**	3,315	3,644
Capitalized interest	**(144)**	(185)	(368)
Advertising expense	**1,428**	1,536	1,410

Balance Sheet Information

Accounts Payable and Accrued Liabilities

(dollars in millions)		
At December 31,	**2003**	2002
Accounts payable	**$ 4,130**	$ 4,851
Accrued expenses	**2,995**	2,796
Accrued vacation pay	**824**	960
Accrued salaries and wages	**3,376**	2,171
Interest payable	**633**	669
Accrued taxes	**2,741**	1,195
	$ 14,699	$ 12,642

Other Current Liabilities

Advance billings and customer deposits	**$ 1,686**	$ 1,566
Dividends payable	**1,084**	1,072
Other	**3,134**	2,375
	$ 5,904	$ 5,013

Cash Flow Information

(dollars in millions)			
Years Ended December 31,	**2003**	2002	2001
Cash Paid			
Income taxes, net of amounts refunded	**$ (713)**	$ 522	$ 932
Interest, net of amounts capitalized	**2,646**	2,855	3,180
Supplemental investing and financing transactions:			
Assets acquired in business combinations	**1,121**	2,697	2,995
Liabilities assumed in business combinations	**13**	1,200	27
Debt assumed in business combinations	**4**	589	215

NOTE 21

GUARANTEES OF SUBSIDIARY DEBT

Verizon has guaranteed $300 million 7% debentures series F issued by Verizon South Inc. due 2041. Verizon South is an indirect wholly owned operating subsidiary of Verizon. This guarantee is full and unconditional and would require Verizon to make scheduled payments immediately if Verizon South failed to do so. Verizon may, in some future period, decide to guarantee $480 million 7% debentures series B, due 2042 issued by Verizon New England Inc., also an indirect wholly owned operating subsidiary of Verizon. Both of these securities were issued in denominations of $25 and were sold primarily to retail investors. SEC rules permit us to include condensed consolidating financial information for Verizon South in our periodic SEC reports rather than filing separate subsidiary periodic SEC reports. In addition, condensed consolidating financial information for Verizon New England is provided in the event that the debt issuance previously described is subsequently guaranteed.

Below is the condensed consolidating financial information. Verizon New England and Verizon South are presented in separate columns. The column labeled Parent represents Verizon's investments in all of its subsidiaries under the equity method and the Other column represents all other subsidiaries of Verizon on a combined basis. The Adjustments column reflects intercompany eliminations.

(dollars in millions)

Condensed Consolidating Statements of Income Year Ended December 31, 2003	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
Operating revenues	$ –	$ 4,102	$ 951	$ 62,976	$ (277)	$ 67,752
Operating expenses	562	4,148	808	55,017	(277)	60,258
Operating Income (Loss)	(562)	(46)	143	7,959	–	7,494
Equity in earnings (loss) of unconsolidated businesses	3,176	(42)	–	1,272	(3,128)	1,278
Income (loss) from other unconsolidated businesses	(10)	–	–	341	–	331
Other income and (expense), net	75	(1)	2	(2)	(36)	38
Interest expense	(78)	(160)	(64)	(2,483)	(12)	(2,797)
Minority interest	–	–	–	(1,583)	–	(1,583)
Income (loss) before provision for income taxes, discontinued operations and cumulative effect of accounting change	2,601	(249)	81	5,504	(3,176)	4,761
Income tax benefit (provision)	476	82	(32)	(1,778)	–	(1,252)
Income (Loss) Before Discontinued Operations And Cumulative Effect Of Accounting Change	3,077	(167)	49	3,726	(3,176)	3,509
Loss on discontinued operations, net of tax	–	–	–	(935)	–	(935)
Cumulative effect of accounting change, net of tax	–	369	47	87	–	503
Net Income (Loss)	$ 3,077	$ 202	$ 96	$ 2,878	$ (3,176)	$ 3,077

(dollars in millions)

