

**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,  
2006

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**  
(State of incorporation)

**23-2259884**  
(I.R.S. Employer Identification No.)

**140 West Street**  
**New York, New York**  
(Address of principal executive offices)

**10007**  
(Zip Code)

**Registrant's telephone number, including area code: (212) 395-1000**

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

| <u>Title of each class</u>    | <u>Name of each exchange on which registered</u>   |
|-------------------------------|--|
| Common Stock, \$.10 par value | New York, Philadelphia, Boston, Chicago, London,<br>Swiss, Amsterdam and Frankfurt Stock Exchanges |

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

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 (Section 229.405 of this chapter) 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 a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

At June 30, 2006, the aggregate market value of the registrant's voting stock held by nonaffiliates was approximately \$93,436,462,000.

At January 31, 2007, 2,909,893,627 shares of the registrant's Common Stock were outstanding, after deducting 57,758,811 shares held in treasury.

Documents incorporated by reference:

Portions of the registrant's Annual Report to Shareowners for the year ended December 31, 2006 (Parts I and II).

Portions of the registrant's Proxy Statement prepared in connection with the 2007 Annual Meeting of Shareowners (Part III).

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Unless otherwise indicated, all information is as of February 23, 2007

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**PART I**

*Item 1. Business*

**General**

Verizon Communications Inc. (Verizon) is one of the world's leading providers of communications services. Our Wireline business provides telephone services, including voice, network access and nationwide long-distance services, broadband video and data services, and other communications products and services. Our wireline business also owns and operates one of the most expansive end-to-end global Internet Protocol (IP) networks. Our domestic wireless business, operating as Verizon Wireless, provides wireless voice and data products and services across the United States using one of the most extensive domestic wireless networks. Stressing diversity and commitment to the communities in which we operate, we have a highly diverse workforce of 242,000 employees.

Verizon, formerly known as Bell Atlantic Corporation, was incorporated in 1983 under the laws of the State of Delaware. We began doing business as Verizon Communications on June 30, 2000 following our merger with GTE Corporation. We completed our merger with MCI on January 6, 2006, and have incorporated its operations into our wireline business.

Our principal executive offices are located at 140 West Street, New York, New York 10007 (telephone number 212-395-1000).

We have two reportable segments, Wireline and Domestic Wireless, 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:

|                          |   |
|--------------------------|---|
| <b>Wireline</b>          | Wireline provides communications services including voice, broadband video and data, next generation IP network services, network access, long distance and other services to consumers, carriers, business and government customers both domestically and globally in 150 countries. |
| <b>Domestic Wireless</b> | Domestic Wireless products and services include wireless voice and data products and other value added services and equipment sales across the United States.   |

You can find additional business information under the heading "Overview" on pages 18 through 19 and segment financial information under the heading "Segment Results of Operations" on pages 24 through 27 and in Note 17 on pages 69 through 71 of the 2006 Verizon Annual Report to Shareowners, which is incorporated herein by reference.

**Wireline**

**Background**

Our Wireline segment, which includes the operations of the former MCI, is comprised of two strategic units, Verizon Telecom and Verizon Business. Revenues in 2006 were \$50,794 million, representing approximately 58% of Verizon's aggregate revenues. Verizon Telecom provides local telecommunications, broadband data and video services in 28 states and Washington, D.C., as well as nationwide long-distance and other communications products and services. Verizon is deploying a fiber-to-the-premises network under the FiOS service mark, that we believe is the platform of the future for digital voice, data and video services with sufficient bandwidth and capabilities to meet our customers needs for the foreseeable future. FiOS allows us to offer our customers fast, reliable broadband access speeds, as well as robust video services. The Wireline segment also includes Verizon Business, a provider of next-generation IP network and Information Technology (IT) products and services to medium and large businesses and government customers.

**Operations**

*Verizon Telecom*

Verizon Telecom consists of three lines of business which operate across our telephone subsidiaries and focus on specific customer market areas. We are not dependent on any single customer. Our telephone operations remain responsible within their respective service areas for the provision of telephone services and regulatory matters.

Our *Mass Markets* line of business markets communications and information services to residential customers and small businesses including basic telecommunication service and end-user access; value-added services such as voicemail, caller ID and call forwarding; and broadband services, which include digital subscriber lines (DSL) and fiber optics to the premise (FiOS data and FiOS television 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. Mass Market revenues in 2006 were approximately \$22,528 million, representing approximately 44% of Wireline's aggregate revenues. These revenues were derived primarily from the provision of telecommunication services to residential users.

Our *Wholesale* line of business markets our long distance and local exchange network facilities for resale to other long distance and competing communications carriers. Wholesale services include switched access, special access, high-capacity, high-speed digital services, unbundled network elements (UNE's) and interconnection revenues from competitive local exchange carriers (CLEC) and wireless carriers. Wholesale revenues in 2006 were approximately \$8,323 million, representing approximately 16% of Wireline's aggregate revenues. Approximately 70% of total Wholesale revenues were derived from interexchange carriers. The remaining revenues principally come from other local exchange carriers, which resell network connections to their own customers.

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*Other* services include operator services (including deaf relay services), public (coin) telephone, as well as former MCI dial around services including 10-10-987, 10-10-220, 1-800-COLLECT and Prepaid phone cards. Other revenues in 2006 were approximately \$2,408 million, representing approximately 5% of Wireline's aggregate revenues.

***Verizon Business***

Verizon Business consists of three lines of business which focus on the needs of our enterprise business customers. We are not dependent on any single customer.

Our *Enterprise Business* line of business markets voice, data and internet communications services to medium and large business customers, multi-national corporations, and state and federal governments. The Enterprise Business also provides value-added services that make communications more secure, reliable and efficient, as well as managed network services that enable customers to outsource all or a portion of their communications and information processing operations. In addition, Enterprise Business provides traditional data services in specific markets, such as Private Line, Frame Relay and ATM services, as well as advanced IP network services, both domestically and internationally. Enterprise Business's fastest growing product line is the Internet suite of products that include Private IP, IP VPN, Web Hosting and Voice over Internet Protocol (VoIP). Enterprise Business revenues in 2006 were approximately \$13,999 million, representing approximately 28% of Wireline's aggregate revenues.

Our *Wholesale* line of business focuses on the domestic wholesale services markets, which includes all wholesale traffic in the United States, as well as traffic that originates in the United States and terminates in a different country. Total Wholesale revenue was approximately \$3,381 million in 2006, representing approximately 7% of Wireline's aggregate revenues. Revenues from Wholesale local and long distance voice products, including transport, were approximately \$1,601 million in 2006, representing 47% of Wholesale's aggregate revenues. Wholesale revenue is influenced by aggressive competitive pricing, in particular long distance voice services. Revenues from Wholesale data and internet products were approximately \$1,780 million in 2006, representing approximately 53% of Wholesale's aggregate revenues.

Our *International and Other* operations serve businesses, government entities and telecommunication carriers outside of the United States and include our Skytel paging business. The International and Other market represents a new revenue stream to Verizon resulting from the MCI acquisition. Our revenues from International and Other were approximately \$3,110 million, representing approximately 6% of Wireline's aggregate revenues in 2006. Of this amount, International and Other had voice revenue of approximately \$1,822 million representing approximately 4% of Wireline's aggregate revenues.

**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 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. Current and potential competitors in telecommunication services include cable companies, wireless service providers, long distance companies, other local telephone companies, 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.

***Cable Services***

Cable competitors have aggressively increased the size and digital capacity of their cable networks. Cable companies have continued to upgrade their networks to offer more digital products and services. They continue to aggressively market competitive bundled offerings that include high-speed internet access, digital television and voice services.

***Voice over Internet Protocol Services***

Our wireline telecommunications services also face increasing competition from companies which provide 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. As a result, more consumers are substituting wireless services for basic wireline service. Wireless telephone services can also be used for data transmission.

***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 Telecommunications Act of 1996 has significantly increased the level of competition in our local exchange markets.

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As a result of the Telecommunications Act of 1996, which required us to permit potential competitors to purchase our services for resale, or access components of our network on an unbundled basis (UNEs) at a prescribed cost, competition in our local exchange markets continues to increase. Our telephone operations generally have been required to sell their services to CLECs at significant discounts from the prices our telephone operations charge their retail customers. The scope of these obligations going forward and the rates we receive, are subject to ongoing review and revision by the Federal Communications Commission (FCC) and state regulators. See “Regulatory and Competitive Trends.”

*Long Distance Services*

We offer long distance services regionally and throughout the United States. State regulatory commissions rather than federal authorities generally regulate regional long distance services. Federal regulators have jurisdiction over interstate long distance services. All of our state regulatory commissions (except in Washington, D.C., where regional long distance is not provided) permit other carriers to provide long distance services within the state. 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.

*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.

*Equipment Manufacturers*

In addition to producing telecommunications products and computer network devices and systems, equipment manufacturers may also provide consulting and outsourcing services that compete directly with products and services we offer.

*International Competition*

Our international business competes 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.

**Network**

Verizon Telecom presently serves a territory of 45.1 million access lines in 28 states and Washington D.C. We continue to upgrade our network in order to provide an ever increasing number of customers with broadband capabilities. Our advanced FiOS network uses state of the art fiber-optic cable and optical electronics to directly link homes and businesses to our network. Our fiber network will offer us the opportunity to provide our customers with improved network reliability and speed for voice, data and video connections. As of the end of 2006, our FiOS network passed more than 6 million homes, doubling the amounts of premises passed from the previous year.

Verizon Business owns and operates one of the most expansive IP backbone networks in the world. The Verizon Business data network includes more than 446,000 route miles, including terrestrial and undersea cable, spanning six continents and access to another 187,000 route miles from Verizon Telecom. Verizon Business provides voice, data and Internet services on its state-of-the-art fiber-optic network to customers in more than 2,700 cities and 150 countries. Verizon Business currently operates eight satellite facilities located throughout the United States and Guam. Verizon Business also operates satellite links to more than 200 teleports worldwide in approximately 110 countries for both government and business customers.

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### **Wireline Offerings**

Verizon Telecom provides a broad array of communications services to our residential and small business customers, including voice, broadband data and video, network access, long-distance and other communications products and services.

- Voice services include the provision of local exchange services, local private line, wire maintenance, voice messaging and value-added services. Value-added services are a family of services that expand the utilization of our network, including products such as Caller ID, Call Waiting and Return Call.
- Broadband data and video services include DSL and FiOS high speed data and FiOS TV services.
- Network access services are provided to end-user customers and long distance and other competing carriers who use our local exchange facilities to provide usage services to their customers.
- Long-distance services include regional toll and long distance voice and data services.
- Other communications products and services include operator services (including deaf relay services), public (coin) telephone, as well as former MCI dial around services including 10-10-987, 10-10-220, 1-800 COLLECT and Prepaid phone cards.

## **Domestic Wireless**

### **Background**

Our Domestic Wireless segment, Cellco Partnership doing business as Verizon Wireless (Verizon Wireless), is a joint venture formed in April 2000 by the combination of the U.S. wireless operations and interests of Verizon and Vodafone Group Plc (Vodafone). Verizon owns a controlling 55% interest in Verizon Wireless and Vodafone owns the remaining 45%.

### **Operations**

Verizon Wireless provides wireless voice and data services across one of the most extensive wireless networks in the U.S. Verizon Wireless is the largest domestic wireless carrier in terms of total revenue and the most profitable, as measured by operating income. We believe, based on publicly available information, that Verizon Wireless has the largest base of retail customers, that is, customers who are directly served and managed by Verizon Wireless and who buy its branded services.

### **Competition**

There is substantial competition in the wireless telecommunications industry. Other wireless providers, including other cellular and PCS operators and resellers, serve each of the markets in which we operate. We currently compete primarily against three other national wireless service providers: AT&T (formerly Cingular), Sprint Nextel and T-Mobile USA. In addition, in many markets we also compete with regional carriers, such as ALLTEL and US Cellular. Competition may increase due to ongoing industry consolidation, if smaller, stand-alone wireless providers transfer licenses to larger, better capitalized and more experienced wireless providers. Resellers, now sometimes referred to as Mobile Virtual Network Operators, who buy bulk wholesale services from facilities-based carriers for resale, provide yet another set of differentiated competitors in the marketplace.

We expect competition for both customers and network usage to intensify as a result of the higher penetration levels that currently exist in the industry, the development and deployment of new technologies, the introduction of new wireless and fixed line products and services, new market entrants, the availability of additional spectrum, both licensed and unlicensed, and regulatory changes. For example, we face increased competition as a result of the use of other high-speed wireless technologies, such as Wi-Fi and WiMAX, which are being deployed or proposed, to meet the growing customer appetite for wireless communications in fixed, nomadic and fully mobile environments. In addition, some cable companies have partnered with wireless carriers, acquired wireless spectrum and are now introducing wireless offerings to their customers. We are also experiencing competition from providers of fixed line VoIP services, which displace in-building usage from cellular/PCS carriers. Additionally, as wireless data proliferates, content is becoming an increasingly significant factor in the appeal of these services. This may give content providers and other participants in the wireless value chain opportunities for increased leverage and/or opportunities to compete for wireless data revenues.

We believe that the following are the most important competitive factors in our industry:

- *Network reliability, capacity and coverage.* Lower prices, improved service quality and new service offerings have led to increased network usage. As a result, the ability to keep pace with network capacity needs and offer highly reliable national coverage through one's own 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 expect to spend significant amounts to expand our capacity and extend our coverage area and maintain and improve the quality of our network. Our

competitors also have these needs and they are using similar means to address them.

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- *Pricing* . Service and equipment pricing is an important area in which wireless carriers compete, as evidenced by recent increases in the marketing of minutes-sharing plans, free mobile-to-mobile calling, and offerings of larger bundles of included minutes at price points, with no roaming or long distance charges. 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.
- *Customer service* . Quality customer service is essential to ensure that we can obtain new customers and retain existing customers. We believe that the quality of our customer service is a key factor in retaining our customers and in attracting both new-to-wireless customers and those customers of other carriers who want to switch their wireless service. Our competitors also recognize the importance of customer service and are also focusing on improving the customer experience.
- *Product Differentiation* . As wireless technologies develop and wireless broadband networks proliferate, continued customer and revenue growth will be increasingly dependent on the development of new and differentiated products and services. We are committed to providing customer solutions through the development and rapid deployment of new and innovative products and services developed both internally and in collaboration with application service providers.
- *Sales and 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 profitability. 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 retail outlets and prepaid replenishment locations, original equipment manufacturers and value-added distributors, as well as various resellers who buy our service on a wholesale basis.

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, new business models, changes in customer preferences, regulatory changes, demographic trends, economic conditions, and pricing strategies of competitors.

## **Network**

A key part of our business strategy is to provide the highest network reliability. We believe that network reliability is a key differentiator in the U.S. market and a driver of customer satisfaction. Consistent with this strategy, we will continue to build-out, expand and upgrade our network in an effort to provide sufficient capacity and seamless and superior coverage and reliability throughout our licensed area so that our customers can enjoy consistent features and high-quality service, regardless of location. In addition, we will continue to explore strategic opportunities to expand our overall national coverage through selective acquisitions of wireless operations and spectrum licenses.

Our network is among the largest in the U.S., with licensed and operational coverage in 49 of the 50 largest metropolitan areas. Our built network covered a population of approximately 256 million and provided service to 59.1 million customers, as of December 31, 2006.

## **Network Technology**

Our primary network technology platform is CDMA, based on spread-spectrum digital radio technology. CDMA technology's compatible 1XRTT upgrade, a wireless technology developed by Qualcomm as part of its family of technologies known as CDMA2000, is presently deployed in virtually all of our cell sites nationwide. 1XRTT increases the voice traffic capacity available to us and provides increased data rates. Further, 1XRTT is a modular infrastructure upgrade that has proven to be cost-efficient and practical for rapid nationwide deployment. In addition to 1XRTT, in 2004 we began deploying EV-DO (Revision 0), a 3G packet-based technology that is a part of the CDMA2000 technology path. EV-DO is intended primarily for high-speed data transmission. As with 1XRTT, we have been able to implement EV-DO by changing and/or adding modular components and software in our network. EV-DO service, branded and marketed as BroadbandAccess, was available in markets covering a population of approximately 200 million as of December 31, 2006. Coverage expansions and additional market launches are planned for 2007. In addition, during 2006, we began deploying EV-DO (Revision A) infrastructure that will enable faster data rates.

## **Spectrum**

We have licenses to provide mobile wireless services on the 800-900 MHz and 1800 -1900 MHz portions of the radio spectrum. In addition, we recently acquired Advanced Wireless Services spectrum on the 1700 and 2100 MHz portions of the radio spectrum, which we anticipate using for advanced wireless broadband services. Collectively, these licenses cover territories in which approximately 292 million people, or approximately 99% of the estimated U.S. population, reside. The 800-900 MHz portion is used to provide both analog and digital cellular voice and data services, while our 1800-1900 MHz portion provides all-digital PCS voice and data services. Our digital wireless service is available to all of the population to which we provide coverage. Digital usage currently accounts for more than 99% of our busy-hour traffic. While we provide digital coverage in all of our markets, we will continue to simultaneously provide analog coverage in our cellular markets. The FCC will no longer require cellular carriers to provide analog cellular service as of February 18, 2008, and our intent is to no longer offer such service after that date.

**Recent Acquisitions**

On November 29, 2006, we were granted thirteen 20 MHz licenses we won in an FCC auction of Advanced Wireless Services spectrum that concluded on September 18, 2006, for which we had bid a total of \$2,809 million. These licenses, which we anticipate using for the provision

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of advanced wireless broadband services, cover a population of nearly 200 million. We have made all required payments to the FCC for these licenses.

In August 2002, Verizon Wireless and Price Communications Corp. (Price) combined Price's wireless business with a portion of Verizon Wireless. The resulting limited partnership, Verizon Wireless of the East LP (VZ East), is controlled and managed by Verizon Wireless. In exchange for its contributed assets, Price received a limited partnership interest in the new partnership which was exchangeable into the common stock of Verizon Wireless if an initial public offering of that stock occurred, or into the common stock of Verizon on the fourth anniversary of the asset contribution date. On August 15, 2006, Verizon delivered 29.5 million shares of newly-issued Verizon common stock to Price valued at \$1,007 million in exchange for Price's limited partnership interest in VZ East. As a result of acquiring Price's limited partnership interest, Verizon recorded goodwill of \$345 million in the third quarter of 2006 attributable to its Domestic Wireless segment.

### **Wireless Offerings**

We believe that increasing the value of our service offerings to customers will help us to retain our existing customers, attract new customers and increase customer usage, all of which will, in turn, drive revenue and net income growth.

Our service packages are designed around key customer groups, from the young adult market to multinational business accounts. We tailor our wireless services, which include both voice and data offerings, and postpaid and prepaid pricing options, to the needs of these customers.

#### *Wireless Services*

*Voice services.* We offer a variety of packages for voice services with features and competitive pricing plans that are predominantly offered on a postpaid basis with a contract term. Specifically, we offer our *America's Choice* plans, which provide a choice in amounts of bundled minutes together with no roaming or long distance charges for calls on our preferred network; family/small group and shared minute plans for multiple-user households and small businesses; and plans targeted to business accounts with over 100 lines and national accounts with over 1,000 lines. In addition, we offer a national prepaid product that enables individuals to obtain wireless voice services without a long-term contract by paying in advance.

*Data services.* We believe that we are in a strong position to take advantage of the growing demand for wireless data services. Our strategy is to continue to expand our wireless data, messaging and multi-media offerings for both consumer and business customers.

We offer an array of data transmission and content services, such as:

- *BroadbandAccess/NationalAccess* . EV-DO, our Wide Area Network packet IP solution, which we market as BroadbandAccess, provides significantly increased data transmission rates on existing applications and enables the provisioning of enhanced data applications that can operate at broadband speeds. In addition, our 1XRTT digital technology, which we market as NationalAccess, enables higher-speed applications, such as e-mail, enterprise applications, image downloads, and full browsing capabilities for laptop computer users.
- *Text and Picture Messaging* . With compatible wireless devices, our customers can send and receive text messages, as well as still pictures and full-motion video clips with sound.
- *V CAST* . Our V CAST service, available on EV-DO-enabled handsets, enables customers to access daily-updated videos from leading content providers of current news, weather, sports and entertainment programming. In addition, our V CAST Music service enables customers to download music either directly to their V CAST Music-enabled phones or to their personal computers.
- *Get It Now* . Our *Get It Now* service enables our customers to download hundreds of applications to their handsets, such as ring tones, games and wallpapers .
- *Mobile Web* . Our Mobile Web service offers customized access to content through our portal, and allows customers to access the Internet, e-mail and personal information management tools, such as calendars and address books, through handset-based menus.
- *Location Based Services (LBS)* . Our location-based service, VZ Navigator, enables customers to obtain audible turn-by-turn directions to their destination, locate various points of interest and access other location-related information by using VZ Navigator-capable handsets.
- *Wireless Business Solutions – VZOffice* . Through our suite of *VZOffice* services, we provide enterprise customers solutions for accessing the Internet and corporate intranet, which allow for optimized wireless access to the customer's corporate applications or databases. In addition, we offer our corporate customers the ability to wirelessly send and receive e-mail using various handheld devices, including wirelessly equipped PDA devices.

#### *Wireless Device*

We believe our position in the U.S. wireless industry has enabled us to become a service provider of choice for wireless device manufacturers and has helped us to develop exclusive offers for our customers and branded handsets that complement our focus on high-quality service and an optimal user experience. The wireless devices that we offer are predominantly EV-DO enabled, and all of them are compatible with our 1XRTT

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network. In addition, all of the handsets that we offer are headphone/earphone compatible and, through GPS functionality, compliant with the FCC's E-911 requirements.