Condensed Consolidating Statements of Income Year Ended December 31, 2002	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
Operating revenues	$ –	$ 4,365	$ 1,350	$ 61,833	$ (244)	$ 67,304
Operating expenses	385	3,826	(753)	49,086	(244)	52,300
Operating Income (Loss)	(385)	539	2,103	12,747	–	15,004
Equity in earnings (loss) of unconsolidated businesses	4,054	29	–	(1,621)	(4,009)	(1,547)
Loss from other unconsolidated businesses	(100)	–	–	(2,757)	–	(2,857)
Other income and (expense), net	62	(33)	16	170	(23)	192
Interest expense	(53)	(164)	(74)	(2,817)	(22)	(3,130)
Minority interest	–	–	–	(1,404)	–	(1,404)
Income (loss) before provision for income taxes, discontinued operations and cumulative effect of accounting change	3,578	371	2,045	4,318	(4,054)	6,258
Income tax benefit (provision)	501	(138)	(794)	(1,166)	–	(1,597)
Income (Loss) Before Discontinued Operations And Cumulative Effect Of Accounting Change	4,079	233	1,251	3,152	(4,054)	4,661
Loss on discontinued operations, net of tax	–	–	–	(86)	–	(86)
Cumulative effect of accounting change, net of tax	–	–	–	(496)	–	(496)
Net Income (Loss)	$ 4,079	$ 233	$ 1,251	$ 2,570	$ (4,054)	$ 4,079

(dollars in millions)

Condensed Consolidating Statements of Income Year Ended December 31, 2001	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
Operating revenues	$ –	$ 4,650	$ 1,613	$ 60,790	$ (340)	$ 66,713
Operating expenses	248	3,768	986	50,578	(340)	55,240
Operating Income (Loss)	(248)	882	627	10,212	–	11,473
Equity in earnings (loss) of unconsolidated businesses	527	(139)	(9)	466	(399)	446
Loss from other unconsolidated businesses	–	–	–	(5,486)	–	(5,486)
Other income and (expense), net	9	22	3	170	(5)	199
Interest expense	(98)	(164)	(73)	(2,818)	(123)	(3,276)
Minority interest	–	–	–	(625)	–	(625)
Income (loss) before provision for income taxes, discontinued operations and cumulative effect of accounting change	190	601	548	1,919	(527)	2,731
Income tax benefit (provision)	199	(306)	(219)	(1,821)	–	(2,147)
Income (Loss) Before Discontinued Operations And Cumulative Effect Of Accounting Change	389	295	329	98	(527)	584
Loss on discontinued operations, net of tax	–	–	–	(13)	–	(13)
Cumulative effect of accounting change, net of tax	–	–	–	(182)	–	(182)
Net Income (Loss)	$ 389	$ 295	$ 329	$ (97)	$ (527)	$ 389

(dollars in millions)

Condensed Consolidating Balance Sheets December 31, 2003	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
Cash	$ –	$ –	$ –	$ 699	$ –	$ 699
Short-term investments	–	200	40	1,932	–	2,172
Accounts receivable, net	3	1,117	162	10,424	(1,801)	9,905
Other current assets	5,201	380	192	5,073	(5,329)	5,517
Total current assets	5,204	1,697	394	18,128	(7,130)	18,293
Plant, property and equipment, net	1	6,751	1,280	67,284	–	75,316
Investments in unconsolidated businesses	30,869	117	–	6,354	(31,551)	5,789
Other assets	152	610	385	65,433	(10)	66,570
Total Assets	$ 36,226	$ 9,175	$ 2,059	$157,199	$(38,691)	$165,968
Debt maturing within one year	$ 30	$ 513	$ –	$ 11,125	$ (5,701)	$ 5,967
Other current liabilities	2,484	1,739	301	17,508	(1,429)	20,603
Total current liabilities	2,514	2,252	301	28,633	(7,130)	26,570
Long-term debt	145	2,749	900	35,629	(10)	39,413
Employee benefit obligations	99	1,787	216	14,657	–	16,759
Deferred income taxes	–	602	238	20,868	–	21,708
Other liabilities	2	235	39	3,428	–	3,704
Minority interest	–	–	–	24,348	–	24,348
Total shareowners' investment	33,466	1,550	365	29,636	(31,551)	33,466
Total Liabilities and Shareowners' Investment	$ 36,226	$ 9,175	$ 2,059	$157,199	$(38,691)	$165,968

(dollars in millions)

Condensed Consolidating Balance Sheets December 31, 2002	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
Cash	$ –	$ –	$ –	$ 1,422	$ –	$ 1,422
Short-term investments	–	284	26	1,732	–	2,042
Accounts receivable, net	7	1,218	186	12,464	(1,379)	12,496
Other current assets	1,557	278	128	6,383	(2,213)	6,133
Total current assets	1,564	1,780	340	22,001	(3,592)	22,093
Plant, property and equipment, net	1	6,524	1,257	65,976	–	73,758
Investments in unconsolidated businesses	33,410	118	–	2,108	(30,650)	4,986
Other assets	109	580	417	65,535	(10)	66,631
Total Assets	$ 35,084	$ 9,002	$ 2,014	$155,620	$(34,252)	$167,468
Debt maturing within one year	$ 29	$ 770	$ –	$ 10,497	$ (2,029)	$ 9,267
Other current liabilities	1,964	1,795	294	16,172	(1,563)	18,662
Total current liabilities	1,993	2,565	294	26,669	(3,592)	27,929
Long-term debt	175	2,625	900	40,313	(10)	44,003
Employee benefit obligations	235	1,731	212	13,211	–	15,389
Deferred income taxes	63	231	208	18,965	–	19,467
Other liabilities	2	208	76	3,721	–	4,007
Minority interest	–	–	–	24,057	–	24,057
Total shareowners' investment	32,616	1,642	324	28,684	(30,650)	32,616
Total Liabilities and Shareowners' Investment	$ 35,084	$ 9,002	$ 2,014	$155,620	$(34,252)	$167,468

(dollars in millions)

Condensed Consolidating Statements of Cash Flows Year Ended December 31, 2003	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
Net cash from operating activities	$ 8,763	$ 1,304	$ 283	$ 20,645	$ (8,513)	$ 22,482
Net cash from investing activities	–	(628)	(229)	(11,516)	127	(12,246)
Net cash from financing activities	(8,763)	(676)	(54)	(9,852)	8,386	(10,959)
Net Decrease in Cash	$ –	$ –	$ –	$ (723)	$ –	$ (723)

(dollars in millions)

Condensed Consolidating Statements of Cash Flows Year Ended December 31, 2002	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
Net cash from operating activities	$ 8,345	$ 1,488	$ (306)	$ 20,716	$ (8,144)	$ 22,099
Net cash from investing activities	–	(754)	2,252	(8,008)	(290)	(6,800)
Net cash from financing activities	(8,345)	(734)	(1,946)	(12,218)	8,434	(14,809)
Net Increase in Cash	$ –	$ –	$ –	$ 490	$ –	$ 490

(dollars in millions)

Condensed Consolidating Statements of Cash Flows Year Ended December 31, 2001	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
Net cash from operating activities	$ 6,239	$ 1,496	$ 500	$ 17,294	$ (6,003)	$ 19,526
Net cash from investing activities	18	(1,689)	(455)	(19,787)	589	(21,324)
Net cash from financing activities	(6,257)	193	(71)	2,694	5,414	1,973
Net Increase (Decrease) in Cash	$ –	$ –	$ (26)	$ 201	$ –	$ 175

NOTE 22

COMMITMENTS AND CONTINGENCIES

Several state and federal regulatory proceedings may require our telephone operations to pay penalties or to refund to customers a portion of the revenues collected in the current and prior periods. There are also various legal actions 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 actions, 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, including the Hicksville matters described below, will have a material effect on our financial condition, but it could have a material effect on our results of operations.

During 2003, under a government-approved plan, remediation of the site of a former facility in Hicksville, New York that processed nuclear fuel rods in the 1950s and 1960s commenced. Remediation beyond original expectations proved to be necessary and a reassessment of the anticipated remediation costs was conducted. In addition, a reassessment of costs related to remediation efforts at several other former facilities was undertaken. As a result, an additional environmental remediation expense of $240 million was recorded in Selling, General and Administrative Expense in the consolidated statements of income in the fourth quarter of 2003. We expect overall remediation efforts, including soil and ground water remediation and property costs, to take place over the next several years, and our cost estimates may be revised as remediation continues.

There are also litigation matters associated with the Hicksville site primarily involving personal injury claims in connection with alleged emissions arising from operations in the 1950s and 1960s at the Hicksville site. These matters are in various stages, and no trial date has been set.

As discussed in Note 4, during 2002 we recorded a pretax charge of $175 million ($114 million after-tax) for a proposed settlement of the NorthPoint litigation. The lawsuit arose from Verizon's decision to terminate an agreement with NorthPoint to combine the two companies' DSL businesses. Verizon terminated the merger agreement due to the deterioration in NorthPoint's business, operations and financial condition. The proposed settlement was approved by the bankruptcy court and paid by Verizon and the NorthPoint litigation has been dismissed with prejudice. Appeals of the bankruptcy court's order were dismissed in early 2003.