**Marketing**

We focus our marketing strategy on targeting solutions based upon our customers' needs, promoting our brand, leveraging our extensive distribution network and cross-marketing with our owners.

Our marketing efforts are focused on a coordinated program of television, print, radio, outdoor signage, Internet and point-of-sale media promotions. We coordinate our marketing efforts throughout our service area in order to ensure that our marketing message is consistently presented across all of our markets. Our promotion of the "Verizon Wireless" brand is complemented by Verizon Communications' own brand marketing efforts, reinforcing the awareness of our services in shared markets and capitalizing on the size and breadth of Verizon Communications' customer base.

*Sales and Distribution Channels*

Our sales strategy is to use a mix of direct, indirect and wholesale distribution channels in order to increase customer growth while reducing customer acquisition costs.

Our company-operated stores are a core component of our distribution strategy. Our experience has been that customers entering through this direct channel are generally higher-value customers who generate higher revenue per month on average and are less likely to cancel their service than those who come through other mass-market channels. We had 2,231 company-operated stores and kiosks (including our "store-within-a-store" kiosks in Circuit City and BJ's Wholesale locations) as of December 31, 2006. In addition, our direct channel also includes our business-to-business organization, which is focused on supporting the needs of our local, regional and national business customers, as well as a telemarketing sales force dedicated to receiving incoming calls. We also offer fully-automated, end-to-end, web-based sales of wireless handsets, accessories and service in all of our markets.

We have indirect retail locations throughout the U.S. selling wireless services, including both full-service locations and locations selling our prepaid products and services, such as Wal-Mart and Target. We also sell wireless access on a wholesale basis. Our wholesale business involves the sale of wholesale access and minutes to independent companies that package and resell wireless services to end-users.

*Customer Service, Retention and Satisfaction*

We believe that quality customer service increases customer satisfaction, which reduces churn, and is a key differentiator in the wireless industry. We are committed to providing high-quality customer service, investing in loyalty and retention efforts and continually monitoring customer satisfaction in all facets of our service.

While our customer service representatives are available during our normal business hours, we also have representatives available 24 hours a day, 7 days a week for emergency and technical customer issues. In addition, customers can do business with us at any time, without having to speak with a customer service representative, through our enhanced self-service applications via our interactive voice response system, through our web site, and via applications accessible from the customer's handset.

Under our enhanced Worry Free Guarantee, a national retention and loyalty initiative, we commit to our customers an extensive and advanced network, responsive customer service with end-to-end resolution, the option to change at any time to any qualifying price plan without payment of any additional fees, a satisfaction guarantee, an early termination fee that declines each full month that a customer remains on their contract and, for customers who do business with us on line, free back-up protection that stores a copy of the customer's phone list on a secure website. The initiative also includes a handset upgrade credit every two years, provided that the customer signs a new two-year contract on a calling plan with at least \$35 monthly access. Another major retention and loyalty program is a customer life cycle management program in which we contact customers at key points in their service tenure with targeted offers and to provide proactive rate-plan analysis.

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**Regulatory and Competitive Trends****Competition and Regulation**

Technological, regulatory and market changes have provided Verizon both new opportunities and challenges. These changes have allowed Verizon to offer new types of services in this increasingly competitive market. At the same time, they have allowed other service providers to broaden the scope of their own competitive offerings. Current and potential competitors for network services include other telephone companies, cable companies, wireless service providers, foreign telecommunications providers, satellite providers, electric utilities, Internet service providers, providers of VoIP services, and other companies that offer network services using a variety of technologies. 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. Many of our competitors also remain subject to fewer regulatory constraints than Verizon.

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.

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### **FCC Regulation**

Our services are subject to the jurisdiction of the FCC with respect to interstate telecommunications services and other matters for which the FCC has jurisdiction under the Communications Act of 1934, as amended (“Communications Act”). The Communications Act generally obligates us not to charge unjust or unreasonable rates nor engage in unreasonable discrimination when we are providing services as a common carrier, and regulates some of the rates, terms and conditions under which we provide certain services. The FCC also has adopted regulations governing various aspects of our business, such as the following: (i) use and disclosure of customer proprietary network information; (ii) telemarketing; (iii) assignment of telephone numbers to customers; (iv) provision to law enforcement agencies of the capability to obtain call identifying information and call content information from calls pursuant to lawful process; (v) accessibility of services and equipment to individuals with disabilities if readily achievable; (vi) interconnection with the networks of other carriers; and (vii) customers’ ability to keep (or “port”) their telephone numbers when switching to another carrier. In addition, we pay various fees to support other FCC programs, such as the universal service program discussed below. Changes to these mandates, or the adoption of additional mandates, could require us to make changes to our operations or otherwise increase our costs of compliance.

#### *Broadband*

The FCC has adopted a series of orders that recognize the competitive nature of the broadband market, and impose lesser regulatory requirements on broadband services and facilities than apply to narrowband. With respect to facilities, the FCC has determined that certain unbundling requirements that apply to narrowband facilities do not apply to broadband facilities such as fiber to the premise loops and packet switches. With respect to services, the FCC has concluded that broadband Internet access services offered by telephone companies and their affiliates qualify as largely deregulated information services. The same order also concluded that telephone companies may offer the underlying broadband transmission services that are used as an input to Internet access services through private carriage arrangements on negotiated commercial terms. In addition, a Verizon petition asking the FCC to forbear from applying common carrier regulation to certain broadband services sold primarily to larger business customers when those services are not used for Internet access was deemed granted by operation of law on March 19, 2006 when the FCC did not deny the petition by the statutory deadline. Both the FCC’s order addressing the appropriate regulatory treatment of broadband Internet access services and the relief obtained through the forbearance petition are the subject of pending appeals.

#### *Video*

The FCC has a body of rules that apply to cable operators under Title VI of the Communications Act, and these rules also generally apply to telephone companies that provide cable services over their networks. In addition, companies that provide cable service over a cable system generally must obtain a local cable franchise. On December 21, 2006, the FCC announced the adoption of rules under Section 621 of the Communications Act to set parameters consistent with federal law, on the timing and scope of franchise negotiations by local franchising authorities.

#### *Interstate Access Charges and Intercarrier Compensation*

The current framework for interstate access rates was established in the Coalition for Affordable Local and Long Distance Services (CALLS) plan, which the FCC adopted on May 31, 2000. The CALLS plan has three main components. First, it establishes portable interstate access universal service support of \$650 million for the industry that replaces implicit support previously 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. Third, the plan set 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. 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 currently is conducting a broad rulemaking proceeding to consider new rules governing intercarrier compensation including, but not limited to, access charges, compensation for Internet traffic, and reciprocal compensation for local traffic. The FCC has sought comments about intercarrier compensation in general, and has requested input on several specific reform proposals.

The FCC also has pending before it issues relating to intercarrier compensation for dial-up Internet-bound traffic. The FCC previously found that this traffic is not subject to reciprocal compensation under Section 251(b)(5) of the Telecommunications Act of 1996. 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 at the same rate as they are required to pay on Internet-bound traffic. 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. The FCC subsequently denied a petition to discontinue the \$.0007 rate cap on this traffic, but removed the caps on the total minutes of Internet-bound traffic subject to compensation. That decision has been upheld on appeal. 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 conducting a rulemaking proceeding to address the regulation of services that use Internet protocol, including whether access charges should apply to voice or other Internet protocol services. The FCC also considered several petitions asking whether, and under what circumstances, services that employ Internet protocol are subject to access charges. The FCC previously has held 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, while a service that utilizes Internet protocol for only one intermediate part of a call's transmission is a telecommunications service that is subject to access charges. Another petition asking the FCC to forbear from applying access charges to voice over Internet protocol services

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that are terminated on switched local exchange networks was withdrawn by the carrier that filed that petition. The FCC also declared the services offered by one provider of a voice over Internet protocol service to be jurisdictionally interstate on the grounds that it was impossible to separate that carrier's Internet protocol service into interstate and intrastate components. The FCC also stated that its conclusion would apply to other services with similar characteristics. That order has been appealed.

The FCC also 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. More than half of special access revenues are now removed from price regulation. The FCC currently has a rulemaking proceeding underway to evaluate experience under its pricing flexibility rules, and to determine whether any changes to those rules are warranted.

### *Universal Service*

The FCC also has a body of rules implementing the universal service provisions of the Telecommunications Act of 1996, including rules governing support to rural and non-rural high-cost areas, support for low income subscribers, and support for schools, libraries and rural health care. The FCC's current rules for support to high-cost areas served by larger "non-rural" local telephone companies were previously remanded by U.S. Court of Appeals for the Tenth Circuit, which had found that the FCC had not adequately justified these rules. The FCC has initiated a rulemaking proceeding in response to the court's remand, but its rules remain in effect pending the results of the rulemaking. The FCC also has proceedings underway to evaluate possible changes to its current rules for assessing contributions to the universal service fund. As an interim step, in June 2006, the FCC ordered that providers of VoIP services are subject to federal universal service obligations. The FCC also increased the percentage of revenues subject to federal universal service obligations that wireless providers may use as a safe harbor. These decisions are the subject of a pending appeal. Any further change in the current assessment mechanism could result in a change in the contribution that local telephone companies, wireless carriers or others must make and that would have to be collected from customers.

### *Unbundling of Network Elements*

Under Section 251 of the Telecommunications Act of 1996, incumbent local exchange carriers were required to provide competing carriers with access to components of their network on an unbundled basis, known as UNEs, where certain statutory standards are satisfied. The Telecommunications Act of 1996 also adopted a cost-based pricing standard for these UNEs, which the FCC interpreted as allowing it to impose a pricing standard known as "total element long run incremental cost" or "TELRIC." The FCC's rules defining the unbundled network elements that must be made available at TELRIC prices have been overturned on multiple occasions by the courts. In its most recent order issued in response to these court decisions, 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. This decision has been upheld on appeal.

As noted above, the FCC has concluded that the requirement under Section 251 of the Telecommunications Act of 1996 to provide unbundled network elements at TELRIC prices generally does not apply with respect to broadband facilities, such as fiber to the premises loops, the packet-switched capabilities of hybrid loops and packet switching. The FCC also has held that any separate unbundling obligations that may be imposed by Section 271 of the Telecommunications Act of 1996 do not apply to these same facilities. The decision with respect to Section 271 has been upheld on appeal and a petition for rehearing of that appellate order was denied.

### *Wireless Services*

The FCC regulates the licensing, construction, operation, acquisition and transfer of wireless communications systems, including the systems that Verizon Wireless operates, pursuant to the Communications Act, other legislation, and the FCC's rules. The FCC and Congress continuously consider changes to these laws and rules. Adoption of new laws or rules may raise the cost of providing service or require modification of Verizon Wireless' business plans or operations.

To use the radio frequency spectrum, wireless communications systems must be licensed by the FCC to operate the wireless network and mobile devices in assigned spectrum segments. Verizon Wireless holds FCC licenses to operate in several different radio services, including the cellular radiotelephone service, personal communications service, advanced wireless service, and point-to-point radio service. The technical and service rules, the specific radio frequencies and amounts of spectrum we hold, and the sizes of the geographic areas we are authorized to operate in, vary for each of these services. However, all of the licenses Verizon Wireless holds allow it to use spectrum to provide a wide range of mobile and fixed communications services, including both voice and data services, and Verizon Wireless operates a seamless network that utilizes those licenses to provide services to customers. Because the FCC issues licenses for only a fixed time, generally 10 years, Verizon Wireless must periodically seek renewal of those licenses. Although the FCC has routinely renewed all of Verizon Wireless' licenses that have

come up for renewal to date, challenges could be brought against the licenses in the future. If a wireless license were revoked or not renewed upon expiration, Verizon Wireless would not be permitted to provide services on the licensed spectrum in the area covered by that license.

The FCC has also imposed specific mandates on carriers that operate wireless communications systems, which increase Verizon Wireless' costs. These mandates include requirements that Verizon Wireless: (i) meet specific construction and geographic coverage requirements during the license term; (ii) meet technical operating standards that, among other things, limit the radio frequency radiation from mobile devices and antennas; (iii) deploy "Enhanced 911" wireless services that provide the wireless caller's number, location and other information upon request by a state or local public safety agency that handles 911 calls; and (iv) comply with regulations for the construction of transmitters and towers that, among other things, restrict siting of towers in environmentally sensitive locations and in places where the towers would affect a site listed

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or eligible for listing on the National Register of Historic Places. Changes to these mandates could require Verizon Wireless to make changes to operations or increase its costs of compliance.

The Communications Act imposes restrictions on foreign ownership of U.S. wireless systems. The FCC has approved the interest that Vodafone Group Plc holds, through various of its subsidiaries, in Verizon Wireless. The FCC may need to approve any increase in Vodafone's interest or the acquisition of an ownership interest by other foreign entities. In addition, as part of the FCC's approval of Vodafone's ownership interest, Verizon Wireless, Verizon and Vodafone entered into an agreement with the U.S. Department of Defense, Department of Justice and Federal Bureau of Investigation which imposes national security and law enforcement-related obligations on the ways in which Verizon Wireless stores information and otherwise conducts its business.

Verizon Wireless anticipates that it will need additional spectrum to meet future demand. It can meet spectrum needs by purchasing licenses or leasing spectrum from other licensees, or by acquiring new spectrum licenses from the FCC. Under the Communications Act, before Verizon Wireless can acquire a license from another licensee in order to expand its coverage or its spectrum capacity in a particular area, it must file an application with the FCC, and the FCC can grant the application only after a period for public notice and comment. This review process can delay acquisition of spectrum needed to expand services. The Communications Act also requires the FCC to award new licenses for most commercial wireless services through a competitive bidding process in which spectrum is awarded to bidders in an auction. Verizon Wireless has participated in spectrum auctions to acquire licenses in the personal communication service and most recently the advanced wireless service. However, the timing of future auctions, and the spectrum being sold, may not match Verizon Wireless' needs, and the company may not be able to secure the spectrum in the auction.

The FCC is also conducting several proceedings to explore whether and how to use spectrum more intensively by, for example, allowing unlicensed wireless devices to operate in licensed spectrum bands. These proceedings could increase radio interference to Verizon Wireless' operations from other spectrum users, or allow other users to share its spectrum. These changes may adversely impact the ways in which it uses spectrum, the capacity of that spectrum to carry traffic, and the value of that spectrum.

## **State Regulation and Local Approvals**

### *Telephone Operations*

State public utility commissions regulate our telephone operations with respect to certain telecommunications intrastate rates and services and other matters. Our competitive local exchange carrier and long distance operations are generally classified as nondominant and lightly regulated the same as other similarly situated carriers. Our incumbent local exchange operations are generally classified as dominant. These latter operations predominantly are subject to alternative forms of regulation (AFORs) in the various states, although they remain subject to rate of return regulation in a few states. Arizona, Illinois, Nevada, New Hampshire, Oregon and Washington are rate of return regulated with various levels of pricing flexibility for competitive services. California, Connecticut, Delaware, the District of Columbia, Florida, Indiana, Maryland, Michigan, Maine, Massachusetts, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, South Carolina, Texas, Vermont, Virginia, West Virginia and Wisconsin are under AFORs with various levels of pricing flexibility, detariffing, and service quality standards. None of the AFORs include earnings regulation. In Idaho, Verizon has made the election under a recent statutory amendment into a deregulatory regime that phases out all price regulation.

### *Video*

Companies that provide cable service over a cable system are typically subject to state and/or local cable television rules and regulations. As noted above, cable operators generally must obtain a local cable franchise from each local unit of government prior to providing cable service in that local area. Some states have recently enacted legislation that enables cable operators to apply for, and obtain, a single cable franchise at the state, rather than local, level. To date, Verizon has applied for and received state-issued franchises in Indiana, New Jersey and Texas. California has enacted statewide franchise reform legislation, but has not yet finalized implementing rules.

### *Wireless Services*

The rapid growth of the wireless industry has led to an increase in efforts by some state legislatures and state public utility commissions to regulate the industry in ways that may impose additional costs on Verizon Wireless. The Communications Act generally preempts regulation by state and local governments of the entry of, or the rates charged by, wireless carriers. Although a state may petition the FCC to allow it to impose rate regulation, no state has done so. In addition, the Communications Act does not prohibit the states from regulating the other "terms and conditions" of wireless service. While numerous state commissions do not currently have jurisdiction over wireless services, state legislatures may decide to grant them such jurisdiction, and those commissions that already have authority to impose regulations on wireless carriers may adopt new rules.

State efforts to regulate wireless services have included proposals to regulate customer billing, termination of service, trial periods for service, advertising, network outages, the use of handsets while driving, and the provision of emergency or alert services. Over the past several years, only a few states have imposed regulation in one or more of these areas, and in 2006 a federal appellate court struck down one such state

statute, but Verizon Wireless expects these efforts to continue. Some states also impose their own universal service support regimes on wireless and other telecommunications carriers, and other states are considering whether to create such regimes.

Verizon Wireless (as well as AT&T (formerly Cingular) and Sprint-Nextel) is a party to an Assurance of Voluntary Compliance (“AVC”) with 33 State Attorneys General. The AVC, which generally reflected Verizon Wireless’ practices at the time it was entered into in July 2004, obligates the company to disclose certain rates and terms during a sales transaction, to provide maps depicting coverage, and to comply with various requirements regarding advertising, billing, and other practices.

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At the state and local level, wireless facilities are subject to zoning and land use regulation. Under the Communications Act, neither state nor local governments may categorically prohibit the construction of wireless facilities in any community or take actions, such as indefinite moratoria, which have the effect of prohibiting service. Nonetheless, securing state and local government approvals for new tower sites has been and is likely to continue to be a difficult, lengthy and expensive process. Finally, state and local governments continue to impose new or higher fees and taxes on wireless carriers.

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## **Recent Developments**

### **MCI Merger**

On January 6, 2006, Verizon acquired 100% of the outstanding common stock of MCI, Inc. (MCI) for a combination of Verizon common shares and cash. MCI was a global communications company that provided Internet, data and voice communication services to businesses and government entities throughout the world and consumers in the United States.

On April 9, 2005, Verizon entered into a stock purchase agreement with eight entities affiliated with Carlos Slim Helú to purchase 43.4 million shares of MCI common stock for \$25.72 per share in cash plus an additional cash amount of 3% per annum from April 9, 2005, until the closing of the purchase of those shares. The transaction closed on May 17, 2005. The total cash payment was \$1,121 million and the investment was accounted for as a cost investment. No payments were made under a provision that required Verizon to pay an additional amount at the end of one year to the extent that the price of Verizon's common stock exceeded \$35.52 per share. We received a special dividend of \$5.60 per MCI share on these 43.4 million MCI shares, or \$243 million, on October 27, 2005.

Under the terms of the merger agreement, MCI shareholders received .5743 shares of Verizon common stock (\$5,050 million in the aggregate) and cash of \$2.738 (\$779 million in the aggregate) for each of their MCI shares. The merger consideration was equal to \$20.40 per MCI share, excluding the \$5.60 per share special dividend paid by MCI to its shareholders on October 27, 2005. There was no purchase price adjustment.

### **Price Communications**

In August 2002, Verizon Wireless and Price Communications Corp. (Price) combined Price's wireless business with a portion of Verizon Wireless. The resulting limited partnership, Verizon Wireless of the East LP (VZ East), is controlled and managed by Verizon Wireless. In exchange for its contributed assets, Price received a limited partnership interest in the new partnership which was exchangeable into the common stock of Verizon Wireless if an initial public offering of that stock occurred, or into the common stock of Verizon on the fourth anniversary of the asset contribution date. On August 15, 2006, Verizon delivered 29.5 million shares of newly-issued Verizon common stock to Price valued at \$1,007 million in exchange for Price's limited partnership interest in VZ East. As a result of acquiring Price's limited partnership interest, Verizon recorded goodwill of \$345 million in the third quarter of 2006 attributable to its Domestic Wireless segment.

### **Disposition of Businesses and Investments**

*Verizon Dominicana C. por A., Telecomunicaciones de Puerto Rico, Inc., and Compañía Anónima Nacional Teléfonos de Venezuela*

During the second quarter of 2006, we reached definitive agreements to sell our interests in our Caribbean and Latin American telecommunications operations in three separate transactions to América Móvil, S.A. de C.V. (América Móvil), a wireless service provider throughout Latin America, and a company owned jointly by Teléfonos de México, S.A. de C.V. (Telmex) and América Móvil. We agreed to sell our 100 percent indirect interest in Verizon Dominicana C. por A. (Verizon Dominicana) and our 52 percent interest in Telecomunicaciones de Puerto Rico, Inc. (TELPRI) to América Móvil. An entity jointly owned by América Móvil and Telmex agreed to purchase our indirect 28.5 percent interest in Compañía Anónima Nacional Teléfonos de Venezuela (CANTV).

In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," (SFAS No. 144) we have classified the results of operations of Verizon Dominicana and TELPRI as discontinued operations. CANTV continues to be accounted for as an equity method investment.

On December 1, 2006, we closed the sale of Verizon Dominicana. The transaction resulted in net pretax cash proceeds of \$2,042 million, net of a purchase price adjustment of \$373 million. The U.S. taxes that became payable and were recognized at the time the transaction closed exceeded the \$30 million pretax gain resulting in an after-tax loss of \$541 million.

We expect to close the sale of our interest in TELPRI in 2007 subject to the receipt of regulatory approvals and in accordance with the terms of the definitive agreement. We expect that the sale will result in approximately \$900 million in net pretax cash proceeds.

During the second quarter of 2006, we entered into a definitive agreement to sell our indirect 28.5% interest in CANTV to an entity jointly owned by America Movil and Telmex for estimated pretax proceeds of \$677 million. Regulatory authorities in Venezuela never commenced the formal review of that transaction and the related tender offers for the remaining equity securities of CANTV. On February 8, 2007, after

two prior extensions, the parties terminated the stock purchase agreement because the parties mutually concluded that the regulatory approvals would not be granted by the Government.

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In January 2007, the Bolivarian Republic of Venezuela (the Republic) declared its intent to nationalize certain companies, including CANTV. On February 12, 2007, we entered into a Memorandum of Understanding (MOU) with the Republic. The MOU provides that the Republic will offer to purchase all of the equity securities of CANTV through public tender offers in Venezuela and the United States at a price equivalent to \$17.85 per ADS. If the tender offers are completed, the aggregate purchase price for Verizon's shares would be \$572 million. If the 2007 dividend that has been recommended by the CANTV Board is approved by shareholders and paid prior to the closing of the tender offers, this amount will be reduced by the amount of the dividend. Verizon has agreed to tender its shares if the offers are commenced. The Republic has agreed to commence the offers within forty-five days assuming the satisfactory completion of its due diligence investigation of CANTV. The tender offers are subject to certain conditions including that a majority of the outstanding shares are tendered to the Government and receipt of regulatory approvals. Based upon the terms of the MOU and our current investment balance in CANTV, we expect that we will record a loss on our investment in the first quarter of 2007. The ultimate amount of the loss depends on a variety of factors, including the successful completion of the tender offer and the satisfaction of other terms in the MOU.

*Spin-off of Verizon Information Services*

On November 17, 2006 we completed the spin-off of Idearc to shareowners of Verizon. Verizon distributed a dividend of one share of Idearc common stock for every 20 shares of Verizon common stock. Cash was paid for fractional shares. The distribution of Idearc common stock is considered a tax free transaction for us and for our shareowners, except for the cash payments for fractional shares which are generally taxable. Idearc now owns what was the Verizon domestic print and Internet yellow pages directories publishing operations, which had been the principal component of our Information Services segment. This transaction resulted in an increase of nearly \$9 billion in shareowners' equity, as well as a reduction of total debt by more than \$7 billion and we received approximately \$2 billion in cash.

*Telephone Access Lines Spin-off*

On January 16, 2007, we announced a definitive agreement with FairPoint Communications, Inc. (FairPoint) that will result in Verizon establishing a separate entity for its local exchange and related business assets in Maine, New Hampshire and Vermont, spinning off that new entity to Verizon's shareowners, and immediately merging it with and into FairPoint.

Upon the closing of the transaction, Verizon shareowners will own approximately 60 percent of the new company and FairPoint stockholders will own approximately 40 percent. Verizon Communications will not own any shares in FairPoint after the merger. In connection with the merger, Verizon shareowners will receive one share of FairPoint stock for approximately every 55 shares of Verizon stock held as of the record date. Both the spin-off and merger are expected to qualify as tax-free transactions, except to the extent that cash is paid to Verizon shareowners in lieu of fractional shares.

The total value to be received by Verizon and its shareowners in exchange for these operations will be approximately \$2,715 million. Verizon shareowners will receive approximately \$1,015 million of FairPoint common stock in the merger, based upon FairPoint's recent stock price and the terms of the merger agreement. Verizon will receive \$1,700 million in value through a combination of cash distributions to Verizon and debt securities issued to Verizon prior to the spin-off. Verizon may exchange these newly issued debt securities for certain debt that was previously issued by Verizon, which would have the effect of reducing Verizon's then-outstanding debt.

**Redemption of Debt***Debt assumed from MCI merger*

On January 17, 2006, Verizon announced offers to purchase two series of MCI senior notes, MCI \$1,983 million aggregate principal amount of 6.688% Senior Notes Due 2009 and MCI \$1,699 million aggregate principal amount of 7.735% Senior Notes Due 2014, at 101% of their par value. Due to the change in control of MCI that occurred in connection with the merger with Verizon on January 6, 2006, Verizon was required to make this offer to noteholders within 30 days of the closing of the merger of MCI and Verizon. Separately, Verizon notified noteholders that MCI was exercising its right to redeem both series of Senior Notes prior to maturity under the optional redemption procedures provided in the indentures. The 6.688% Notes were redeemed on March 1, 2006, and the 7.735% Notes were redeemed on February 16, 2006.

In addition, on January 20, 2006, Verizon announced an offer to repurchase MCI \$1,983 million aggregate principal amount of 5.908% Senior Notes Due 2007 at 101% of their par value. On February 21, 2006, \$1,804 million of these notes were redeemed by Verizon. Verizon satisfied and discharged the indenture governing this series of notes shortly after the close of the offer for those noteholders who did not accept this offer.

*Zero-Coupon Convertible Notes*

Previously, Verizon Global Funding issued approximately \$5,442 million in principal amount at maturity of zero-coupon convertible notes due 2021 which were callable by Verizon on or after May 15, 2006. On May 15, 2006, we redeemed the remaining \$1,375 million accreted principal of the outstanding zero-coupon convertible notes at a redemption price of \$639.76 per \$1,000 principal plus interest of approximately \$0.5767 per \$1,000 principal. The total payment on the date of redemption was approximately \$1,377 million.

*Other Debt Redemptions/Prepayments*

Other debt redemptions/prepayments included approximately \$697 million of outstanding debt issuances at various rates associated with our operating telephone companies. Original maturity dates ranged from 2010 through 2026.

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On December 15, 2006, Verizon Wireless's six year 5.375% fixed rate note of \$2.5 billion matured. At December 31, 2006, Verizon Wireless had no third-party debt outstanding.

On January 8, 2007, we redeemed the remaining \$1,580 million of the outstanding notes of the Verizon Communications Inc. floating rate notes due 2007.

The gain/(loss) on these redemptions and prepayments were immaterial.

**Issuance of Debt**

In February 2006, Verizon issued \$4,000 million of floating rate and fixed rate notes maturing from 2007 through 2035.

**Spectrum Purchases**

On November 29, 2006, we were granted thirteen 20 MHz licenses we won in an FCC auction of Advanced Wireless Services spectrum that concluded on September 18, 2006, for which we had bid a total of \$2,809 million. These licenses, which we anticipate using for the provision of advanced wireless broadband services, cover a population of nearly 200 million. We have made all required payments to the FCC for these licenses.

**Environmental Matters**

During 2003, under a government-approved plan, remediation commenced at the site of a former Sylvania facility in Hicksville, New York that processed nuclear fuel rods in the 1950s and 1960s. Remediation beyond original expectations proved to be necessary and a reassessment of the anticipated remediation costs was conducted. A reassessment of costs related to remediation efforts at several other former facilities was also undertaken. In September 2005, the Army Corps of Engineers (ACE) accepted the Hicksville site into the Formerly Utilized Sites Remedial Action Program. This may result in the ACE performing some or all of the remediation effort for the Hicksville site with a corresponding decrease in costs to Verizon. To the extent that the ACE assumes responsibility for remedial work at the Hicksville site, an adjustment to a reserve previously established for the remediation may be made. Adjustments may also be made based upon actual conditions discovered during the remediation at any of the sites requiring remediation.

**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 on lower Manhattan. These funds will be distributed through the Lower Manhattan Development Corporation following an application and audit process. As of September 2004, we had applied for reimbursement of approximately \$266 million under Category One, although we did not record this amount as a receivable. We received advances totaling \$88 million in connection with this application process. On December 22, 2004, we applied for reimbursement of an additional \$136 million of Category Two losses, and on March 29, 2005 we amended our application seeking an additional \$3 million. Category Two funding is for permanent restoration and infrastructure improvement. According to the plan, permanent restoration is reimbursed up to 75% of the loss. On November 3, 2005, we received the results of preliminary audit findings disallowing all but \$44 million of our \$266 million of Category One application. On December 8, 2005, we provided a detailed rebuttal to the preliminary audit findings. We received a copy of the final audit report for Verizon's Category One applications and, on January 4, 2007, we filed an appeal of the final audit report. That appeal, as well as our Category Two applications, are pending.

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**Employees**

As of December 31, 2006, Verizon and its subsidiaries had approximately 242,000 employees. Unions represent approximately 40% of our employees.

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**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 Securities and Exchange Commission (SEC). Our website address is [www.verizon.com](http://www.verizon.com). This information is included in "Investor Information" on our website.

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**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:

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- 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, including disruption of our suppliers' provisioning of critical products or services;
- 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;
- 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;
- 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;
- the timing of the closings of the sales of our Latin American and Caribbean properties; and
- the extent and timing of our ability to obtain revenue enhancements and cost savings following our business combination with MCI, Inc.

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**Table of Contents****Item 1A. Risk Factors**

*We face significant competition that may reduce our market share and lower our profits.*

We face significant competition in our industry. The rapid development of new technologies, services and products has eliminated the traditional lines between local, long distance, wireless, cable and Internet communication services and brought new competitors to our markets, including other telephone companies, cable companies, wireless service providers, satellite providers, electric utilities, and providers of VoIP services. While these changes have enabled us to offer new types of services, they have also allowed other service providers to broaden the scope of their own competitive offerings. Our ability to compete successfully will depend on how successfully we anticipate and respond to various competitive factors, including new services that may be introduced by our competitors, changes in consumer preferences, demographic trends and pricing pressures. Because we are subject to more regulation and have higher cost structures than many of our competitors, due in part to the presence of a unionized workforce and a large retiree population in our wireline business, our competitors may be able to offer services at lower prices. The resulting pressure on the price of services provided by us may result in reduced revenues and reduction of profits. In addition, while the workforce of our wireless business is almost entirely non-union, we cannot predict what level of success unions may have in organizing this workforce or the potentially negative impact of such labor organizing on our costs.

*Unless we are able to take advantage of technological developments in the telecommunications industry on a timely basis, we may experience a decline in a demand for our services or may be unable to implement our business strategy.*

Our industry is experiencing rapid change as new technologies are developed that offer consumers an array of choices for their communications needs. In order to grow and remain competitive, we will need to adapt to future changes in technology, to enhance our existing offerings and introduce new offerings to address our customers' changing demands. If we are unable to meet future advances in competing technologies on a timely basis or at an acceptable cost, we could lose customers to our competitors. In general, the development of new services in our industry requires us to anticipate and respond to the varied and continually changing demands of our customers. We may not be able to accurately predict technological trends or the success of new services in the market. In addition, there could be legal or regulatory restraints to our introduction of new services. If these services fail to gain acceptance in the marketplace, or if costs associated with implementation and completion of the introduction of these services materially increase, our ability to retain and attract customers could be adversely affected.

While we believe our primary wireless technology platform, CDMA, and its upgrades offer many advantages, many competing wireless service providers have chosen GSM or other technologies as the technology platforms for their wireless networks. There are risks that current or future versions of the wireless technologies and evolutionary path that we have selected may not be demanded by existing and prospective customers or provide the advantages that we expect. In addition, there are risks that other wireless carriers on whom our customers roam may change their technology to GSM or other technologies that are incompatible with ours. As a result, the ability of our and such other carriers' customers to roam on our respective wireless networks could be adversely affected. If these risks materialize, our ability to provide national wireless service to our customers, to retain and attract customers, and to maintain and grow our customer revenues could be materially adversely affected.

*We depend on key suppliers and vendors to provide equipment that we need to operate our business.*

We also depend upon various key suppliers and vendors to provide us with the equipment that we need to operate our business. If these suppliers or vendors fail to provide equipment or service to us on a timely basis, it could have an adverse impact on our ability to implement our business strategy and, in addition, we might be unable to satisfy the requirements contained in our FCC licenses regarding the construction of our wireless network. These suppliers and vendors may be subject to litigation with respect to technology that we depend on for our service offerings.

*Changes in the regulatory framework under which we operate could adversely affect our business prospects or results of operations.*

Our operations are subject to regulation by the FCC and other federal, state and local agencies. It is impossible to predict with any certainty the outcome of pending federal and state regulatory proceedings relating to our provision of retail or wholesale services, or the reviews by federal or state courts of regulatory rulings. Unless we are able to obtain relief, existing laws and regulations may inhibit our ability to expand our business and introduce new products and services. In addition, the adoption of new laws or regulations or changes to the existing regulatory framework could adversely affect our business plans. For example, the development of new technologies, such as Internet Protocol-based services, including VoIP and super high-speed broadband and video, could be subject to conflicting regulation between the FCC and various state and local authorities, which could significantly increase the cost of implementing and introducing new services based on this technology. In addition, the rapid growth of the wireless industry has led to an increase in efforts by some state legislatures and state public utility commissions to regulate the industry in ways that may impose additional costs on Verizon Wireless. Moreover, many states have also imposed significant taxes on providers in the wireless industry.

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*We are subject to a significant amount of litigation, which could require us to pay significant damages or settlements.*

Our business faces a substantial amount of litigation, including patent infringement lawsuits, antitrust class actions, personal injury claims and lawsuits relating to our advertising, sales, billing and collection practices. In addition, our wireless business also faces personal injury and consumer class action lawsuits relating to alleged health effects of wireless phones or radiofrequency transmitters, and class action lawsuits that challenge marketing practices and disclosures relating to alleged adverse health effects of handheld wireless phones. We may incur significant expenses in defending these lawsuits. In addition, we may be required to pay significant awards or settlements.

### **Item 1B. Unresolved Staff Comments**

None.

### **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 \$204 billion at December 31, 2006 and \$188 billion at December 31, 2005, 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:

|  | 2006          | 2005          |
|--|---------------|---------------|
| Network equipment                      | 80.1%         | 81.2%         |
| Land, buildings and building equipment | 9.9           | 9.1           |
| Furniture and other equipment          | 6.3           | 6.5           |
| Other                                  | 3.7           | 3.2           |
|  | <b>100.0%</b> | <b>100.0%</b> |

Our properties are divided among our operating segments at December 31, as follows:

|                     | 2006          | 2005          |
|---------------------|---------------|---------------|
| Wireline            | 76.7%         | 76.9%         |
| Wireless            | 22.7          | 22.4          |
| Corporate and Other | 0.6           | 0.7           |
|                     | <b>100.0%</b> | <b>100.0%</b> |

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, 2006, 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 Wireline was \$10,259 million in 2006, \$8,267 million in 2005 and \$7,118 million in 2004. Capital spending for Domestic Wireless was \$6,618 million in 2006, \$6,484 million in 2005 and \$5,633 million in 2004. In 2007, Verizon management expects capital expenditures to be in the range of \$17.5 billion to \$17.9 billion.

### **Item 3. Legal Proceedings**

Verizon and a number of other telecommunications companies have been the subject of multiple class action suits concerning its alleged participation in intelligence-gathering activities allegedly carried out by the federal government, at the direction of the President of the United States, as part of the government's post-September 11 program to prevent terrorist attacks. Plaintiffs generally allege that Verizon has

participated by permitting the government to gain access to the content of its subscribers' telephone calls and/or records concerning those calls and that such action violates federal and/or state constitutional and statutory law. Relief sought in the cases includes injunctive relief, attorneys' fees, and statutory and punitive damages. On August 9, 2006, the Judicial Panel on Multidistrict Litigation ("Panel") ordered that these actions be transferred, consolidated and coordinated in the U.S. District Court for the Northern District of California. The Panel subsequently ordered that a number of "tag along" actions also be transferred to the Northern District of California. Verizon has not answered or otherwise responded to any of the complaints. Verizon believes that these lawsuits are without merit.

In the Matter of Certain Baseband Processor Chips and Chipsets, Transmitter and Receiver (Radio) Chips, Power Control Chips, and Products Containing Same, Including Cellular Telephone Handsets, an action brought before the United States International Trade Commission,

## Table of Contents

Broadcom Corporation alleges that certain chips and chipsets manufactured by respondent Qualcomm Corporation infringe three Broadcom patents. Broadcom is currently seeking a ban on the importation of certain devices containing Qualcomm's EV-DO chipsets, but not with respect to data cards, PDAs, smartphones or handheld email devices containing those chips. Verizon Wireless was granted permission to intervene in the proceeding on the issue of remedy but not on the issue of liability. The ITC staff, which is a party to the proceeding, has supported Broadcom's position with respect to liability and remedy. The trial on remedy was completed on July 11, 2006 before an ITC administrative law judge. The Administrative Law Judge issued an initial determination, finding that Qualcomm has infringed one of the three Broadcom patents and recommended that Qualcomm's chipsets should be excluded from importation into the United States. However, the Administrative Law Judge further recommended that Verizon Wireless handsets that incorporate the Qualcomm EV-DO chipsets should not be subject to an exclusion order. Broadcom and the ITC staff requested review of the initial determination by the full ITC. On December 8, 2006, the ITC affirmed in substantial part the Administrative Law Judge's initial determination with respect to liability, determining that Qualcomm infringed one Broadcom patent. The ITC will hold a public hearing on the issues of remedy and the public interest on March 21, 2007. The decision of the full ITC with respect to remedy is expected to be made by May 8, 2007. During a 60-day period following any exclusion order by the ITC, the President of the United States may disapprove the order. Further, ITC exclusion orders are reviewable by the U.S. Court of Appeals for the Federal Circuit. Disruption of the supply of handsets incorporating Qualcomm EV-DO chipsets could have a material adverse effect on the availability of handsets to sell to Verizon Wireless customers and could therefore have a material adverse effect on its business.

### 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      | 60  | Chairman and Chief Executive Officer                                 | 2000       |
| William P. Barr         | 56  | Executive Vice President and General Counsel                         | 2000       |
| Thomas A. Bartlett      | 48  | Senior Vice President and Controller                                 | 2005       |
| John W. Dierksen        | 57  | Executive Vice President – Strategy, Development and Planning        | 2003       |
| Shaygan Kheradpir       | 46  | Executive Vice President and Chief Information Officer               | 2007       |
| John F. Killian         | 52  | President – Verizon Business   | 2006       |
| Lowell C. McAdam        | 52  | President and Chief Executive Officer – Verizon Wireless             | 2007       |
| Marc C. Reed            | 48  | Executive Vice President – Human Resources                           | 2004       |
| Virginia P. Ruesterholz | 45  | President – Verizon Telecom  | 2006       |
| John G. Stratton        | 45  | Executive Vice President and Chief Marketing Officer                 | 2007       |
| Dennis F. Strigl        | 60  | President and Chief Operating Officer                                | 2007       |
| Thomas J. Tauke         | 56  | Executive Vice President – Public Affairs, Policy and Communications | 2004       |
| Doreen A. Toben         | 57  | Executive Vice President and Chief Financial Officer                 | 2002       |
| Catherine T. Webster    | 54  | Senior Vice President and Treasurer                                  | 2005       |

Prior to serving as an executive officer, each of the above officers 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.

Lawrence T. Babbio Jr. (62) served as Vice Chairman and President and as an executive officer through December 31, 2006.

## 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 and Philadelphia stock exchanges. As of December 31, 2006, there were 887,678 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 Declared |
|------|----------------|--------------|----------|------------------------|
|      |                | High         | Low      |                        |
| 2006 | First Quarter  | \$ 33.89     | \$ 28.95 | \$ .405                |
|      | Second Quarter | 33.46        | 29.00    | .405                   |
|      | Third Quarter  | 36.62        | 30.22    | .405                   |

|      |                       |              |              |             |
|------|-----------------------|--------------|--------------|-------------|
|      | <b>Fourth Quarter</b> | <b>37.64</b> | <b>33.99</b> | <b>.405</b> |
| 2005 | First Quarter         | \$ 39.56     | \$ 33.13     | \$ .405     |
|      | Second Quarter        | 34.93        | 32.48        | .405        |
|      | Third Quarter         | 33.70        | 30.50        | .405        |
|      | Fourth Quarter        | 31.59        | 28.07        | .405        |

\* All Verizon prices have been adjusted for the spin-off of Idearc.

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The following table provides information about Verizon's common stock repurchases during the fourth quarter of 2006.

| <b>Period</b> | <b>Total Number of Shares Purchased</b> | <b>Average Price Paid per Share</b> | <b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)</b> | <b>Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (2)</b> |
|---------------|---|-------------------------------------|---|---|
| October       | 3,555,000                               | \$ 37.22                            | 3,555,000   | 56,020,200  |
| November      | 475,000                                 | 37.65                               | 475,000   | 55,545,200  |
| December      | 5,611,600                               | 35.80                               | 5,611,600   | 49,933,600  |
|               | <u>9,641,600</u>                        |                                     | <u>9,641,600</u>  | <u>49,933,600</u>   |

- (1) On January 19, 2006, Verizon's Board of Directors authorized a common stock repurchase program.
- (2) The program authorizes total repurchases of up to 100 million common shares terminating no later than the close of business on February 28, 2008. 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 2006 Verizon Annual Report to Shareowners under the heading "Selected Financial Data" on page 17, which is incorporated herein by reference.

### **Item 7. Management's Discussion and Analysis of Results of Financial Condition and Results of Operations**

Information required by this item is included in the 2006 Verizon Annual Report to Shareowners under the heading "Management's Discussion and Analysis of Results of Operations and Financial Condition" on pages 18 through 39, which is incorporated herein by reference.

### **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

Information required by this item is included in the 2006 Verizon Annual Report to Shareowners under the heading "Market Risk" on page 32, which is incorporated herein by reference.

### **Item 8. Financial Statements and Supplementary Data**

Information required by this item is included in the 2006 Verizon Annual Report to Shareowners on pages 40 through 79, 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, our chief executive officer and chief financial officer have concluded that the registrant's disclosure controls and procedures were effective as of December 31, 2006.