Our commercial relationship continues with Level 3 Communications LLC (Level 3), the purchaser of substantially all of Genuity's domestic assets and the assignee of Genuity's principal contract with us. We have a multi-year purchase commitment expiring on December 31, 2005 for services such as dedicated Internet access, managed web hosting, Internet security and some transport services. Under this purchase commitment, Verizon has agreed to pay Level 3 a minimum of $250 million between February 4, 2003 and December 31, 2005. Through December 31, 2003, $71 million of that purchase commitment had been met by Verizon.

We have several commitments primarily to purchase network services, equipment and software from a variety of suppliers, including the Level 3 commitment in the preceding paragraph, totaling $630 million. Of this total amount, $413 million, $194 million and $23 million are expected to be purchased in 2004, 2005 and 2006, respectively.

NOTE 23

QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

(dollars in millions, except per share amounts)

Quarter Ended	Operating Revenues	Operating Income (Loss)	Income (Loss) Before Discontinued Operations and Cumulative Effect of Accounting Change			Net Income (Loss)
			Amount	Per Share-Basic	Per Share-Diluted	
2003						
March 31	**$ 16,490**	**$ 3,707**	**$ 1,910**	**$ .70**	**$ .69**	**$ 2,406**
June 30[a]	**16,829**	**2,730**	**1,266**	**.46**	**.46**	**338**
September 30	**17,155**	**3,205**	**1,791**	**.65**	**.64**	**1,791**
December 31[b]	**17,278**	**(2,148)**	**(1,458)**	**(.53)**	**(.53)**	**(1,458)**
2002						
March 31[c]	$ 16,285	$ 3,512	$ 6	$ –	$ –	$ (501)
June 30[d]	16,752	2,686	(2,077)	(.76)	(.76)	(2,115)
September 30[e]	17,113	6,014	4,415	1.62	1.61	4,405
December 31[f]	17,154	2,792	2,317	.85	.84	2,290

(a) Results of operations for the second quarter of 2003 include a $436 million after-tax charge for severance and related pension settlement benefits.

(b) Results of operations for the fourth quarter of 2003 include a $2,882 million after-tax charge for severance and related pension settlement benefits.

(c) Results of operations for the first quarter of 2002 include a $2,026 million after-tax loss on investments.

(d) Results of operations for the second quarter of 2002 include a $3,305 million after-tax loss on investments and a $475 million after-tax charge for severance and related pension settlement benefits.

(e) Results of operations for the third quarter of 2002 include a $1,550 million after-tax gain on the sale of non-strategic access lines and tax benefits of $983 million related to current and prior year investment losses.

(f) Results of operations for the fourth quarter of 2002 include tax benefits of $1,121 million related to current and prior year investment losses, partially offset by an after-tax severance, pension and benefits charge of $604 million.

Income (loss) before discontinued operations and cumulative effect of accounting change per common share is computed independently for each quarter and the sum of the quarters may not equal the annual amount.

board of directors*

James R. Barker
Chairman
Interlake Steamship Co.
and *Vice Chairman*
Mormac Marine Group, Inc. and
Moran Towing Corporation

Richard L. Carrión
Chairman, President and
Chief Executive Officer
Popular, Inc.
and *Chairman, President and*
Chief Executive Officer
Banco Popular de Puerto Rico

Robert W. Lane
Chairman and Chief Executive Officer
Deere & Company

Sandra O. Moose
President
Strategic Advisory Services

Joseph Neubauer
Executive Chairman of the Board
ARAMARK Corporation

Thomas H. O'Brien
Retired Chairman and Chief Executive Officer
The PNC Financial Services Group, Inc.
and PNC Bank, N.A.

Hugh B. Price
Senior Advisor
Piper Rudnick LLP

Ivan G. Seidenberg
Chairman and
Chief Executive Officer
Verizon Communications Inc.