We completed the merger with MCI on January 6, 2006, at which time MCI became a subsidiary of Verizon. The Company has extended its Section 404 compliance program under the Sarbanes-Oxley Act of 2002 and the applicable rules and regulations under such Act to include the merged entity's internal controls over financial reporting.

There were no changes in the registrant's internal control over financial reporting during the fourth quarter of 2006 that have materially affected, or are reasonably likely to materially affect the registrant's 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 2006 Verizon Annual Report to Shareowners on pages 40 through 41 and is incorporated herein by reference.

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**Table of Contents****Item 9B. Other Information**

None.

**PART III****Item 10. Directors, Executive Officers and Corporate Governance 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 sections entitled “Election of Directors,” “Structure and Practices of the Board” and “Section 16(a) Beneficial Ownership Reporting Compliance” in the Proxy Statement for our 2007 Annual Meeting of Shareholders filed pursuant to Regulation 14A, which is incorporated herein by reference.

**Item 11. Executive Compensation**

For information with respect to executive compensation, see the section entitled “Executive Compensation” in the Proxy Statement for our 2007 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 and Related Stockholder Matters**

For information with respect to the security ownership of the Directors and Executive Officers and related stockholder matters, see the section entitled “Security Ownership of Certain Beneficial Owners and Management” in the Proxy Statement for our 2007 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:

| <b>Plan category</b>                                       | <b>Number of securities to be issued upon exercise of outstanding options, warrants and rights</b> | <b>Weighted average exercise price of outstanding options, warrants and rights</b> | <b>Number of securities remaining available for future issuance under equity compensation plans</b> |
|--|--|--|---|
| Equity compensation plans approved by security holders     | 185,110,937  | \$ 47.55   | 128,833,578   |
| Equity compensation plans not approved by security holders | 45,337,060   | 41.90  | 9,900,616*  |
| <b>Total</b>   | <b>230,447,997</b>   | <b>46.44</b>   | <b>138,734,194</b>  |

\* 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, and Director Independence**

For information with respect to certain relationships and related transactions, and director independence, see the “Structure and Practices of the Board” section of the Proxy Statement for our 2007 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 2007 Annual Meeting of Shareholders filed pursuant to Regulation 14A, which is incorporated herein by reference.

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**PART IV**

*Item 15. Exhibits, Financial Statement Schedules*

Documents filed as part of this report:

|   | Page |
|---|------|
| (1) Report of Management on Internal Control Over Financial Reporting   | *    |
| (2) Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting  | *    |
| (3) 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, 2006. (See Part II.) |      |
| (4) Financial Statement Schedule  |      |
| II – Valuation and Qualifying Accounts  | 24   |
| (5) Exhibits  |      |

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**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, 2005).
- 3b Bylaws of Verizon, as amended and restated (Exhibit 3b to Form 10-Q for the period ended September 30, 2006).
- 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 (Exhibit 10a(i) to Form 10-K for the year ended December 31, 2004).
- 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).\*
- 10j(i) Performance Stock Unit Agreement 2003-2005 Award Cycle (Exhibit 10j(i) to Form 10-K for the year ended December 31, 2005).\*
- 10j(ii) Performance Stock Unit Agreement 2004-2006 Award Cycle (Exhibit 10j(ii) to Form 10-K for the year ended December 31, 2005).\*
- 10j(iii) Restricted Stock Unit Agreement 2005-2007 Award Cycle (Exhibit 10a to Form 10-Q for the period ended March 31, 2005).\*
- 10j(iv) Performance Stock Unit Agreement 2005-2007 Award Cycle (Exhibit 10b to Form 10-Q for the period ended March 31, 2005).\*
- 10j(iv)(a) Addendum to Performance Stock Unit Agreement 2005-2007 Award Cycle (Exhibit 10j(iv)(a) to Form 10-K for the year ended December 31, 2005).\*
- 10j(v) Restricted Stock Unit Agreement 2006-2008 Award Cycle (Exhibit 10j(v) to Form 10-K for the year ended December 31, 2005).\*
- 10j(vi) Performance Stock Unit Agreement 2006-2008 Award Cycle (Exhibit 10j(vi) to Form 10-K for the year ended December 31, 2005).\*
- 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).\*
- 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).\*

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|         |   |
|---------|---|
| 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 (Exhibit 10o(i) to Form 10-K for the year ended December 31, 2004).*   |
| 10p     | Verizon Communications Inc. Excess Pension Plan (Exhibit 10p to Form 10-K for the year ended December 31, 2004).*   |
| 10p(i)  | Description of Amendment to Plan (Exhibit 10p(i) to Form 10-K for the year ended December 31, 2004).*   |
| 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).*   |
| 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     | Summary Plan Description of Verizon Executive Deferral Plan (Exhibit 10(v) to Form 10-K for the year ended December 31, 2005).*   |
| 10w     | Description of salary increase for Ivan G. Seidenberg (Exhibit 10w to Form 10-K for the year ended December 31, 2004).*   |
| 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).*   |
| 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 (Exhibit 10dd(i) to Form 10-K for the year ended December 31, 2004).*  |
| 10ee    | Employment Agreement between Verizon 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 (Exhibit 10gg to the Form 10-K for the year ended December 31, 2004).*   |
| 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, 2006. 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.   |

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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.

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**Table of Contents****Schedule II – Valuation and Qualifying Accounts****Verizon Communications Inc. and Subsidiaries**

For the Years Ended December 31, 2006, 2005 and 2004

| Description                                      | Balance at<br>Beginning of<br>Period | Additions              |  | Deductions<br>Note (b) | Balance at End<br>of Period |
|--|--------------------------------------|------------------------|--|------------------------|-----------------------------|
|  |                                      | Charged To<br>Expenses | Charged to<br>Other Accounts<br>Note (a) |                        |                             |
| (dollars in millions)                            |                                      |                        |  |                        |                             |
| Allowance for Uncollectible Accounts Receivable: |                                      |                        |  |                        |                             |
| <b>Year 2006</b>                                 | <b>\$ 1,100</b>                      | <b>\$ 1,034</b>        | <b>\$ 1,627</b>                          | <b>\$ 2,622</b>        | <b>\$ 1,139</b>             |
| Year 2005  | 1,363                                | 1,076                  | 794                                      | 2,133                  | 1,100                       |
| Year 2004  | 2,382                                | 890                    | 1,234                                    | 3,143                  | 1,363                       |
| Valuation Allowance for Deferred Tax Assets:     |                                      |                        |  |                        |                             |
| <b>Year 2006</b>                                 | <b>\$ 815</b>                        | <b>\$ 51</b>           | <b>\$ 2,234</b>                          | <b>\$ 500</b>          | <b>\$ 2,600</b>             |
| Year 2005  | 1,217                                | 46                     | 43                                       | 491                    | 815                         |
| Year 2004  | 1,463                                | 6                      | –  | 252                    | 1,217                       |
| Discontinued Businesses:                         |                                      |                        |  |                        |                             |
| <b>Year 2006</b>                                 | <b>\$ 248</b>                        | <b>\$ –</b>            | <b>\$ –</b>                              | <b>\$ 11</b>           | <b>\$ 237</b>               |
| Year 2005  | 287                                  | 5                      | –  | 44                     | 248                         |
| Year 2004  | 331                                  | 39                     | 15                                       | 98                     | 287                         |

(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. The 2006 amounts charged to other accounts for the allowance for uncollectible accounts receivable and valuation allowance for deferred tax assets were primarily due to the acquisition of MCI.

(b) Amounts written off as uncollectible or transferred to other accounts or utilized.

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**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 1, 2007

By: /s/ Thomas A. Bartlett

\_\_\_\_\_  
Thomas A. Bartlett  
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

Chairman and  
Chief Executive Officer

March 1, 2007

\_\_\_\_\_  
Ivan G. Seidenberg

Principal Financial Officer:

/s/ Doreen A. Toben

Executive Vice President and  
Chief Financial Officer

March 1, 2007

\_\_\_\_\_  
Doreen A. Toben

Principal Accounting Officer:

/s/ Thomas A. Bartlett

Senior Vice President and  
Controller

March 1, 2007

\_\_\_\_\_  
Thomas A. Bartlett

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**Signatures – Continued**

|                               |          |               |
|-------------------------------|----------|---------------|
| /s/ Ivan G. Seidenberg        | Director | March 1, 2007 |
| _____<br>Ivan G. Seidenberg   |          |               |
| /s/ James R. Barker           | Director | March 1, 2007 |
| _____<br>James R. Barker      |          |               |
| /s/ Richard L. Carrión        | Director | March 1, 2007 |
| _____<br>Richard L. Carrión   |          |               |
| /s/ M. Frances Keeth          | Director | March 1, 2007 |
| _____<br>M. Frances Keeth     |          |               |
| /s/ Robert W. Lane            | Director | March 1, 2007 |
| _____<br>Robert W. Lane       |          |               |
| /s/ Sandra O. Moose           | Director | March 1, 2007 |
| _____<br>Sandra O. Moose      |          |               |
| /s/ Joseph Neubauer           | Director | March 1, 2007 |
| _____<br>Joseph Neubauer      |          |               |
| /s/ Donald T. Nicolaisen      | Director | March 1, 2007 |
| _____<br>Donald T. Nicolaisen |          |               |
| /s/ Thomas H. O'Brien         | Director | March 1, 2007 |
| _____<br>Thomas H. O'Brien    |          |               |
| /s/ Clarence Otis, Jr.        | Director | March 1, 2007 |
| _____<br>Clarence Otis, Jr.   |          |               |
| /s/ Hugh B. Price             | Director | March 1, 2007 |
| _____<br>Hugh B. Price        |          |               |
| /s/ Walter V. Shipley         | Director | March 1, 2007 |
| _____<br>Walter V. Shipley    |          |               |
| /s/ John W. Snow              | Director | March 1, 2007 |
| _____<br>John W. Snow         |          |               |
| /s/ John R. Stafford          | Director | March 1, 2007 |
| _____<br>John R. Stafford     |          |               |
| /s/ Robert D. Storey          | Director | March 1, 2007 |
| _____<br>Robert D. Storey     |          |               |



**Computation of Ratio of Earnings to Fixed Charges**  
**Verizon Communications Inc. and Subsidiaries**

| Years Ended December 31,   | 2006             | 2005             | 2004             | (dollars in millions) |                  |
|--|------------------|------------------|------------------|-----------------------|------------------|
|  |                  |                  |                  | 2003                  | 2002             |
| Income before provision for income taxes, discontinued operations, extraordinary items, and cumulative effect of accounting change | \$ 8,154         | \$ 8,448         | \$ 7,977         | \$ 2,681              | \$ 3,797         |
| Minority interest  | 4,038            | 3,001            | 2,329            | 1,562                 | 1,303            |
| Equity in (earnings) loss of unconsolidated businesses   | (773)            | (686)            | (1,690)          | (1,273)               | 1,548            |
| Dividends from unconsolidated businesses   | 42               | 2,336            | 162              | 198                   | 96               |
| Interest expense   | 2,349            | 2,129            | 2,336            | 2,741                 | 3,072            |
| Portion of rent expense representing interest  | 530              | 511              | 449              | 432                   | 391              |
| Amortization of capitalized interest   | 112              | 108              | 104              | 103                   | 87               |
| <b>Income, as adjusted</b>   | <b>\$ 14,452</b> | <b>\$ 15,847</b> | <b>\$ 11,667</b> | <b>\$ 6,444</b>       | <b>\$ 10,294</b> |
| <b>Fixed charges:</b>  |                  |                  |                  |                       |                  |
| Interest expense   | \$ 2,349         | \$ 2,129         | \$ 2,336         | \$ 2,741              | \$ 3,072         |
| Portion of rent expense representing interest  | 530              | 511              | 449              | 432                   | 391              |
| Capitalized interest   | 462              | 352              | 177              | 144                   | 185              |
| Preferred stock dividend requirement   | 2                | 9                | 8                | 12                    | 18               |
| <b>Fixed Charges</b>   | <b>\$ 3,343</b>  | <b>\$ 3,001</b>  | <b>\$ 2,970</b>  | <b>\$ 3,329</b>       | <b>\$ 3,666</b>  |
| <b>Ratio of Earnings to Fixed Charges</b>  | <b>4.32</b>      | <b>5.28</b>      | <b>3.93</b>      | <b>1.94</b>           | <b>2.81</b>      |

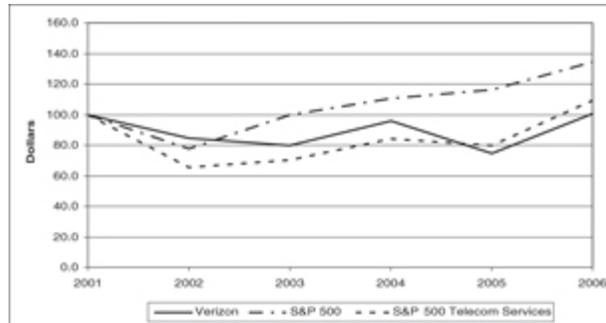
**Selected Financial Data** Verizon Communications Inc. and Subsidiaries

|  | 2006       | 2005       | 2004       | (dollars in millions, except per share amounts) |            |
|--|------------|------------|------------|---|------------|
|  |            |            |            | 2003  | 2002       |
| <b>Results of Operations</b>   |            |            |            |   |            |
| Operating revenues   | \$ 88,144  | \$ 69,518  | \$ 65,751  | \$ 61,754                                       | \$ 60,907  |
| Operating income   | 13,373     | 12,581     | 10,870     | 5,312   | 12,386     |
| Income before discontinued operations and cumulative effect of accounting change | 5,480      | 6,027      | 5,899      | 2,168   | 3,016      |
| Per common share – basic   | 1.88       | 2.18       | 2.13       | .79   | 1.11       |
| Per common share – diluted   | 1.88       | 2.16       | 2.11       | .79   | 1.11       |
| Net income   | 6,197      | 7,397      | 7,831      | 3,077   | 4,079      |
| Net income available to common shareowners                                       | 6,197      | 7,397      | 7,831      | 3,077   | 4,079      |
| Per common share – basic   | 2.13       | 2.67       | 2.83       | 1.12  | 1.49       |
| Per common share – diluted   | 2.12       | 2.65       | 2.79       | 1.12  | 1.49       |
| Cash dividends declared per common share   | 1.62       | 1.62       | 1.54       | 1.54  | 1.54       |
| <b>Financial Position</b>  |            |            |            |   |            |
| Total assets   | \$ 188,804 | \$ 168,130 | \$ 165,958 | \$ 165,968                                      | \$ 167,468 |
| Long-term debt   | 28,646     | 31,569     | 34,970     | 38,609  | 43,066     |
| Employee benefit obligations   | 30,779     | 17,693     | 16,796     | 15,726  | 14,484     |
| Minority interest  | 28,337     | 26,433     | 24,709     | 24,023  | 23,749     |
| Shareowners' investment  | 48,535     | 39,680     | 37,560     | 33,466  | 32,616     |

- Significant events affecting our historical earnings trends in 2004 through 2006 are described in Management's Discussion and Analysis of Results of Operations and Financial Condition.
- 2003 data includes severance, pension and benefit charges and other special and/or non-recurring items.
- 2002 data includes gains on investments and sales of businesses and other special and/or non-recurring items.

## Stock Performance Graph

### COMPARISON OF FIVE-YEAR TOTAL RETURN AMONG VERIZON, S&P 500 TELECOM SERVICES INDEX AND S&P 500 STOCK INDEX



| Data Points in Dollars*  | At December 31, |      |       |       |       |      |
|--------------------------|-----------------|------|-------|-------|-------|------|
|                          | 2001            | 2002 | 2003  | 2004  | 2005  | 2006 |
| Verizon                  | 100.0           | 84.9 | 80.3  | 96.5  | 75.2  | 101  |
| S&P 500                  | 100.0           | 77.9 | 100.2 | 111.1 | 116.6 | 135  |
| S&P 500 Telecom Services | 100.0           | 65.9 | 70.7  | 84.7  | 80.2  | 109  |

\* Assumes \$100 invested on December 31, 2001

The graph compares the cumulative total returns of Verizon, the S&P 500 Telecommunications Services Index, and the S&P 500 Stock Index over a five-year period. It assumes \$100 was invested on December 31, 2001, with dividends reinvested.

## Management's Discussion and Analysis of Results of Operations and Financial Condition

### Overview

Verizon Communications Inc. (Verizon) is one of the world's leading providers of communications services. Verizon's wireline business, which includes the operations of the former MCI, provides telephone services, including voice, broadband data and video services, network access, nationwide long-distance and other communications products and services, and also owns and operates one of the most expansive end-to-end global Internet Protocol (IP) networks. Verizon's domestic wireless business, operating as Verizon Wireless, provides wireless voice and data products and services across the United States using one of the most extensive and reliable wireless networks. Stressing diversity and commitment to the communities in which we operate, Verizon has a highly diverse workforce of approximately 242,000 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 growth, devoting more resources to higher growth markets such as wireless, including wireless data, wireline broadband connections, including fiber optics to the premises (Verizon's FiOS data and TV services), digital subscriber lines (DSL) and other data services, long distance, as well as expanded strategic services to business markets, rather than to the traditional wireline voice market, where we have been experiencing access line losses. Verizon reported consolidated revenue growth of 26.8% in 2006 compared to 2005, primarily driven by the merger with MCI and 17.8% higher revenue at Domestic Wireless. Verizon added 7,715,000 wireless customers and 1,838,000 broadband connections in 2006.
- **Operational Efficiency** – While focusing resources on growth, we are continually challenging our management team to lower expenses, particularly through technology-assisted productivity improvements including self-service initiatives. The effect of these and other efforts, such as real estate consolidations, call center routing improvements and the formation of Verizon Services Organization, has been to change the company's cost structure and maintain stable operating income margins. Real estate consolidations include the establishment of the Verizon Center. The Verizon Services Organization provides centralized services across our business, including procurement, finance operations and real estate services. With our deployment of the FiOS network, we expect to realize savings in annual, ongoing operating expenses as a result of efficiencies gained from fiber network facilities. As the deployment of the FiOS network gains scale and installation automation improvements occur, costs per home connected are expected to decline. Since the merger with MCI, we have gained operational benefits from sales force and product and systems integration initiatives. While workforce levels in 2006 increased to 242,000 from 206,000 primarily as a result of the acquisition of MCI, productivity improvements and merger synergy savings led to headcount reductions of about 9,200 in our wireline business.
- **Capital Allocation** – Our capital spending continues to be directed toward growth markets. High-speed wireless data (Evolution-Data Optimized, or EV-DO) services, replacement of copper access lines with fiber optics to the premises, as well as expanded services to business markets are examples of areas of capital spending in support of these growth markets. Excluding discontinued operations, in 2006, capital expenditures were \$17,101 million compared to 2005 capital expenditures of \$14,964 million. Of the increase, \$1,602 million was primarily attributable to capital spending related to the former MCI, with the remainder in support of growth initiatives. In 2007, Verizon management expects capital expenditures to be in the range of \$17.5 billion to \$17.9 billion. In addition to capital expenditures, Verizon Wireless continues to participate in the Federal Communications Commission's (FCC) wireless spectrum auctions and continues to evaluate spectrum acquisitions in support of expanding data applications and its growing customer base. In 2006, this included participation in the FCC Auction 66 of Advanced Wireless Services spectrum (AWS auction) in which Verizon Wireless was the high bidder on thirteen 20 MHz licenses covering a population of nearly 200 million.
- **Cash Flow Generation and Shareowner Value Creation** – The financial statements reflect the emphasis of management on not only directing resources to growth markets, but also creating value for shareowners through the use of cash provided by our operating and investing activities for the repayment of debt, share repurchases and providing a stable dividend to our shareowners, in addition to returning value to shareowners through spin-off and other strategic transactions. Verizon's total debt decreased to \$36,361 million as of December 31, 2006 from \$38,257 million as of December 31, 2005, primarily as a result of the debt reduction resulting from the spin-off of Idearc Inc. (Idearc), formerly our U.S. print and Internet yellow pages directories business, and the use of cash acquired in the MCI merger and generated through strategic asset sales (see "Other Factors That May Affect Future Results – Recent Developments"), partially offset by debt acquired in connection with the MCI merger. Strategic asset sales included the sale of Verizon Dominicana C. por A.

(Verizon Dominicana), which closed on December 1, 2006. Verizon's ratio of debt to debt combined with shareowners' equity was 42.8% as of December 31, 2006 compared with 49.1% as of December 31, 2005. Management has recommended to the Board of Directors that our dividend be maintained at a level no less than that immediately preceding the Idearc spin-off. In addition, we repurchased \$1,700 million of our common stock as part of our previously announced program during 2006, and we plan to continue our share buyback program at

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similar levels in 2007. Additionally, Verizon's balance of cash and cash equivalents at December 31, 2006 of \$3,219 million increased by \$2,459 million from \$760 million at December 31, 2005.

Supporting these key focus areas are continuing initiatives to enhance the value of our products and services through well-managed deployment of proven advanced technology and through competitive products and services packaging. At Wireline, as of December 31, 2006, we met our goal of passing six million premises with our high-capacity fiber network (FiOS), doubling the number of premises passed compared to year-end 2005. We added 517,000 new FiOS data connections in 2006. In 2005, Verizon began offering video on the FiOS network in three markets. By the end of 2006, Verizon had obtained over 600 video franchises covering 7.3 million households with service available for sale to 2.4 million premises. We had 207,000 FiOS TV customers by the end of 2006. We are also developing and marketing innovative product bundles to include local wireline, long distance, wireless and broadband services for consumer and general business retail customers. These efforts will also help counter the effects of competition and technology substitution that have resulted in access line losses, and will enable us to grow revenues by becoming a leading video provider.

Also at Wireline, we will continue to focus investments in strategic areas by rolling-out next generation global IP networks to meet the ongoing global enterprise market shift to IP-based products and services. Deployment of new strategic service offerings, including expansion of our voice over IP (VoIP) and international Ethernet capabilities, introduction of cutting edge video and web-based conferencing capabilities and enhancements to our virtual private network portfolio, will allow us to continue to gain share in the enterprise market. Additionally, we will continue to integrate the business of the former MCI to drive continued growth in synergy, supporting a focus on operational efficiency and continued creation of shareowner value.

At Verizon Wireless, we will continue to execute on the fundamentals of our network superiority and value proposition to deliver growth for the business and provide new and innovative products and services for our customers such as Broadband Access, our EV-DO service. To accomplish our goal of being the acknowledged market leader in providing wireless voice and data communication services in the U.S, we will continue to implement the following key elements of our business strategy: provide the highest network reliability through our code division multiple access (CDMA) 1XRTT technology and EV-DO (Revision A) infrastructure, which significantly increases data transmission rates; profitably acquire, satisfy and retain our customers; and increase the value of our service offerings to customers while achieving revenue and net income growth. We also continue to expand our wireless data, messaging and multi-media offerings for both consumer and business customers and take advantage of the growing demand for wireless data services and focus on operating margins and capital efficiency by driving down costs and leveraging our scale.

In January 2007, Verizon announced a definitive agreement with FairPoint Communications, Inc. (FairPoint) that will result in Verizon establishing a separate entity for its local exchange access lines and related business assets in Maine, New Hampshire and Vermont, spinning off that new entity to Verizon's shareowners, and immediately merging it with and into FairPoint. The total value to be received by Verizon and its shareowners in exchange for these operations will be approximately \$2,715 million.

## Consolidated Results of Operations

In this section, we discuss our overall results of operations and highlight special and non-recurring items. As a result of the spin-off of our U.S. print and Internet yellow pages directories business, which was included in the Information Services segment, as well as reaching definitive agreements to sell our interests in Telecomunicaciones de Puerto Rico, Inc. (TELPRI) and Verizon Dominicana, each of which was included in the International segment, the operations of our former U.S. print and Internet yellow pages directories business, Verizon Dominicana and TELPRI are reported as discontinued operations and assets held for sale. Accordingly, we now have two reportable segments – Wireline and Domestic Wireless. Prior period amounts and discussions are revised to reflect this change. We include in our results of operations the results of the former MCI business subsequent to the close of the merger on January 6, 2006.

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. In the following section, we review the performance of our two 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.

## Consolidated Revenues

| Years Ended December 31,           | (dollars in millions) |                  |             |                  |                  |            |
|------------------------------------|-----------------------|------------------|-------------|------------------|------------------|------------|
|                                    | 2006                  | 2005             | % Change    | 2005             | 2004             | % Change   |
| <b>Wireline</b>                    |                       |                  |             |                  |                  |            |
| Verizon Telecom                    | \$ 33,259             | \$ 32,114        |             | \$ 32,114        | \$ 32,261        |            |
| Verizon Business                   | 20,490                | 7,394            |             | 7,394            | 7,414            |            |
| Intrasegment eliminations          | (2,955)               | (1,892)          |             | (1,892)          | (1,654)          |            |
|                                    | <b>50,794</b>         | 37,616           | 35.0%       | 37,616           | 38,021           | (1.1%)     |
| Domestic Wireless                  | 38,043                | 32,301           | 17.8        | 32,301           | 27,662           | 16.8       |
| Corporate & Other                  | (693)                 | (579)            | 19.7        | (579)            | (461)            | 25.6       |
| Revenues of Hawaii operations sold | —                     | 180              | (100.0)     | 180              | 529              | (66.0)     |
| <b>Consolidated Revenues</b>       | <b>\$ 88,144</b>      | <b>\$ 69,518</b> | <b>26.8</b> | <b>\$ 69,518</b> | <b>\$ 65,751</b> | <b>5.7</b> |

### 2006 Compared to 2005

Consolidated revenues in 2006 were higher by \$18,626 million, or 26.8% compared to 2005 revenues. This increase was primarily the result of significantly higher revenues at Wireline and Domestic Wireless.

Wireline's revenues in 2006 increased by \$13,178 million, or 35.0% compared to 2005 due to the acquisition of MCI and growth from broadband and long distance services. We added 1.8 million new broadband connections, for a total of 7.0 million lines in service at December 31, 2006, an increase of 35.7% compared to 5.1 million lines in service at December 31, 2005. The number of Freedom service plans continue to stimulate growth in long distance services, as the number of packages reached 7.9 million as of December 31, 2006, representing a 44.1% increase from December 31, 2005. These increases were partially offset by declines in wholesale revenues at Verizon Telecom due to subscriber losses resulting from technology substitution, including wireless and VoIP. Wholesale revenues at Verizon Telecom declined by \$752 million, or 8.3% in 2006 compared to similar periods in 2005 primarily due to the exclusion of affiliated access revenues billed to the former MCI mass market entities in 2006. Revenues at Verizon Business increased primarily due to the acquisition of MCI.

Domestic Wireless's revenues increased by \$5,742 million, or 17.8% compared to 2005 due to increases in service revenues, including data revenues, and equipment and other revenues. Data revenues increased by \$2,232 million or 99.5% compared to 2005. Domestic Wireless ended 2006 with 59.1 million customers, an increase of 15.0% over 2005. Domestic Wireless's retail customer base as of December 31, 2006 was approximately 56.8 million, a 15.9% increase over December 31, 2005, and comprised approximately 96.1% of our total customer base. Average service revenue per customer (ARPU) increased by 0.6% to \$49.80 in 2006 compared to 2005, primarily attributable to increases in data revenue per customer driven by increased use of our messaging and other data services. Retail ARPU increased by 0.7% to \$50.44 for 2006 compared to 2005. Increases in wireless devices sold and revenue per unit sold drove increases in equipment and other revenue in 2006 compared to 2005.

Lower revenue of Hawaii operations sold of \$180 million, or 100% in 2006 compared to 2005 was the result of their sale during the second quarter of 2005.

### 2005 Compared to 2004

Consolidated revenues in 2005 were higher by \$3,767 million, or 5.7% compared to 2004 revenues. This increase was primarily the result of significantly higher revenues at Domestic Wireless, partially offset by lower revenues at Wireline and the sale of our Hawaii wireline operations in the second quarter of 2005.

Wireline's revenues in 2005 were lower than 2004 by \$405 million, or 1.1% primarily due to lower revenues from local services, partially offset by higher network access and long distance services revenues. We added 1.7 million new broadband connections, for a total of 5.1 million lines in service at December 31, 2005, an increase of 47.6% compared to 3.5 million lines in service at December 31, 2004. The introduction of our Freedom service plans stimulated growth in long distance services. As of December 31, 2005, approximately 53% of our local wireline customers chose Verizon as their long distance carrier. These increases were offset by declines in wholesale revenues at Verizon Telecom due to subscriber losses resulting from technology substitution, including wireless and VoIP.

Domestic Wireless's revenues increased by \$4,639 million, or 16.8% in 2005 compared to 2004 due to increases in service revenues, including data revenues, and equipment and other revenues. Data revenues increased by \$1,127 million or 101.0% compared to 2004. Domestic Wireless ended 2005 with 51.3 million customers, an increase of 17.2% over 2004. Domestic Wireless's retail customer base as of December 31, 2005 was approximately 49.0 million, a 17.2% increase over December 31, 2004, and comprised approximately 95.5% of our total customer base. ARPU decreased 1.5% to \$49.49 in 2005 compared to 2004, primarily due to pricing changes in early 2005, partially offset by a 71.7% increase in data revenue per customer in 2005 compared to 2004, driven by increased use of our messaging and other data services. Increases in wireless devices sold and revenue per unit sold drove increases in equipment and other revenue in 2005 compared to 2004.

Lower revenue of Hawaii operations sold of \$349 million, or 66.0% in 2005 compared to 2004 was the result of the sale during the second quarter of 2005 of our wireline and directory operations in Hawaii.

### Consolidated Operating Expenses

| Years Ended December 31,                    | 2006      | 2005      | % Change | (dollars in millions) |           |          |
|---|-----------|-----------|----------|-----------------------|-----------|----------|
|   |           |           |          | 2005                  | 2004      | % Change |
| Cost of services and sales                  | \$ 34,994 | \$ 24,200 | 44.6%    | \$ 24,200             | \$ 22,032 | 9.8%     |
| Selling, general and administrative expense | 25,232    | 19,652    | 28.4     | 19,652                | 19,346    | 1.6      |
| Depreciation and amortization expense       | 14,545    | 13,615    | 6.8      | 13,615                | 13,503    | 0.8      |
| Sales of businesses, net                    | —         | (530)     | (100.0)  | (530)                 | —         | nm       |
| Consolidated Operating Expenses             | \$ 74,771 | \$ 56,937 | 31.3     | \$ 56,937             | \$ 54,881 | 3.7      |

nm – Not meaningful

### 2006 Compared to 2005

#### *Cost of Services and Sales*

Cost of services and sales increased by \$10,794 million, or 44.6% in 2006 compared to 2005. This increase was driven by the inclusion of the former MCI operations, higher wireless network costs, increases in wireless equipment costs and increases in pension and other postretirement benefit costs, partially offset by the net impact of productivity improvement initiatives.

The higher wireless network costs were caused by increased network usage relating to both voice and data services in 2006 compared to 2005, partially offset by decreased roaming, local interconnection and long distance rates. Cost of wireless equipment sales increased in 2006 compared to 2005 primarily as a result of an increase in wireless devices sold due to an increase in gross activations and equipment upgrades, together with an increase in cost per unit.

Costs in these periods were also impacted by increased pension and other postretirement benefit costs. The overall impact of the 2006 assumptions, combined with the impact of lower than expected actual asset returns over the past several years, resulted in pension and other postretirement benefit expense of approximately \$1,377 million in 2006 compared to net pension and postretirement benefit expense of \$1,231 million in 2005. Special and non-recurring items recorded during 2006 included \$25 million of merger integration costs.

#### *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 \$5,580 million, or 28.4% in 2006 compared to 2005. This increase was driven by the inclusion of the former MCI operations, increases in the Domestic Wireless segment primarily related to increased salary and benefits expenses, and special and non-recurring charges. Special and non-recurring items in selling, general and administrative expenses in 2006 were \$816 million compared to special and non-recurring items in 2005 of \$311 million.

Special and non-recurring items in 2006 included \$56 million related to pension settlement losses incurred in connection with our benefit plans, a net pretax charge of \$369 million for employee severance and severance-related activities in connection with the involuntary separation of approximately 4,100 employees, who were separated in 2006. Special and non-recurring charges in 2006 also included \$207 million of merger integration costs, primarily for advertising and other costs related to re-branding initiatives and systems integration activities, and a net pretax charge of \$184 million for Verizon Center relocation costs. Special and non-recurring items in 2005 included a pretax impairment charge of \$125 million pertaining to our leasing operations for aircraft leased to airlines experiencing financial difficulties, a net pretax charge of \$98 million related to the restructuring of the Verizon management retirement benefit plans and a pretax charge of \$59 million associated with employee severance costs and severance-related activities in connection with the voluntary separation program for surplus union-represented employees.

#### *Depreciation and Amortization Expense*

Depreciation and amortization expense increased by \$930 million, or 6.8% in 2006 compared to 2005. This increase was primarily due to higher depreciable and amortizable asset bases as a result of the MCI merger and, to a lesser extent, increased capital expenditures.

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## 2005 Compared to 2004

### *Cost of Services and Sales*

Cost of services and sales increased by \$2,168 million, or 9.8% in 2005 compared to 2004. This increase was principally due to increases in pension and other postretirement benefit costs, higher direct wireless network costs, increases in wireless equipment costs and higher costs associated with our wireline growth businesses.

The overall impact of pension and other postretirement benefit plan assumption changes, combined with lower asset returns over the last several years, increased net pension and postretirement benefit expenses by \$407 million in 2005 (primarily in cost of services and sales) compared to 2004. Higher direct wireless network charges resulted from increased network usage in 2005 compared to 2004, partially offset by lower roaming, local interconnection and long distance rates. Cost of equipment sales was higher in 2005 due primarily to an increase in wireless devices sold together with an increase in cost per unit sold, driven by growth in customer additions and an increase in equipment upgrades in 2005. Higher costs associated with our wireline growth businesses, long distance and broadband connections, included a 2,400, or 1.7% increase in the number of Wireline employees as of December 31, 2005 compared to December 31, 2004. Costs in 2004 were impacted by lower interconnection expense charged by competitive local exchange carriers (CLECs) and settlements with carriers, including the MCI settlement recorded in 2004.

### *Selling, General and Administrative Expense*

Selling, general and administrative expense increased by \$306 million, or 1.6% in 2005 compared to 2004. This increase was driven by increases in salary, pension and benefits costs, including an increase in the customer care and sales channel work force and sales commissions, partially offset by gains on real estate sales in 2005 and lower bad debt costs. Special and non-recurring items in selling, general and administrative expenses in 2005 were \$311 million compared to special and non-recurring items in 2004 of \$971 million.

Special and non-recurring items in 2005 included a pretax impairment charge of \$125 million pertaining to our leasing operations for aircraft leased to airlines experiencing financial difficulties, a net pretax charge of \$98 million related to the restructuring of the Verizon management retirement benefit plans and a pretax charge of \$59 million associated with employee severance costs and severance-related activities in connection with the voluntary separation program to surplus union-represented employees. Special and non-recurring items recorded in 2004 included \$805 million 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 2004. Special charges in 2004 also include an expense credit of \$204 million resulting from the favorable resolution of pre-bankruptcy amounts due from MCI, partially offset by a charge of \$113 million related to operating asset losses.

### *Depreciation and Amortization Expense*

Depreciation and amortization expense increased by \$112 million, or 0.8% in 2005 compared to 2004. This increase was primarily due to the increase in depreciable assets and software, partially offset by lower rates of depreciation on telephone plant.

### *Sales of Businesses, Net*

During the second quarter of 2005, we sold our wireline and directory businesses in Hawaii and recorded a net pretax gain of \$530 million.

## **Pension and Other Postretirement Benefits**

For 2006 pension and other postretirement benefit costs, the discount rate assumption remained at 5.75%, consistent with interest rate levels at the end of 2005. The expected rate of return on pension plan assets remained 8.50%, while the expected rate of return on postretirement benefit plan assets was increased to 8.25% from 7.75% in 2005. The medical cost trend rate was 10% for 2006. For 2005 pension and other postretirement benefit costs, the discount rate assumption was lowered to 5.75% from 6.25% in 2004, consistent with interest rate levels at the end of 2004. The medical cost trend rate assumption was 10% in 2005. The expected rate of return on pension and postretirement benefit plan assets for 2004 was maintained at 8.50%.

For 2007 pension and other postretirement benefit costs, we evaluated our key employee benefit plan assumptions in response to current conditions in the securities markets and medical and prescription drug cost trends. The discount rate assumption will be increased to 6.00%, consistent with interest rate levels at the end of 2006. The medical cost trend rate will be 10% for 2007. The expected rate of return on pension plan assets will remain at 8.50% and the expected rate of return on postretirement benefit plan assets will remain at 8.25% in 2007.

During 2006, we recorded net pension and postretirement benefit expense of \$1,377 million, compared to net pension and postretirement benefit expense of \$1,231 million in 2005 and net pension and postretirement benefit expense of \$824 million in 2004.

## Other Consolidated Results

### Equity in Earnings of Unconsolidated Businesses

Equity in earnings of unconsolidated businesses increased by \$87 million, or 12.7% in 2006 compared to 2005. The increase is primarily due to additional pension liabilities that Compañía Anónima Nacional Teléfonos de Venezuela (CANTV) recognized in 2005, as well as the effect of favorable operating results and lower taxes in 2006. In addition, the increase reflects our proportionate share, or \$85 million, of a tax benefit at Vodafone Omnitel N.V. (Vodafone Omnitel) in the third quarter of 2006. A similar benefit was recorded in the third quarter of 2005 of \$76 million.

Equity in earnings of unconsolidated businesses decreased by \$1,004 million, or 59.4% in 2005 compared to 2004. The decrease is primarily due to a pretax gain of \$787 million recorded on the sale of our 20.5% interest in TELUS Corporation (TELUS) in the fourth quarter of 2004 and the sale of another investment in 2004, lower equity income resulting from the sale of TELUS and estimated additional pension liabilities at CANTV, partially offset by higher tax benefits and operational results at Vodafone Omnitel.

### Other Income and (Expense), Net

| Years Ended December 31,             | (dollars in millions) |        |       |
|--------------------------------------|-----------------------|--------|-------|
|                                      | 2006                  | 2005   | 2004  |
| Interest income                      | \$ 201                | \$ 103 | \$ 97 |
| Foreign exchange gains (losses), net | (3)                   | 11     | (7)   |
| Other, net                           | 197                   | 197    | (8)   |
| Total                                | \$ 395                | \$ 311 | \$ 82 |

Other Income and (Expense), Net in 2006 increased \$84 million, or 27% compared to 2005. The increase was primarily due to increased interest income as a result of higher average cash balances coupled with higher interest rates in 2006 compared to 2005, partially offset by foreign exchange losses. Other, net in 2006 includes pretax gains on sales of investments, as well as leased asset gains.

Other, net in 2005 includes a pretax gain on the sale of a small international business and investment gains. Other Income and (Expense), Net in 2005 and 2004 include expenses of \$14 million and \$55 million, respectively, related to the early retirement of debt.

### Interest Expense

| Years Ended December 31,              | (dollars in millions) |           |           |
|---------------------------------------|-----------------------|-----------|-----------|
|                                       | 2006                  | 2005      | 2004      |
| Interest expense                      | \$ 2,349              | \$ 2,129  | \$ 2,336  |
| Capitalized interest costs            | 462                   | 352       | 177       |
| Total interest costs on debt balances | \$ 2,811              | \$ 2,481  | \$ 2,513  |
| Weighted average debt outstanding     | \$ 41,500             | \$ 39,152 | \$ 41,781 |
| Effective interest rate               | 6.8%                  | 6.3%      | 6.0%      |

In 2006, interest costs increased \$330 million compared to 2005 primarily due to an increase in average debt level of \$2,348 million and increased interest rates compared to 2005. Higher capital expenditures in 2006 contributed to higher capitalized interest costs.

In 2005, the decrease in interest costs was primarily due to a reduction in average debt level of \$2,629 million compared to 2004, partially offset by higher average interest rates. Higher capital expenditures in 2005 contributed to higher capitalized interest costs.

## Minority Interest

| Years Ended December 31, | (dollars in millions) |          |          |
|--------------------------|-----------------------|----------|----------|
|                          | 2006                  | 2005     | 2004     |
| Minority interest        | \$ 4,038              | \$ 3,001 | \$ 2,329 |

The increase in minority interest expense in 2006 compared to 2005, and in 2005 compared to 2004 was attributable to higher earnings at Domestic Wireless, which is 45% owned by Vodafone Group Plc (Vodafone).

## Provision for Income Taxes

| Years Ended December 31,   | (dollars in millions) |          |          |
|----------------------------|-----------------------|----------|----------|
|                            | 2006                  | 2005     | 2004     |
| Provision for income taxes | \$ 2,674              | \$ 2,421 | \$ 2,078 |
| Effective income tax rate  | 32.8%                 | 28.7%    | 26.1%    |

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 in 2006 was higher than 2005 primarily as a result of favorable tax settlements and the recognition of capital loss carryforwards in 2005. These increases were partially offset by tax benefits from foreign operations and lower state taxes in 2006 compared to 2005.

Our effective income tax rate in 2005 was higher than 2004 due to taxes on overseas earnings repatriated during the year, lower foreign-related tax benefits and lower favorable deferred tax reconciliation adjustments. Included in the provision of income taxes in 2005 are capital gains realized in connection with the sale of our Hawaii business, which resulted in the realization of tax benefits of \$336 million primarily related to capital loss carryforwards. This was largely offset by a tax provision of \$206 million related to the repatriation of foreign earnings under the provisions of the American Jobs Creation Act of 2004. The effective income tax rate in 2004 was favorably impacted by the reversal of a valuation allowance relating to investments, tax benefits related to deferred tax balance adjustments and expense credits that are not taxable.

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 represents the results of operations of TELPRI for all years presented in the consolidated statements of income and Verizon Dominicana, Verizon Information Services and Verizon Information Services Canada Inc. prior to their sale or spin-off in December 2006, November 2006 and the fourth quarter of 2004, respectively.

In the second quarter of 2006, we announced our decision to sell Verizon Dominicana and TELPRI and, in accordance with Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, (SFAS No. 144) we have classified the results of operations of Verizon Dominicana and TELPRI as discontinued operations. The sale of Dominicana closed in December 2006 and, primarily due to taxes on previously unremitted earnings, a pretax gain of \$30 million resulted in an after-tax loss of \$541 million (or \$.18 per diluted share).

We completed the spin-off of Idearc to our shareholders on November 17, 2006, which resulted in an \$8,695 million increase to contributed capital in shareowners' investment.

Discontinued operations also include the results of operations of Verizon Information Services Canada Inc. prior to its sale in the fourth quarter of 2004. The sale resulted in a pretax gain of \$1,017 million (\$516 million after-tax, or \$.18 per diluted share).