Walter V. Shipley
Retired Chairman of the Board
The Chase Manhattan Corporation

John R. Stafford
Consultant
Retired Chairman of the Board
Wyeth

Robert D. Storey
Partner
Thompson Hine LLP

corporate officers

Ivan G. Seidenberg
Chairman and
Chief Executive Officer

Lawrence T. Babbio, Jr.
Vice Chairman and President -
Domestic Telecom

Dennis F. Strigl
Executive Vice President and President
and Chief Executive Officer -
Verizon Wireless

Doreen A. Toben
Executive Vice President and
Chief Financial Officer

William P. Barr
Executive Vice President and
General Counsel

Mary Beth Bardin
Executive Vice President -
Public Affairs and Communications

Marc C. Reed**
Executive Vice President -
Human Resources

David H. Benson
Senior Vice President and Controller

John W. Diercksen
Senior Vice President -
Strategy, Development and Planning

Marianne Drost
Senior Vice President, Deputy General
Counsel and Corporate Secretary

William F. Heitmann
Senior Vice President and Treasurer

Joleen D. Moden
Senior Vice President - Internal Auditing

Thomas A. Bartlett
Senior Vice President - Investor Relations

Thomas J. Tauke
Senior Vice President -
Public Policy and External Affairs

executive leadership

Katherine J. Harless
President - Information Services

Robert E. Ingalls
President - Retail Markets Group

Shaygan Kheradpir
Chief Information Officer -
Domestic Telecom

John F. Killian
Senior Vice President and CFO -
Domestic Telecom

Paul A. Lacouture
President - Network Services

Richard J. Lynch
Chief Technical Officer
Verizon Wireless

Lowell C. McAdam
Chief Operating Officer
Verizon Wireless

Eduardo R. Menascé
President - Enterprise Solutions

Daniel C. Petri
President - International

Virginia P. Ruesterholz
President - Wholesale Markets

John M. Bell**
Senior Vice President - Human Resources
Domestic Telecom

* Directors standing for election at the April 2004 Annual Meeting

** Effective April 1, 2004

Investor information

Registered Shareowner Services

Questions or requests for assistance regarding changes to or transfers of your registered stock ownership should be directed to our transfer agent, EquiServe Trust Company, N.A. at:

Verizon Communications Shareowner Services
c/o EquiServe
P.O. Box 43005
Providence, RI 02940-3005
Phone: 800 631-2355
Website: www.equiserve.com
Email: verizon@equiserve.com

Persons outside the U.S. may call: 816 843-4284

Persons using a telecommunications device for the deaf (TDD) may call: 800 524-9955

Online Account Access – Registered shareowners can view account information online at: www.verizon.equiserve.com

You will need your account number, a password and taxpayer identification number to enroll. For more information, contact EquiServe.

Electronic Delivery of Proxy Materials – Registered shareowners can receive their Annual Report, Proxy Statement and Proxy Card online, instead of receiving printed materials by mail. Enroll at www.econsent.com/vz

Direct Dividend Deposit Service – Verizon offers an electronic funds transfer service to registered shareowners wishing to deposit dividends directly into savings or checking accounts on dividend payment dates. For more information, contact EquiServe.

Direct Invest Stock Purchase and Ownership Plan – Verizon offers a direct stock purchase and share ownership plan. The plan allows current and new investors to purchase common stock and to reinvest the dividends toward the purchase of additional shares. To receive a Plan Prospectus and enrollment form, contact EquiServe or visit their website.

Corporate Governance

Verizon's Corporate Governance Guidelines are available through the Corporate Governance link on our website – www.verizon.com/investor

If you would prefer to receive a printed copy in the mail, please contact the Assistant Corporate Secretary:

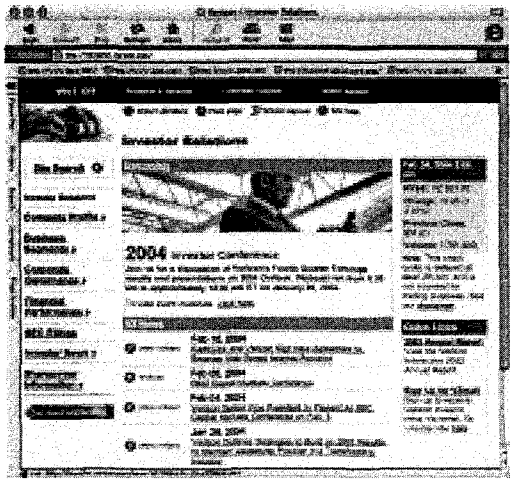
Verizon Communications Inc.
Assistant Corporate Secretary
1095 Avenue of the Americas – Room 3883
New York, NY 10036

Equal Opportunity Policy

The company maintains a long-standing commitment to equal opportunity and valuing the diversity of its employees, suppliers and customers. Verizon is fully committed to a workplace free from discrimination and harassment for all persons, without regard to race, color, religion, age, gender, national origin, sexual orientation, marital status, citizenship status, veteran status, disability or other protected classifications.