Income from discontinued operations, net of tax decreased by \$611 million, or 44.6% in 2006 compared to 2005. This decrease was primarily due to the after-tax loss recorded in 2006 on the sale of Verizon Dominicana, partially offset by cessation of depreciation on fixed assets held for sale. Income from discontinued operations, net of tax decreased by \$562 million, or 29.1% in 2005 compared to 2004. The decrease was primarily driven by the after-tax gain recorded on the sale of Verizon Information Services Canada Inc. in 2004.

## Cumulative Effect of Accounting Change

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123(R), *Share-Based Payment*, (SFAS No. 123(R)) which revises SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS No. 123). SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized as compensation expense based on their fair value. 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* (SFAS No. 148)) for all new awards granted, modified or

settled after January 1, 2003. Under the prospective method, employee compensation expense in the first year is 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 2006, 2005 and 2004 are less than what would have been recorded if the fair value method had been applied to previously issued awards.

Effective January 1, 2006, we adopted SFAS No. 123(R) utilizing the modified prospective method. SFAS No. 123(R) requires the measurement of stock-based compensation expense based on the fair value of the award on the date of grant. Under the modified prospective method, the provisions of SFAS No. 123(R) apply to all awards granted or modified after the date of adoption. SFAS No. 123(R) is supplemented by Staff Accounting Bulletin (SAB) No. 107, "Share-Based Payments" (SAB No. 107). This SAB, which was issued by the Securities and Exchange Commission (SEC) in March 2005, expresses the views of the SEC staff regarding the relationship between SFAS No. 123(R) and certain SEC rules and regulations. In particular, this SAB provides guidance related to valuation methods, the classification of compensation expense, non-GAAP financial measures, the accounting for income tax effects of share-based payment arrangements, disclosures in Management's Discussion and Analysis subsequent to adoption of SFAS No. 123(R), and interpretations of other share-based payment arrangements. We also adopted SAB No. 107 on January 1, 2006.

We recorded a \$42 million cumulative effect of accounting change as of January 1, 2006, net of taxes and after minority interest, to recognize the effect of initially measuring the outstanding liability awards (VARs) of the Verizon Wireless joint venture at fair value utilizing a Black-Scholes model. We do not expect SFAS No. 123(R) to have a material effect on our consolidated financial statements in future periods.

### Segment Results of Operations

On November 17, 2006, we completed the spin-off to our shareowners of our U.S. print and Internet yellow pages directories, which was included in the Information Services segment. The spin-off resulted in a new company, named Idearc Inc. In addition, on April 2, 2006, we reached definitive agreements to sell our interests in TELPRI and Verizon Dominicana, each of which was included in the International segment. In accordance with SFAS No. 144, we have classified the results of operations for our U.S. print and Internet yellow pages directories business, Verizon Dominicana and TELPRI as discontinued operations and assets held for sale. Accordingly, we now have two reportable segments and prior period amounts and discussions are revised to reflect this change. Our segments are Wireline and Domestic Wireless. 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. Corporate, eliminations and other includes unallocated corporate expenses, intersegment eliminations recorded in consolidation, the results of other businesses such as our investments in unconsolidated businesses, primarily Omnitel and CANTV, lease financing, and asset impairments and expenses that are not allocated in assessing segment performance due to their non-recurring nature. These 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.

### Wireline

The Wireline segment, which includes the operations of the former MCI, consists of the operations of Verizon Telecom, a provider of telephone services, including voice, broadband video and data, network access, long distance, and other services to consumer and small business customers and carriers, and Verizon Business, a provider of next-generation IP network services globally to medium and large businesses and government customers. As discussed earlier under "Consolidated Results of Operations," in the second quarter of 2005, we sold wireline properties in Hawaii representing approximately 700,000 access lines or 1% of the total Verizon Telecom switched access lines in service. For comparability purposes, the results of operations shown in the tables below exclude the Hawaii properties that have been sold.

### Operating Revenues

| Years Ended December 31,                 | (dollars in millions) |                  |                  |
|--|-----------------------|------------------|------------------|
|  | 2006                  | 2005             | 2004             |
| Verizon Telecom                          |                       |                  |                  |
| Mass Markets                             | \$ 22,528             | \$ 20,446        | \$ 20,447        |
| Wholesale                                | 8,323                 | 9,075            | 9,128            |
| Other                                    | 2,408                 | 2,593            | 2,686            |
| Verizon Business                         |                       |                  |                  |
| Enterprise Business                      | 13,999                | 6,018            | 6,196            |
| Wholesale                                | 3,381                 | 1,376            | 1,218            |
| International and Other                  | 3,110                 | -                | -                |
| Intrasegment Eliminations                | (2,955)               | (1,892)          | (1,654)          |
| <b>Total Wireline Operating Revenues</b> | <b>\$ 50,794</b>      | <b>\$ 37,616</b> | <b>\$ 38,021</b> |

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In connection with the completion of the MCI merger, our product lines were realigned to be reflective of the Line of Business structure in which the product lines are currently being managed. Prior period amounts and discussions were reclassified to conform to the current presentation.

### *Verizon Telecom*

#### Mass Markets

Verizon Telecom's Mass Markets revenue includes local exchange (basic service and end-user access), value-added services, long distance, broadband services for residential and certain small business accounts and FiOS TV services. Value-added services are a family of services that expand the utilization of the network, including products such as Caller ID, Call Waiting, Home Voicemail and Return Call. Long distance includes both regional toll services and long distance services. Broadband services include DSL and FiOS.

Our Mass Market revenues increased by \$2,082 million, or 10.2% in 2006, and decreased by \$1 million, or 0.0% in 2005. The increase in 2006 was principally due to the inclusion of revenues from the former MCI and, in 2006 and 2005, growth from broadband and long distance. In both years revenue increases were offset by lower demand and usage of our basic local exchange and accompanying services attributable to subscriber losses due to technology substitution, including wireless and VoIP.

We added 1,838,000 new broadband connections, including 517,000 for FiOS in 2006, for a total of 6,982,000 lines at December 31, 2006, an increase of 35.7% compared to 5,144,000 lines in service at December 31, 2005. We have achieved a FiOS data penetration rate of 14% across all markets where we have been selling this service. Our Freedom service plans continue to stimulate growth in long distance services, as the number of plans reached 7.9 million as of December 31, 2006, representing a 44.1% increase from December 31, 2005. As of December 31, 2006, approximately 58% of our legacy Verizon wireline customers have chosen Verizon as their long distance carrier.

Declines in switched access lines in service of 7.6% in 2006 and 6.7% in 2005 were mainly driven by the effects of competition and technology substitution. Demand for legacy Verizon residential access lines declined 7.1% in 2006 and 6.3% in 2005, as customers substituted wireless, broadband and cable services for traditional landline services. At the same time, legacy Verizon business access lines declined 3.2% in 2006, and 4.2% in 2005, 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 and Internet access services in a discounted bundle available on one bill. We have introduced our Freedom service plans in nearly all of our key markets.

#### Wholesale

Wholesale revenues are earned from 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 that buy dedicated local exchange capacity to support their private networks. Wholesale services also include local wholesale revenues from unbundled network elements (UNEs), interconnection revenues from CLECs and wireless carriers, and some data transport revenues.

Wholesale revenues decreased by \$752 million, or 8.3% in 2006 and by \$53 million, or 0.6% in 2005, due to the exclusion, in 2006, of affiliated access revenues billed to the former MCI mass market entities, and, in 2006 and 2005, to declines in legacy Verizon switched access revenues and local wholesale revenues, offset by increases in special access revenues.

Switched minutes of use declined in 2006 and 2005, reflecting the impact of access line loss and technology substitution. Wholesale lines decreased by 17.1% in 2006 due to the impact of a decision by a major competitor to deemphasize their local market initiatives in 2005. 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. As of December 31, 2006, customer demand for high capacity and digital data services increased 8.9% compared to 2005.

The FCC regulates the rates that we charge customers for interstate access services. See "Other Factors That May Affect Future Results – Regulatory and Competitive Trends – FCC Regulation" for additional information on FCC rulemaking concerning federal access rates, universal service and certain broadband services.

#### Other

Other revenues include services such as operator services (including deaf relay services), public (coin) telephone, card services and supply sales, as well as former MCI dial-around services including 10-10-987, 10-10-220, 1-800-COLLECT and Prepaid Cards.

Verizon Telecom's revenues from other services decreased by \$185 million, or 7.1% in 2006, and by \$93 million, or 3.5% in 2005. These revenue decreases were mainly due to the discontinuation of non-strategic businesses, including the termination of a large commercial

inventory management contract in 2005, and reduced business volumes, which were partially offset by the inclusion of revenues from the former MCI in 2006.

## Verizon Business

### Enterprise Business

Our Enterprise Business market provides voice, data and internet communications services to medium and large business customers, multi-national corporations, and state and federal government customers. In addition, the Enterprise Business market also provides value-added services that make communications more secure, reliable and efficient managed network services for customers that outsource all or portions of their communications and information processing operations. Traditional local and long distance services comprise \$6,551 million, or 47% of revenue in 2006, \$4,110 million, or 68% of revenue in 2005, and \$4,447 million, or 72% of total Enterprise Business revenue in 2004. Enterprise Business also provides data services such as Private Line, Frame Relay and ATM services, both domestically and internationally, as well as managed network services to its customers.

Enterprise Business 2006 revenues of \$13,999 million, increased \$7,981 million, or 132.6% compared to 2005 primarily due to the acquisition of MCI, and declined \$178 million, or 2.9% in 2005 compared to 2004. Data services revenue was \$5,430, or 39% of Enterprise Business's revenue stream in 2006, \$1,908 million, or 32% in 2005, and \$1,749 million, or 28% in 2004. Internet services revenue was \$2,018 million in 2006, or 14% of Enterprise Business's revenues, the first year Enterprise Business offered Internet services. The Internet suite of products is Enterprise Business's fastest growing and includes Private IP, IP VPN, Web Hosting and VoIP.

Enterprise Business 2005 revenues of \$6,018 million declined \$178 million compared to 2004, primarily due to a 3.5% decline in business access lines, reflecting competition and a shift to high-speed, high volume special access lines.

### Wholesale

Our Wholesale revenues relate to domestic wholesale services, which include all wholesale traffic sold in the United States, as well as international traffic that originates in the United States.

In the year ended December 31, 2006, our Verizon Business Wholesale revenues of \$3,381 million, increased \$2,005 million, or 145.7%, compared to 2005, primarily due to the MCI acquisition. Local and long distance voice products, including transport, represented \$1,601 million or 47% of the market's total revenue in 2006, the first year the Wholesale business group has offered voice products. Wholesale revenue is influenced by aggressive competitive pricing, in particular long distance voice services. Wholesale data and Internet revenues were \$1,780 million, or 52% of total Wholesale revenue for the year ended December 31, 2006, \$1,376 million, or 100% of total Wholesale revenue in 2005 and \$1,218 million, or 100% of total Wholesale revenues in 2004.

### International and Other

Our International operations serve businesses, government entities and telecommunication carriers outside of the United States. Other operations include our Skytel paging business.

Our revenues from International and Other in the year ended December 31, 2006 were \$3,110 million. This market represents a new revenue stream to Verizon resulting from the MCI acquisition. International and Other had voice revenue of \$1,822 million in the year ended December 31, 2006, or 58% of the total International and Other revenues. Internet revenue represented \$894 million, or 29% of total revenue in the period. Data revenue was \$394 million, or 13% of total International and Other revenue in the year ended December 31, 2006.

### **Operating Expenses**

| Years Ended December 31,                    | (dollars in millions) |                  |                  |
|---|-----------------------|------------------|------------------|
|   | 2006                  | 2005             | 2004             |
| Cost of services and sales                  | \$ 24,522             | \$ 15,604        | \$ 14,830        |
| Selling, general and administrative expense | 12,116                | 8,419            | 8,621            |
| Depreciation and amortization expense       | 9,590                 | 8,801            | 8,910            |
|   | <b>\$ 46,228</b>      | <b>\$ 32,824</b> | <b>\$ 32,361</b> |

### *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, costs to support our outsourcing contracts and technical facilities, contributions to the universal service fund, customer provisioning costs 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 increased by \$8,918 million, or 57.2% in 2006 compared to 2005. These increases were primarily due to the MCI merger in 2006 partially offset by the net impact of other cost changes. Higher costs associated with our growth businesses and annual wage increases were partially offset by productivity improvement initiatives, which reduced cost of services and sales expenses in 2006. Expenses were also impacted by increased net pension and other postretirement benefit costs. The overall impact of the 2006 assumption changes

combined with the impact of lower than expected actual asset returns over the past several years, resulted in pension and other postretirement benefit expense of \$1,408 million (primarily in cost of services and sales) in 2006 compared to net pension and postretirement benefit expense of \$1,248 million in 2005. Further, expenses decreased in both years due to the discontinuation of non-strategic businesses, including the termination of a large commercial inventory management contract in 2005.

In 2005, our cost of services and sales increased by \$774 million, or 5.2% compared to 2004. Costs in 2005 were impacted by increased pension and other postretirement benefit costs. At December 31, 2004, in connection with an evaluation of key employee benefit plan assumptions, the discount rate assumption was lowered from 6.25% in 2004 to 5.75% in 2005, consistent with interest rate levels at the end of 2004. Further, there was an increase in the retiree health care cost trend rates. The overall impact of these assumption changes, combined with the impact of lower than expected actual asset returns over the last several years, resulted in net pension and other postretirement benefit expense (primarily in cost of services and sales) of \$1,248 million in 2005, compared to net pension and postretirement benefit expense of \$803 million in 2004. Also contributing to expense increases in cost of services and sales were higher costs associated with our growth businesses. Further, the expense increase was impacted by favorable adjustments to our interconnection expense in 2004, as a result of our ongoing reviews of local interconnection expense charged by CLECs and settlements with carriers.

#### *Selling, General and Administrative Expense*

Selling, general and administrative expenses in 2006 increased by \$3,697 million or 43.9% compared to 2005. These increases were primarily due to the inclusion of expenses from the former MCI in 2006 partially offset by synergy savings resulting from our merger integration efforts, the impact of gains from real estate sales and lower bad debt costs.

In 2005, our selling, general and administrative expense decreased by \$202 million, or 2.3% compared to 2004. This decrease was attributable to gains on the sale of real estate in 2005, lower property and gross receipts taxes and reduced bad debt costs, partially offset by higher net pension and benefit costs, as described above, and a prior year gain on the sale of two small business units.

#### *Depreciation and Amortization Expense*

The increase in depreciation and amortization expense of \$789 million, or 9.0% in 2006 was mainly driven by the acquisition of MCI's depreciable property and equipment and finite-lived intangibles, including its customer lists and capitalized non-network software, measured at fair value and by growth in depreciable telephone plant and non-network software assets. The decrease in depreciation and amortization expense of \$109 million or 1.2%, in 2005 compared to 2004 was mainly driven by lower rates of depreciation, partially offset by higher plant, property and equipment balances and software amortization costs.

### **Segment Income**

| Years Ended December 31, | (dollars in millions) |          |          |
|--------------------------|-----------------------|----------|----------|
|                          | 2006                  | 2005     | 2004     |
| Segment Income           | <b>\$ 1,634</b>       | \$ 1,906 | \$ 2,652 |

Segment income decreased by \$272 million, or 14.3% in 2006 and by \$746 million, or 28.1% in 2005, due to the after-tax impact of operating revenues and operating expenses described above, along with the impact of favorable income tax adjustments in 2005.

Special and non-recurring items not included in Verizon Wireline's segment income totaled \$407 million, (\$168) million and \$346 million in 2006, 2005, and 2004 respectively. Special and non-recurring items in 2006 included costs associated with severance activity, pension settlement losses, Verizon Center relocation-related costs, and merger integration costs. Merger integration costs primarily included costs related to advertising and re-branding initiatives, and labor and contractor costs related to information technology integration initiatives. Special and non-recurring items in 2005 related to the Hawaii results of operations and gain on the sale of the Hawaii wireline operations, the net gain on the sale of a New York City office building, changes to management retirement benefit plans, severance costs, and Verizon Center relocation-related costs. Special and non-recurring items in 2004 primarily included pension settlement losses, operating asset losses, 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.

### **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**

| Years Ended December 31,    | (dollars in millions) |           |           |
|-----------------------------|-----------------------|-----------|-----------|
|                             | 2006                  | 2005      | 2004      |
| Wireless sales and services | <b>\$ 38,043</b>      | \$ 32,301 | \$ 27,662 |

Domestic Wireless's total revenues of \$38,043 million were \$5,742 million, or 17.8% higher in 2006 compared to 2005. Service revenues of \$32,796 million were \$4,665 million, or 16.6% higher than 2005. The service revenue increase was primarily due to a 15.0% increase in customers as of December 31, 2006 compared to December 31, 2005, and increased average revenue per customer. Equipment and other revenue increased \$1,077 million, or 25.8% in 2006 compared to 2005 principally as a result of increases in the number and price of wireless devices sold. Other revenue also increased due to increases in regulatory fees, primarily the universal service fund, and cost recovery surcharges.

Our Domestic Wireless segment ended 2006 with 59.1 million customers, an increase of 7.7 million net new customers, or 15.0% compared to December 31, 2005. Substantially all of the net customers added during 2006 were retail customers. The overall composition of our Domestic Wireless customer base as of December 31, 2006 was 92.6% retail postpaid, 3.6% retail prepaid and 3.8% resellers. Total average monthly churn, the rate at which customers disconnect service, decreased to 1.17% in 2006 compared to 1.26% in 2005. Retail postpaid churn decreased to 0.9% in 2006 compared to 1.1% in 2005.

Average revenue per customer per month increased 0.6% to \$49.80 in 2006 compared to 2005. Average service revenue per customer reflected a 72% increase in data revenue per customer in 2006, compared to 2005, driven by increased use of our messaging, *VZAccess* and other data services. Retail service revenue per retail customer of \$50.44 also grew in 2006, compared to 2005. However, Domestic Wireless continued to experience an increase in the proportion of customers on its Family Share price plans, which put downward pressure on average service revenue per customer during 2006. Data revenues were \$4,475 million and accounted for 13.6% of service revenue in 2006, compared to \$2,243 million and 8.0% of service revenue in 2005.

Domestic Wireless's total revenues of \$32,301 million were \$4,639 million, or 16.8% higher in 2005 compared to 2004. Service revenues of \$28,131 million were \$3,731 million, or 15.3% higher than 2004. This revenue growth was primarily due to increased customers, partially offset by a decrease in average revenue per customer per month, and increases in equipment and other revenue, principally as a result of an increase in wireless devices sold together with an increase in revenue per unit sold. At December 31, 2005, customers totaled 51.3 million, an increase of 17.2% compared to December 31, 2004. Retail net additions accounted for 7.2 million, or 95.8% of the total net additions. Total churn decreased to 1.3% in 2005, compared to 1.5% in 2004. Retail postpaid churn decreased to 1.1% in 2005 compared to 1.3% in 2004.

Average revenue per customer per month decreased 1.5% to \$49.49 in 2005 compared to 2004, primarily due to pricing changes to our America's Choice and Family Share plans earlier in the year. Partially offsetting the impact of these pricing changes was a 71.7% increase in data revenue per customer in 2005 compared to 2004, driven by increased use of our messaging and other data services. Data revenues were \$2,243 million and accounted for 8.0% of service revenue in 2005, compared to \$1,116 million and 4.6% of service revenue in 2004.

## Operating Expenses

| Years Ended December 31,                    | (dollars in millions) |                  |                  |
|---|-----------------------|------------------|------------------|
|   | 2006                  | 2005             | 2004             |
| Cost of services and sales                  | \$ 11,491             | \$ 9,393         | \$ 7,747         |
| Selling, general and administrative expense | 12,039                | 10,768           | 9,591            |
| Depreciation and amortization expense       | 4,913                 | 4,760            | 4,486            |
|   | <b>\$ 28,443</b>      | <b>\$ 24,921</b> | <b>\$ 21,824</b> |

### *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 \$2,098 million, or 22.3% in 2006 compared to 2005. Cost of services increased due to higher wireless network costs in 2006 caused by increased network usage relating to both voice and data services, partially offset by lower rates for long distance, roaming and local interconnection. Cost of equipment sales grew by 29.7% in 2006 compared to 2005. The increase was primarily attributed to an increase in wireless devices sold, resulting from an increase in equipment upgrades and gross retail activations, together with an increase in cost per unit driven by increased sales of higher cost advanced wireless devices, in 2006, compared to 2005.

Cost of services and sales increased by \$1,646 million, or 21.2% in 2005 compared to 2004. This increase was primarily due to higher network charges resulting from increased network usage in 2005 compared to 2004, and an increase in cost of equipment sales driven by increased wireless devices sold and equipment upgrades in 2005 compared to 2004.

### *Selling, General and Administrative Expense*

Selling, general and administrative expense increased by \$1,271 million, or 11.8% in 2006 compared to 2005. This increase was primarily due to an increase in salary and benefits expense of \$632 million, resulting from an increase in employees, primarily in the sales and customer care areas, and higher per employee salary and benefit costs. Advertising and promotion expense increased \$207 million in 2006, compared to 2005. Also contributing to the increase were higher costs associated with regulatory fees, primarily the universal service fund, which increased by \$167 million in 2006 compared to 2005.

Selling, general and administrative expense increased by \$1,177 million, or 12.3% in 2005 compared to 2004. This increase was primarily due to increased salary and benefits expense and higher sales commissions, related to an increase in customer additions and renewals during 2005 compared to 2004.

#### *Depreciation and Amortization Expense*

Depreciation and amortization expense increased by \$153 million, or 3.2% in 2006 compared to 2005 and increased by \$274 million, or 6.1% in 2005 compared to 2004. These increases were primarily due to increased depreciation expense related to the increases in depreciable assets. The increase in 2006 was partially offset by a decrease in amortization expense due to fully amortized customer lists.

#### **Segment Income**

| Years Ended December 31, | (dollars in millions) |          |          |
|--------------------------|-----------------------|----------|----------|
|                          | 2006                  | 2005     | 2004     |
| Segment Income           | <b>\$ 2,976</b>       | \$ 2,219 | \$ 1,645 |

Segment income increased by \$757 million, or 34.1% in 2006 compared to 2005 and increased by \$574 million, or 34.9% in 2005 compared to 2004, primarily as a result of the after-tax impact of operating revenues and operating expenses described above, partially offset by higher minority interest expense. Special and non-recurring items of \$42 million after-tax were due to the adoption of SFAS 123 (R). There were no special items affecting this segment in 2005 or 2004.

Increases in minority interest expense in 2006 and 2005 were principally due to the increased income of the wireless joint venture and the significant minority interest attributable to Vodafone.

#### **Special Items**

#### **Disposition of Businesses and Investments**

##### **Sale of Discontinued Operations**

On December 1, 2006, we closed the sale of Verizon Dominicana. The transaction resulted in net pretax cash proceeds of \$2,042 million. The U.S. taxes that became payable and were recognized at the time the transaction closed significantly exceeded the amount of the pretax gain of \$30 million. The sale resulted in an after-tax loss of \$541 million (or \$.18 per diluted share). There were no similar items in 2005. In 2004, we closed on the sale of Verizon Information Services Canada Inc. and recorded a gain of \$1,017 million (\$516 million after-tax, or \$.18 per diluted share).

##### **Sales of Businesses, Net**

During 2005, we sold our wireline and directory businesses in Hawaii, including Verizon Hawaii Inc. which operated approximately 700,000 switched access lines, as well as the services and assets of Verizon Long Distance, Verizon Online, Verizon Information Services and Verizon Select Services Inc. in Hawaii, to an affiliate of The Carlyle Group for \$1,326 million in cash proceeds. In connection with this sale, we recorded a net pretax gain of \$530 million (\$336 million after-tax, or \$.12 per diluted share). There were no similar items in 2006 and 2004.

##### **Sales of Investments, Net**

During 2004, we recorded a pretax gain of \$787 million (\$565 million after-tax, or \$.20 per diluted share) on the sale of our 20.5% interest in TELUS in an underwritten public offering in the U.S. and Canada. In connection with this sale transaction, Verizon recorded a contribution of \$100 million to Verizon Foundation to fund its charitable activities and increase its self-sufficiency. Consequently, we recorded a net gain of \$500 million after taxes, or \$.18 per diluted share related to this transaction and the accrual of the Verizon Foundation contribution.

Also during 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). This preferred stock was received in 2000 in connection with the sale of access lines in Iowa. There were no similar items in 2006 and 2005.

##### **Spin-off Related Charges**

In 2006, we recorded pretax charges of \$117 million (\$101 million after-tax, or \$.03 per diluted share) for costs related to the spin-off of Idearc. These costs primarily consisted of banking and legal fees, as well as filing fees, printing and mailing costs. There were no similar charges in 2005 and 2004.

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## Merger Integration Costs

In 2006, we recorded pretax charges of \$232 million (\$146 million after-tax, or \$.05 per diluted share) related to integration costs associated with the MCI acquisition that closed on January 6, 2006. These costs are primarily comprised of advertising and other costs related to re-branding initiatives and systems integration activities. There were no similar charges incurred in 2005 and 2004.

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## Facility and Employee-Related Items

During 2006, we recorded pretax charges of \$184 million (\$118 million after-tax) in connection with the continued relocation of employees and business operations to Verizon Center located in Basking Ridge, New Jersey. During 2005, we recorded a net pretax gain of \$18 million (\$8 million after-tax) in connection with this relocation of our new operations center, Verizon Center, including a pretax gain of \$120 million (\$72 million after-tax) related to the sale of a New York City office building, partially offset by a pretax charge of \$102 million (\$64 million after-tax) primarily associated with relocation, employee severance and related activities. There were no similar charges incurred in 2004.

During 2006, we recorded net pretax severance, pension and benefits charges of \$425 million (\$258 million after-tax, including \$3 million of income recorded to discontinued operations, or \$.09 per diluted share). These charges included net pretax pension settlement losses of \$56 million (\$26 million after-tax, or \$.01 per diluted share) related to employees that received lump-sum distributions primarily resulting from our separation plans. 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* (SFAS No. 88), which requires that settlement losses be recorded once prescribed payment thresholds have been reached. Also included are pretax charges of \$369 million (\$228 million after-tax, or \$.08 per diluted share), for employee severance and severance-related costs in connection with the involuntary separation of approximately 4,100 employees. In addition, during 2005 we recorded a charge of \$59 million (\$36 million after-tax, or \$.01 per diluted share) associated with employee severance costs and severance-related activities in connection with the voluntary separation program for surplus union-represented employees.

During 2005, we recorded a net pretax charge of \$98 million (\$59 million after-tax) related to the restructuring of the Verizon management retirement benefit plans. This pretax charge was recorded in accordance with SFAS No. 88, and SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions* (SFAS No. 106) and includes the unamortized cost of prior pension enhancements of \$430 million offset partially by a pretax curtailment gain of \$332 million related to retiree medical benefits. In connection with this restructuring, management employees: no longer earn pension benefits or earn service towards the company retiree medical subsidy after June 30, 2006; received an 18-month enhancement of the value of their pension and retiree medical subsidy; and receive a higher savings plan matching contribution.

During 2004, we recorded pretax pension settlement losses of \$805 million (\$492 million after-tax) related to employees that received lump-sum distributions during 2004 in connection with the 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. In addition, we recorded a \$7 million after-tax charge in income from discontinued operations, related to the 2003 separation plan.

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## Tax Matters

During 2005, we recorded tax benefits of \$336 million in connection with capital gains and prior year investment losses. As a result of the capital gain realized in 2005 in connection with the sale of our Hawaii businesses, we recorded a tax benefit of \$242 million related to capital losses incurred in previous years. The investment losses pertain to Iusacell, CTI Holdings, S.A. (CTI) and TelecomAsia.

Also during 2005, we recorded a net tax provision of \$206 million related to the repatriation of foreign earnings under the provisions of the American Jobs Creation Act of 2004, for two of our foreign investments.

As a result of the capital gain realized in 2004 in connection with the sale of Verizon Information Services Canada, we recorded tax benefits of \$234 million in the fourth quarter of 2004 pertaining to prior year investment impairments. The investment impairments primarily related to debt and equity investments in CTI, Cable & Wireless plc and NTL Incorporated.

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## Other Special Items

During 2006, we recorded pretax charges of \$26 million (\$16 million after-tax, or \$.01 per diluted share) resulting from the extinguishment of debt assumed in connection with the completion of the MCI merger.

As discussed in the "Cumulative Effect of Accounting Change" section, during 2006, we recorded after-tax charges of \$42 million (\$.01 per diluted share) to recognize the adoption of SFAS No. 123 (R).

During 2005, we recorded pretax charges of \$139 million (\$133 million after-tax, or \$.05 per diluted share) including a pretax impairment charge of \$125 million (\$125 million after-tax, or \$.04 per diluted share) pertaining to aircraft leased to airlines involved in bankruptcy proceedings and a pretax charge of \$14 million (\$8 million after-tax, or less than \$.01 per diluted share) in connection with the early extinguishment of debt.

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 that were recovered upon the emergence of MCI from bankruptcy.

Also during 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 \$55 million (\$34 million after-tax, or \$.01 per diluted share) in connection with the early extinguishment of debt.

### Consolidated Financial Condition

| Years Ended December 31,                                | (dollars in millions) |            |           |
|---|-----------------------|------------|-----------|
|   | 2006                  | 2005       | 2004      |
| <b>Cash Flows Provided By (Used In)</b>                 |                       |            |           |
| Operating activities                                    | <b>\$ 24,106</b>      | \$ 22,025  | \$ 21,791 |
| Investing activities                                    | <b>(15,616)</b>       | (18,492)   | (10,343)  |
| Financing activities                                    | <b>(6,031)</b>        | (5,034)    | (9,856)   |
| <b>Increase (Decrease) In Cash and Cash Equivalents</b> | <b>\$ 2,459</b>       | \$ (1,501) | \$ 1,592  |

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 2006, the increase in cash from operating activities compared to 2005 was primarily due to higher earnings at Domestic Wireless, which included higher minority interest earnings, and lower dividends paid to minority partners. Total minority interest earnings, net of dividends paid to minority interest partners, was \$3.2 billion in 2006 compared to \$1.7 billion in 2005. In addition, higher operating cash flow in 2006 compared to 2005 was due to lower cash taxes paid in 2006, resulting from 2005 tax payments related to foreign operations and investments sold during the fourth quarter of 2004. Partially offsetting these increases were significant 2005 repatriations of foreign earnings of unconsolidated businesses.

In 2005, the increase in cash from operations compared to 2004 was primarily driven higher by the repatriation of \$2.2 billion of foreign earnings from unconsolidated businesses, higher minority interest earnings, net of dividends paid to minority partners of \$1.0 billion and lower severance payments in 2005. These increases were largely offset by higher cash income tax payments, including taxes paid in 2005 related to the 2004 sales of Verizon Information Services Canada and TELUS shares, and higher pension fund contributions.

Operating cash flows from discontinued operations decreased \$505 million to \$1,076 million in 2006 due to the completion of the Idearc spin-off on November 17, 2006 and the close of the sale of Verizon Dominicana on December 1, 2006, partially offset by the operating activities of the remaining assets held for sale. Operating cash flows from discontinued operations decreased \$34 million from \$1,615 million in 2004 to \$1,581 million in 2005 due to the completion of the sale of Verizon Information Services Canada in the fourth quarter of 2004, partially offset by operating activities of the remaining assets held for sale.

### Cash Flows Used In Investing Activities

Capital expenditures continue to be our primary use of capital resources as they 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 \$10,259 million in our Wireline business in 2006, compared to \$8,267 million and \$7,118 million in 2005 and 2004, respectively. We also invested \$6,618 million in our Verizon Wireless business in 2006, compared to \$6,484 million and \$5,633 million in 2005 and 2004, respectively. The increase in capital spending at Wireline is mainly driven by the acquisition of MCI, coupled with increased spending in high growth areas such as broadband. Capital spending at Verizon Wireless represents our continuing effort to invest in this high growth business.

In 2007, capital expenditures including capitalized software are expected to be in the range of \$17.5 billion to \$17.9 billion.

In 2006, we invested \$1,422 million in acquisitions and investments in businesses, including \$2,809 million to acquire thirteen 20 MHz licenses in connection with the FCC Advanced Wireless Services auction and \$57 million to acquire other wireless properties. This was offset by MCI's cash balances of \$2,361 million at the date of the merger, of which \$779 million was used for a cash payment to MCI shareholders. In 2005, we invested \$4,684 million in acquisitions and investments in businesses, including \$3,003 million to acquire NextWave Telecom Inc. (NextWave) personal communications services licenses, \$641 million to acquire 63 broadband wireless licenses in connection with FCC auction 58, \$419 million to purchase Qwest Wireless, LLC's spectrum licenses and wireless network assets in several existing and new markets, \$230 million to purchase spectrum from MetroPCS, Inc. and \$297 million for other wireless properties and licenses. In 2004, we

invested \$1,196 million in acquisitions and investments in businesses, including \$1,052 million for wireless licenses and businesses, including a NextWave license covering the New York metropolitan area, and \$144 million related to Verizon's limited partnership investments in entities that invest in affordable housing projects.

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In 2005, we received cash proceeds of \$1,326 million in connection with the sale of Verizon's wireline operations in Hawaii. In 2004, we received cash proceeds of \$117 million from the sale of a small business unit.

Our short-term investments include principally cash equivalents held in trust accounts for payment of employee benefits. In 2006, 2005 and 2004, we invested \$1,915 million, \$1,955 million and \$1,801 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 \$2,205 million, \$1,609 million and \$1,711 million in the years 2006, 2005 and 2004, respectively.

Other, net investing activities for 2006 include cash proceeds of \$283 million from property sales. Other, net investing activities for 2005 includes a net investment of \$913 million for the purchase of 43.4 million shares of MCI common stock from eight entities affiliated with Carlos Slim Helú, offset by cash proceeds of \$713 million from property sales, including a New York City office building, and \$349 million of repatriated proceeds from the sales of European investments in prior years. Other, net investing activities for 2004 includes net cash proceeds of \$1,632 million received in connection with the sale of our 20.5% interest in TELUS and \$650 million in connection with sales of our interests in various other investments, including a partnership venture with Crown Castle International Corp., EuroTel Bratislava, a.s. and Iowa Telecom preferred stock.

In 2006, investing activities of discontinued operations include net pretax cash proceeds of \$2,042 million in connection with the sale of Verizon Dominicana. In 2005, investing activities of discontinued operations are primarily related to capital expenditures related to discontinued operations. In 2004, investing activities of discontinued operations include cash proceeds of \$1,603 million from the sale of Verizon Information Services Canada, partially offset by capital expenditures related to discontinued operations.

Under the terms of an investment agreement, Vodafone had the right to require Verizon Wireless to purchase up to an aggregate of \$20 billion worth of Vodafone's interest in Verizon Wireless at designated times (put windows) at its then fair market value, not to exceed \$10 billion in any one put window. Vodafone had the right to require the purchase of up to \$10 billion during a 61-day period which opened on June 10 and closed on August 9 in 2006, and did not exercise that right. As of December 31, 2006, Vodafone only has the right to require the purchase of up to \$10 billion worth of its interest, during a 61-day period opening on June 10 and closing on August 9 in 2007, under its one remaining put window. 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. In the event Vodafone exercises its one remaining put right, we (instead of Verizon Wireless) have the right, exercisable at our sole discretion, to purchase up to \$2.5 billion of Vodafone's interest for cash or Verizon stock at our option.

#### **Cash Flows Used In Financing Activities**

Our total debt was reduced by \$1,896 million during 2006. We repaid \$6,838 million of Wireline debt, including premiums associated with the retirement of \$5,665 million of aggregate principal amount of long-term debt assumed in connection with the MCI merger. The Wireline repayments also included the early retirement/prepayment of \$697 million of long-term debt and \$155 million of other long-term debt at maturity. We repaid \$2.5 billion of Domestic Wireless 5.375% fixed rate notes that matured on December 15, 2006. At December 31, 2006, Verizon Wireless had no third-party debt. Also, we redeemed the \$1,375 million accreted principal of our remaining zero-coupon convertible notes and retired \$482 million of other corporate long-term debt at maturity. These repayments were partially offset by our issuance of long-term debt with a total aggregate principal amount of \$4,000 million, resulting in cash proceeds of \$3,958 million, net of discounts, issuance costs and the receipt of cash proceeds related to hedges on the interest rate of an anticipated financing. In connection with the spin-off of Idearc, we received net cash proceeds of approximately \$2 billion and retired debt in the aggregate principal amount of approximately \$7 billion (see Other Consolidated Results – Discontinued Operations – Verizon Information Services).

Cash of \$240 million was used to reduce our total debt during 2005. We repaid \$1,533 million of Domestic Wireless, \$1,183 million of Wireline and \$1,109 million of Verizon corporate long-term debt. The Wireline debt repayment included the early retirement of \$350 million of long-term debt and \$806 million of other long-term debt at maturity. This decrease was largely offset by the issuance by Verizon corporate of long-term debt with a total principal amount of \$1,500 million, resulting in total cash proceeds of \$1,478 million, net of discounts and costs, and an increase in our short-term borrowings of \$2,098 million.

Cash of \$5,401 million was used to reduce our total debt during 2004. We repaid \$2,315 million and \$2,769 million of Wireline and Verizon corporate long-term debt, respectively. The Wireline debt repayment includes the early retirement of \$1,275 million of long-term debt and \$950 million of other long-term debt at maturity. The corporate debt repayment includes \$1,984 million of zero-coupon convertible notes redeemed by Verizon corporate and \$723 million of other corporate long-term debt at maturity. Also, during 2004, we decreased our short-term borrowings by \$747 million and Verizon corporate issued \$500 million of long-term debt.

Our ratio of debt to debt combined with shareowners' equity was 42.8% at December 31, 2006 compared to 49.1% at December 31, 2005.

As of December 31, 2006, we had no bank borrowings outstanding. We also had approximately \$6.2 billion of unused bank lines of credit (including a \$6.0 billion three-year committed facility that expires in September 2009 and various other facilities totaling approximately \$400 million) and we had shelf registrations for the issuance of up to \$4.5 billion of unsecured debt securities. The debt securities of Verizon and our telephone subsidiaries continue to be accorded high ratings by primary rating agencies. In order to simplify and streamline our

financing entities, Verizon Global Funding merged into Verizon Communications on February 1, 2006. Verizon Communications is now the primary issuer of all long-term and short-term debt for Verizon. The short-term ratings of Verizon Communications are: Moody's P-2;

S&P A-1; and Fitch F1. The long-term ratings of Verizon Communications are: Moody's A3 with stable outlook; S&P A with negative outlook; and Fitch A+ with stable outlook. In June 2006, the long-term debt rating of Verizon Wireless was upgraded by Moody's to A2 from A3 and assigned a stable outlook and the long-term debt rating of Verizon Communications was affirmed at A3 with a stable outlook. In December 2006, Fitch affirmed the long-term debt rating of Verizon Communications at A+ with a stable outlook. Following the maturity of its remaining external debt in December 2006, Moody's and Fitch withdrew the rating on Verizon Wireless.

We and our consolidated subsidiaries are in compliance with all of our 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 2006 and 2005, Verizon declared quarterly cash dividends of \$.405 per share. In 2004, we declared quarterly cash dividends of \$.385 per share.

Common stock has been used from time to time to satisfy some of the funding requirements of employee and shareowner plans. On January 19, 2006, the Board of Directors determined that no additional common shares could be purchased under previously authorized share repurchase programs and gave authorization to repurchase of up to 100 million common shares terminating no later than the close of business on February 28, 2008. We repurchased \$1,700 million of our common stock as part of this program.

#### **Increase (Decrease) In Cash and Cash Equivalents**

Our cash and cash equivalents at December 31, 2006 totaled \$3,219 million, a \$2,459 increase compared to cash and cash equivalents at December 31, 2005 of \$760 million. The increase in cash and cash equivalents in 2006 was primarily driven by proceeds from the disposition of Verizon Dominicana and the spin-off of Idearc, cash acquired in connection with the merger of MCI and higher debt borrowings, partially offset by increased capital expenditures and higher repayments of borrowings. Our cash and cash equivalents at December 31, 2005 totaled \$760 million, a \$1,501 million decrease compared to cash and cash equivalents at December 31, 2004 of \$2,261 million. The decrease in cash and cash equivalents in 2005 was primarily driven by increased capital expenditures and higher acquisitions and investments, partially offset by proceeds from the sale of businesses and lower repayments of borrowings.

#### **Employee Benefit Plan Funded Status and Contributions**

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106, and 132(R)* (SFAS No. 158). SFAS No. 158 requires the recognition of a defined benefit postretirement plan's funded status as either an asset or liability on the balance sheet. SFAS No. 158 also requires the immediate recognition of the unrecognized actuarial gains and losses and prior service costs and credits that arise during the period as a component of Other Accumulated Comprehensive Income, net of applicable income taxes. Additionally, the fair value of plan assets must be determined as of the company's year-end. We adopted SFAS No. 158 effective December 31, 2006 which resulted in a net decrease to shareowners' investment of \$6,883 million. This included a net increase in pension obligations of \$2,403 million, an increase in Other Postretirement Benefits Obligations of \$10,828 million and an increase in Other Employee Benefit Obligations of \$31 million, partially offset by a net decrease of \$1,205 million to reverse the Additional Minimum Pension Liability and an increase in deferred taxes of \$5,174 million.

Prior to the adoption of SFAS No. 158 we evaluated each pension plan to determine whether an additional minimum pension liability was required or whether any adjustment was necessary as determined by the provisions of SFAS No. 87, *Employers' Accounting for Pensions*. In 2005, we recorded a benefit of \$51 million, net of tax, primarily in Employee Benefit Obligations in the consolidated balance sheets. The changes in the assets and liabilities were 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. The majority of Verizon's pension plans are adequately funded. We contributed \$451 million, \$593 million and \$145 million in 2006, 2005 and 2004, respectively, to our qualified pension trusts. We also contributed \$117 million, \$105 million and \$114 million to our nonqualified pension plans in 2006, 2005 and 2004, respectively.

Based on the funded status of the plans at December 31, 2006, we anticipate qualified pension trust contributions of \$510 million in 2007. Our estimate of required qualified pension trust contributions for 2008 is approximately \$300 million. Nonqualified pension contributions are estimated to be approximately \$120 million and \$180 million for 2007 and 2008, respectively.

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 funding requirements similar to the pension plans. We contributed \$1,099 million, \$1,040 million and \$1,099 million to our other postretirement benefit plans in 2006, 2005 and 2004, respectively. Contributions to our other postretirement benefit plans are estimated to be approximately \$1,210 million in 2007 and \$1,580 million in 2008, prior to anticipated receipts related to Medicare subsidies.