Investor Services

Investor Website – Get company information and news on our website – www.verizon.com/investor



VZ Mail – Get the latest investor information delivered directly to your computer desktop. Subscribe to VZ mail at our investor information website.

Stock Market Information

Shareowners of record at December 31, 2003: 1,064,000

Verizon is listed on the New York Stock Exchange (ticker symbol: VZ)

Also listed on the Philadelphia, Boston, Chicago, Pacific, London, Swiss, Amsterdam and Frankfurt exchanges.

Common Stock Price and Dividend Information

	Market Price		Cash Dividend
	High	Low	Declared
2003			
First Quarter	**$ 44.31**	**$ 32.06**	**$ 0.385**
Second Quarter	**41.35**	**32.80**	**0.385**
Third Quarter	**40.25**	**32.05**	**0.385**
Fourth Quarter	**35.25**	**31.10**	**0.385**
2002			
First Quarter	$ 51.09	$ 43.02	$ 0.385
Second Quarter	46.01	36.50	0.385
Third Quarter	40.20	26.01	0.385
Fourth Quarter	43.20	27.50	0.385

Form 10-K

To receive a copy of the 2003 Verizon Annual Report on Form 10-K, which is filed with the Securities and Exchange Commission, contact Investor Relations:

Verizon Communications Inc.
Investor Relations
1095 Avenue of the Americas
36th Floor
New York, NY 10036
Phone: 212 395-1525
Fax: 212 921-2917

Verizon Communications Inc.
1095 Avenue of the Americas
New York, New York 10036
212 395-2121

Make progress every day

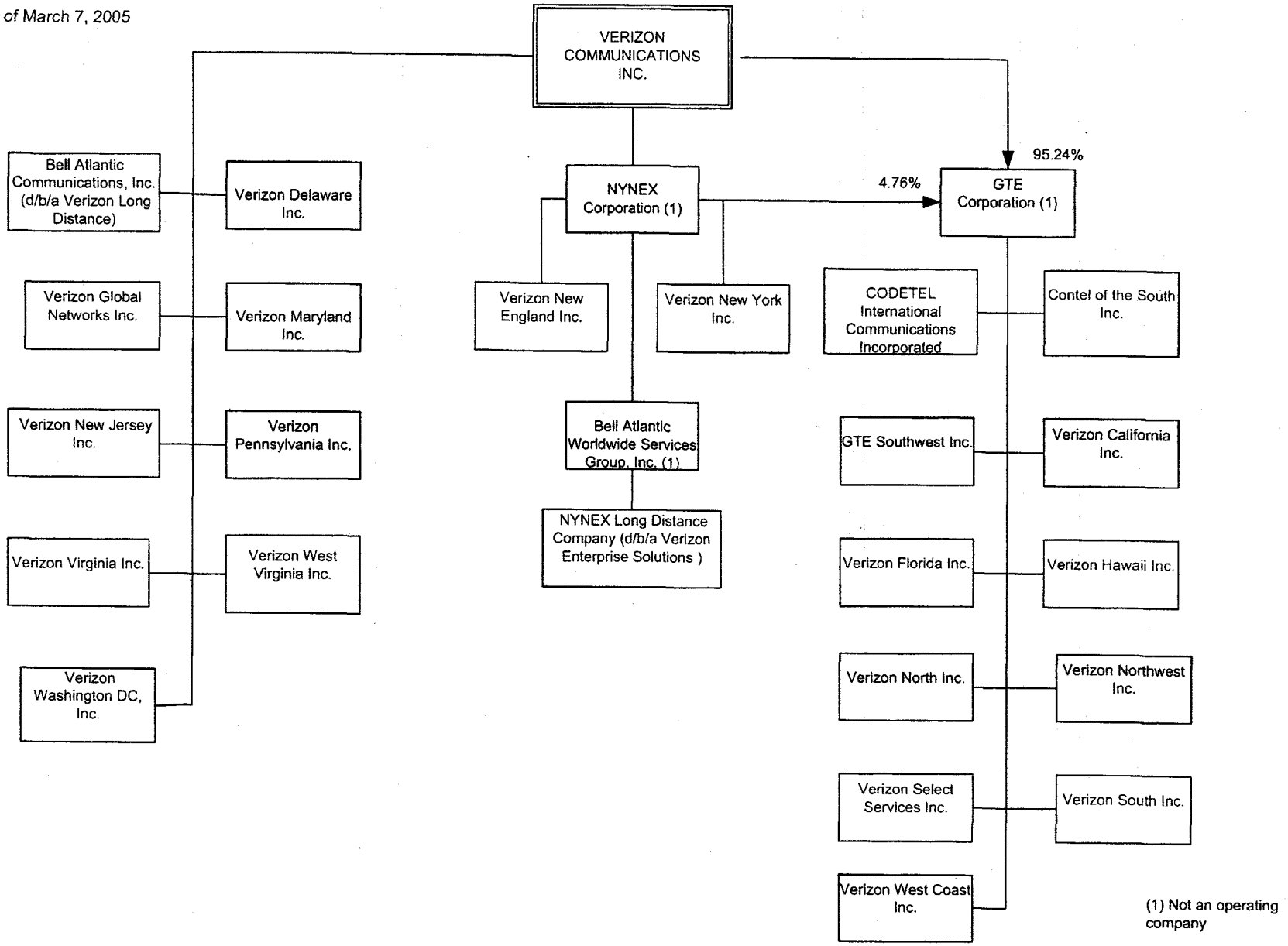
verizon.com

©2004. Verizon. All Rights Reserved.

Printed on recycled paper

EXHIBIT 8

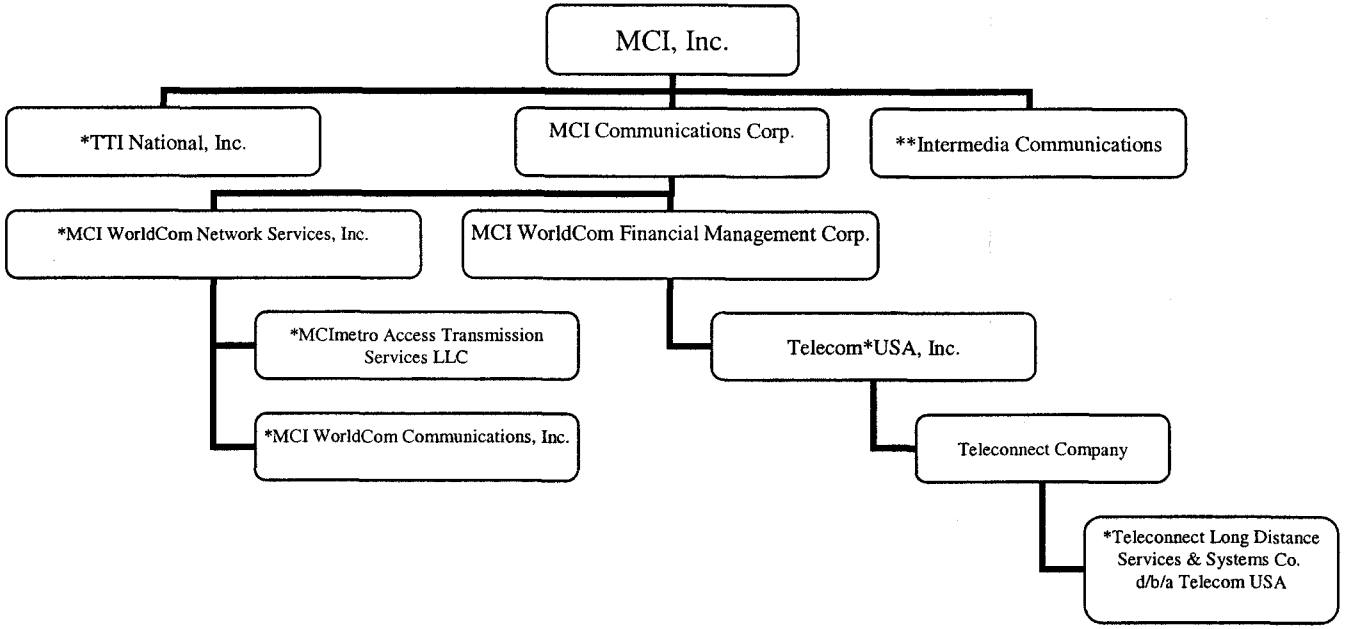
as of March 7, 2005



(1) Not an operating company

EXHIBIT 9

ARIZONA



*Denotes entities regulated by commission

**Application pending to cancel certificate held by Intermedia Communications