## 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, telecommunications and other equipment are leased for remaining terms of less than 1 year to 49 years as of December 31, 2006. 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 assets and rentals, the related principal and interest have been offset against the minimum lease payments receivable in accordance with generally accepted accounting principles. All recourse debt is reflected in our consolidated balance sheets. See "Special Items" for a discussion of lease impairment charges.

## 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, 2006. Additional detail about these items is included in the notes to the consolidated financial statements.

(dollars in millions)

| Contractual Obligations                   | Payments Due By Period |                  |           |           |                   |
|---|------------------------|------------------|-----------|-----------|-------------------|
|   | Total                  | Less than 1 year | 1-3 years | 3-5 years | More than 5 years |
| Long-term debt (see Note 11)              | \$ 32,425              | \$ 4,084         | \$ 3,784  | \$ 5,316  | \$ 19,241         |
| Capital lease obligations (see Note 10)   | 360                    | 55               | 101       | 81        | 123               |
| Total long-term debt                      | 32,785                 | 4,139            | 3,885     | 5,397     | 19,364            |
| Interest on long-term debt (see Note 11)  | 23,300                 | 1,915            | 3,449     | 2,965     | 14,971            |
| Operating leases (see Note 10)            | 6,843                  | 1,739            | 2,192     | 1,183     | 1,729             |
| Purchase obligations (see Note 21)        | 812                    | 566              | 217       | 16        | 13                |
| Other long-term liabilities (see Note 15) | 3,600                  | 1,720            | 1,880     | –         | –                 |
| Total contractual obligations             | \$ 67,340              | \$ 10,079        | \$ 11,623 | \$ 9,561  | \$ 36,077         |

## Guarantees

In connection with the execution of agreements for the sales of businesses and investments, Verizon ordinarily provides representations and warranties to the purchasers pertaining to a variety of nonfinancial matters, such as ownership of the securities being sold, as well as financial losses.

As of December 31, 2006, letters of credit totaling \$223 million had been executed in the normal course of business, which support several financing arrangements and payment obligations to third parties.

## 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 and collars and equity options. 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.

## Interest Rate Risk

The table that follows summarizes the fair values of our long-term debt and interest rate derivatives as of December 31, 2006 and 2005. 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.

|  | Fair Value | Fair Value assuming<br>+100 basis point shift | (dollars in millions)<br>Fair Value assuming<br>-100 basis point shift |
|--|------------|---|--|
| At December 31, 2006                         |            |   |  |
| Long-term debt and interest rate derivatives | \$ 33,569  | \$ 31,724                                     | \$ 35,607  |
| At December 31, 2005                         |            |   |  |
| Long-term debt and interest rate derivatives | \$ 37,340  | \$ 35,421                                     | \$ 39,478  |

## Foreign Currency Translation

The functional currency for our foreign operations is primarily the local currency. The translation of income statement and balance sheet amounts of our foreign operations into U.S. dollars are recorded as cumulative translation adjustments, which are included in Accumulated Other Comprehensive Loss in our consolidated balance sheets. The translation gains and losses of foreign currency transactions and balances are recorded in the consolidated statements of income in Other Income and (Expense), Net and Income from Discontinued Operations, Net of Tax. At December 31, 2006, our primary translation exposure was to the Venezuelan bolivar, British pound and the euro. During 2005, we entered into zero cost euro collars to hedge a portion of our net investment in Vodafone Omnitel. 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 impact of foreign currency changes on the value of our net investment in the operation being hedged. As of December 31, 2005, our positions in the zero cost euro collars have been settled. We have not hedged our accounting translation exposure to foreign currency fluctuations relative to the carrying value of our other investments.

## Significant Accounting Policies and Recent Accounting Pronouncements

### 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. Special and non-recurring items include asset impairment losses, which 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.
- Verizon's plant, property and equipment balance represents a significant component of our consolidated assets. Depreciation expense on Verizon's local telephone operations is principally based on the composite group remaining life method and straight-line composite rates, which 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. We depreciate other plant, property and equipment generally on a straight-line basis over the estimated useful life of the assets. Changes in the remaining useful lives of assets as a result of technological change or other changes in circumstances, including competitive factors in the markets where we operate, can have a significant impact on asset balances and depreciation expense.
- 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 health care trend rates 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"). A sensitivity analysis of the impact of changes in these assumptions on the benefit obligations and expense (income) recorded as of December 31, 2006 and for the year then ended pertaining to Verizon's pension and postretirement benefit plans is provided in the tables below. Note that some of these sensitivities are not symmetrical as the calculations were based on all of the actuarial assumptions as of year-end.

|  | Percentage point change | Benefit obligation increase (decrease) at December 31, 2006 | (dollars in millions)<br>Expense increase (decrease) for the year ended December 31, 2006 |
|--|-------------------------|---|---|
| Pension plans discount rate                            | + 1.00                  | \$ (3,844)  | \$ (130)  |
|  | - 1.00                  | 4,597   | 266   |
| Long-term rate of return on pension plan assets        | + 1.00                  | —   | (378)   |
|  | - 1.00                  | —   | 378   |
| Postretirement plans discount rate                     | + 1.00                  | (3,245)   | (209)   |
|  | - 1.00                  | 3,693   | 236   |
| Long-term rate of return on postretirement plan assets | + 1.00                  | —   | (40)  |
|  | - 1.00                  | —   | 40  |
| Health care trend rates                                | + 1.00                  | 3,339   | 472   |
|  | - 1.00                  | (2,731)   | (357)   |

- 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 the adoption of new accounting standards, acquisitions of businesses and 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.
- Goodwill and other intangible assets are a significant component of our consolidated assets. Wireline goodwill of \$5,310 million represents the largest component of our goodwill and, as required by SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS No. 142), is periodically evaluated for impairment. The evaluation of Wireline goodwill for impairment is primarily based on a discounted cash flow model that includes estimates of future cash flows. There is inherent subjectivity involved in estimating future cash flows, which can have a material impact on the amount of any potential impairment. Wireless licenses of \$50,959 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 not 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. For 2004 and 2003, we used a residual method, which determined fair value by estimating future cash flows of the wireless business. Beginning in 2005, we began using a direct value approach in accordance with a September 29, 2004 Staff Announcement from the staff of the Securities and Exchange Commission (SEC), “Use of the Residual Method to Value Acquired Assets Other Than Goodwill.” The direct value approach also determines fair value by estimating future cash flows. There is inherent subjectivity involved in estimating future cash flows, which can have a material impact on the amount of any impairment.

## Other Recent Accounting Pronouncements

### Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans

In September 2006, the FASB issued SFAS No. 158, *Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)* (SFAS No. 158). SFAS No. 158 requires the recognition of a defined benefit postretirement plan’s funded status as either an asset or liability on the balance sheet. SFAS No. 158 also requires the immediate recognition of the unrecognized actuarial gains and losses and prior service costs and credits that arise during the period as a component of Other Accumulated Comprehensive Income, net of applicable income taxes. Additionally, the fair value of plan assets must be determined as of the company’s year-end. We adopted SFAS No. 158 effective December 31, 2006, which resulted in a net decrease to shareowners’ investment of \$6,883 million.

### Uncertainty in Income Taxes

In July 2006, the FASB issued Interpretation No. 48, “Accounting for Uncertainty in Income Taxes” (FIN 48). FIN 48 requires the use of a two-step approach for recognizing and measuring tax benefits taken or expected to be taken in a tax return and disclosures regarding

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uncertainties in income tax positions. We are required to adopt FIN 48 effective January 1, 2007. The cumulative effect of initially adopting FIN 48 will be recorded as an adjustment to opening retained earnings (or to goodwill, in certain cases for a prior acquisition) in the year of adoption and will be presented separately. Only tax positions that meet the more likely than not recognition threshold at the effective date may be recognized upon adoption of FIN 48. We anticipate that as a result of the adoption of FIN 48, we will record an adjustment to our opening retained earnings. We are also reviewing the potential impact of FIN 48 on prior purchase accounting. Any such purchase accounting adjustment will not impact retained earnings or current earnings. We are reviewing the final impact of the adoption of FIN 48. We anticipate that any required adjustment under the adoption of FIN 48 will not be material.

### **Leveraged Leases**

In July 2006, the FASB issued Staff Position No. FAS 13-2, "Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction" (FSP 13-2). FSP 13-2 requires that changes in the projected timing of income tax cash flows generated by a leveraged lease transaction be recognized as a gain or loss in the year in which change occurs. We are required to adopt FSP 13-2 effective January 1, 2007. The cumulative effect of initially adopting this FSP will be recorded as an adjustment to opening retained earnings in the year of adoption. We anticipate that any required adjustment under the adoption of FSP 13-2 will not be material.

### **Fair Value Measurements**

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurement* (SFAS No. 157). SFAS No. 157 expands disclosures about fair value measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and establishes a hierarchy that categorizes and prioritizes the sources to be used to estimate fair value. We are required to adopt SFAS No. 157 effective January 1, 2008 on a prospective basis. We are currently evaluating the impact this new standard will have on our future results of operations and financial position.

## **Other Factors That May Affect Future Results**

### **Recent Developments**

#### **MCI Merger**

On January 6, 2006, Verizon acquired 100% of the outstanding common stock of MCI, Inc. (MCI) for a combination of Verizon common shares and cash. MCI was a global communications company that provided Internet, data and voice communication services to businesses and government entities throughout the world and consumers in the United States.

On April 9, 2005, Verizon entered into a stock purchase agreement with eight entities affiliated with Carlos Slim Helú to purchase 43.4 million shares of MCI common stock for \$25.72 per share in cash plus an additional cash amount of 3% per annum from April 9, 2005, until the closing of the purchase of those shares. The transaction closed on May 17, 2005. The total cash payment was \$1,121 million and the investment was originally accounted for as a cost investment. No payments were made under a provision that required Verizon to pay an additional amount at the end of one year to the extent that the price of Verizon's common stock exceeded \$35.52 per share. We received a special dividend of \$5.60 per MCI share on these 43.4 million MCI shares, or \$243 million, on October 27, 2005.

Under the terms of the merger agreement, MCI shareholders received .5743 shares of Verizon common stock (\$5,050 million in the aggregate) and cash of \$2.738 (\$779 million in the aggregate) for each of their MCI shares. The merger consideration was equal to \$20.40 per MCI share, excluding the \$5.60 per share special dividend paid by MCI to its shareholders on October 27, 2005. There was no purchase price adjustment.

#### **Price Communications**

In August 2002, Verizon Wireless and Price Communications Corp. (Price) combined Price's wireless business with a portion of Verizon Wireless. The resulting limited partnership, Verizon Wireless of the East LP (VZ East), is controlled and managed by Verizon Wireless. In exchange for its contributed assets, Price received a limited partnership interest in the new partnership which was exchangeable into the common stock of Verizon Wireless if an initial public offering of that stock occurred, or into the common stock of Verizon on the fourth anniversary of the asset contribution date. On August 15, 2006, Verizon delivered 29.5 million shares of newly-issued Verizon common stock to Price valued at \$1,007 million in exchange for Price's limited partnership interest in VZ East. As a result of acquiring Price's limited partnership interest, Verizon recorded goodwill of \$345 million in the third quarter of 2006 attributable to its Domestic Wireless segment.

#### **Disposition of Businesses and Investments**

*Verizon Dominicana C. por A., Telecomunicaciones de Puerto Rico, Inc., and Compañía Anónima Nacional Teléfonos de Venezuela*

During the second quarter of 2006, we reached definitive agreements to sell our interests in our Caribbean and Latin American telecommunications operations in three separate transactions to América Móvil, S.A. de C.V. (América Móvil), a wireless service provider throughout Latin America, and a company owned jointly by Teléfonos de México, S.A. de C.V. (Telmex) and América Móvil. We agreed to

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sell our 100 percent indirect interest in Verizon Dominicana and our 52 percent interest in Telecomunicaciones de Puerto Rico, Inc. (TELPRI) to América Móvil. An entity jointly owned by América Móvil and Telmex agreed to purchase our indirect 28.5 percent interest in CANTV.

In accordance with SFAS No. 144 we have classified the results of operations of Verizon Dominicana and TELPRI as discontinued operations. CANTV continues to be accounted for as an equity method investment.

On December 1, 2006, we closed the sale of Verizon Dominicana. The transaction resulted in net pretax cash proceeds of \$2,042 million, net of a purchase price adjustment of \$373 million. The U.S. taxes that became payable and were recognized at the time the transaction closed exceeded the \$30 million pretax gain resulting in an after-tax loss of \$541 million (or \$.18 per diluted share).

We expect to close the sale of our interest in TELPRI in 2007 subject to the receipt of regulatory approvals and in accordance with the terms of the definitive agreement. We expect that the sale will result in approximately \$900 million in net pretax cash proceeds.

During the second quarter of 2006, we entered into a definitive agreement to sell our indirect 28.5% interest in CANTV to an entity jointly owned by América Móvil and Telmex for estimated pretax proceeds of \$677 million. Regulatory authorities in Venezuela never commenced the formal review of that transaction and the related tender offers for the remaining equity securities of CANTV. On February 8, 2007, after two prior extensions, the parties terminated the stock purchase agreement because the parties mutually concluded that the regulatory approvals would not be granted by the Government.

In January 2007, the Bolivarian Republic of Venezuela (the Republic) declared its intent to nationalize certain companies, including CANTV. On February 12, 2007, we entered into a Memorandum of Understanding (MOU) with the Republic. The MOU provides that the Republic will offer to purchase all of the equity securities of CANTV through public tender offers in Venezuela and the United States at a price equivalent to \$17.85 per ADS. If the tender offers are completed, the aggregate purchase price for Verizon's shares would be \$572 million. If the 2007 dividend that has been recommended by the CANTV Board is approved by shareholders and paid prior to the closing of the tender offers, this amount will be reduced by the amount of the dividend. Verizon has agreed to tender its shares if the offers are commenced. The Republic has agreed to commence the offers within forty-five days assuming the satisfactory completion of its due diligence investigation of CANTV. The tender offers are subject to certain conditions including that a majority of the outstanding shares are tendered to the Government and receipt of regulatory approvals. Based upon the terms of the MOU and our current investment balance in CANTV, we expect that we will record a loss on our investment in the first quarter of 2007. The ultimate amount of the loss depends on a variety of factors, including the successful completion of the tender offer and the satisfaction of other terms in the MOU.

#### *Spin-off of Idearc*

On November 17, 2006 we completed the spin-off of Idearc to shareowners of Verizon. Verizon distributed a dividend of one share of Idearc common stock for every 20 shares of Verizon common stock. Cash was paid for fractional shares. The distribution of Idearc common stock is considered a tax free transaction for us and for our shareowners, except for the cash payments for fractional shares which are generally taxable. Idearc now owns what was the Verizon domestic print and Internet yellow pages directories publishing operations, which had been the principal component of our Information Services segment. This transaction resulted in an increase of nearly \$9 billion in shareowners' equity, as well as a reduction of total debt by more than \$7 billion and we received approximately \$2 billion in cash.

#### *Telephone Access Lines Spin-off*

On January 16, 2007, we announced a definitive agreement with FairPoint Communications, Inc. (FairPoint) that will result in Verizon establishing a separate entity for its local exchange and related business assets in Maine, New Hampshire and Vermont, spinning off that new entity to Verizon shareowners, and immediately merging it with and into FairPoint.

Upon the closing of the transaction, Verizon shareowners will own approximately 60 percent of the new company and FairPoint stockholders will own approximately 40 percent. Verizon Communications will not own any shares in FairPoint after the merger. In connection with the merger, Verizon shareowners will receive one share of FairPoint stock for approximately every 55 shares of Verizon stock held as of the record date. Both the spin-off and merger are expected to qualify as tax-free transactions, except to the extent that cash is paid to Verizon shareowners in lieu of fractional shares.

The total value to be received by Verizon and its shareowners in exchange for these operations will be approximately \$2,715 million. Verizon shareowners will receive approximately \$1,015 million of FairPoint common stock in the merger, based upon FairPoint's recent stock price and the terms of the merger agreement. Verizon will receive \$1,700 million in value through a combination of cash distributions to Verizon and debt securities issued to Verizon prior to the spin-off. Verizon may exchange these newly issued debt securities for certain debt that was previously issued by Verizon, which would have the effect of reducing Verizon's then-outstanding debt.

#### **Redemption of Debt**

##### *Debt assumed from MCI merger*

On January 17, 2006, Verizon announced offers to purchase two series of MCI senior notes, MCI \$1,983 million aggregate principal amount of 6.688% Senior Notes Due 2009 and MCI \$1,699 million aggregate principal amount of 7.735% Senior Notes Due 2014, at 101% of their par value. Due to the change in control of MCI that occurred in connection with the merger with Verizon on January 6, 2006, Verizon was required

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to make this offer to noteholders within 30 days of the closing of the merger of MCI and Verizon. Separately, Verizon notified noteholders that MCI was exercising its right to redeem both series of Senior Notes prior to maturity under the optional redemption procedures provided in the indentures. The 6.688% Notes were redeemed on March 1, 2006, and the 7.735% Notes were redeemed on February 16, 2006.

In addition, on January 20, 2006, Verizon announced an offer to repurchase MCI \$1,983 million aggregate principal amount of 5.908% Senior Notes Due 2007 at 101% of their par value. On February 21, 2006, \$1,804 million of these notes were redeemed by Verizon. Verizon satisfied and discharged the indenture governing this series of notes shortly after the close of the offer for those noteholders who did not accept this offer.

#### *Zero-Coupon Convertible Notes*

Previously, Verizon Global Funding issued approximately \$5,442 million in principal amount at maturity of zero-coupon convertible notes due 2021 which were callable by Verizon on or after May 15, 2006. On May 15, 2006, we redeemed the remaining \$1,375 million accreted principal of the outstanding zero-coupon convertible notes at a redemption price of \$639.76 per \$1,000 principal plus interest of approximately \$0.5767 per \$1,000 principal. The total payment on the date of redemption was approximately \$1,377 million.

#### *Other Debt Redemptions/Prepayments*

Other debt redemptions/prepayments included approximately \$697 million of outstanding debt issuances at various rates associated with our operating telephone companies. Original maturity dates ranged from 2010 through 2026. On December 15, 2006, Verizon Wireless' six year 5.375% fixed rate note of \$2.5 billion matured. At December 31, 2006, Verizon Wireless had no third-party debt outstanding. On January 8, 2007, we redeemed the remaining \$1,580 million of the outstanding notes of the Verizon Communications Inc. floating rate notes due 2007. The gain/(loss) on these redemptions and prepayments were immaterial.

#### **Issuance of Debt**

In February 2006, Verizon issued \$4,000 million of floating rate and fixed rate notes maturing from 2007 through 2035.

#### **Spectrum Purchases**

On November 29, 2006, we were granted thirteen 20 MHz licenses we won in an FCC auction of Advanced Wireless Services spectrum that concluded on September 18, 2006, for which we had bid a total of \$2,809 million. These licenses, which we anticipate using for the provision of advanced wireless broadband services, cover a population of nearly 200 million. We have made all required payments to the FCC for these licenses.

#### **Environmental Matters**

During 2003, under a government-approved plan, remediation commenced at the site of a former Sylvania facility in Hicksville, New York that processed nuclear fuel rods in the 1950s and 1960s. Remediation beyond original expectations proved to be necessary and a reassessment of the anticipated remediation costs was conducted. A reassessment of costs related to remediation efforts at several other former facilities was also undertaken. In September 2005, the Army Corps of Engineers (ACE) accepted the Hicksville site into the Formerly Utilized Sites Remedial Action Program. This may result in the ACE performing some or all of the remediation effort for the Hicksville site with a corresponding decrease in costs to Verizon. To the extent that the ACE assumes responsibility for remedial work at the Hicksville site, an adjustment to a reserve previously established for the remediation may be made. Adjustments may also be made based upon actual conditions discovered during the remediation at any of the sites requiring remediation.

#### **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 on lower Manhattan. These funds will be distributed through the Lower Manhattan Development Corporation following an application and audit process. As of September 2004, we had applied for reimbursement of approximately \$266 million under Category One, although we did not record this amount as a receivable. We received advances totaling \$88 million in connection with this application process. On December 22, 2004, we applied for reimbursement of an additional \$136 million of Category Two losses, and on March 29, 2005 we amended our application seeking an additional \$3 million. Category Two funding is for permanent restoration and infrastructure improvement. According to the plan, permanent restoration is reimbursed up to 75% of the loss. On November 3, 2005, we received the results of preliminary audit findings disallowing all but \$44 million of our \$266 million of Category One application. On December 8, 2005, we provided a detailed rebuttal to the preliminary audit findings. We received a copy of the final audit report for Verizon's Category One applications and, on January 4, 2007, we filed an appeal of the final audit report. That appeal, as well as our Category Two applications, are pending.

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## Regulatory and Competitive Trends

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### Competition and Regulation

Technological, regulatory and market changes have provided Verizon both new opportunities and challenges. These changes have allowed Verizon to offer new types of services in this increasingly competitive market. At the same time, they have allowed other service providers to broaden the scope of their own competitive offerings. Current and potential competitors for network services include other telephone companies, cable companies, wireless service providers, foreign telecommunications providers, satellite providers, electric utilities, Internet Service Providers, providers of VoIP services, and other companies that offer network services using a variety of technologies. 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. Many of our competitors also remain subject to fewer regulatory constraints than Verizon.

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.

### FCC Regulation

Our services are subject to the jurisdiction of the FCC with respect to interstate telecommunications services and other matters for which the FCC has jurisdiction under the Communications Act of 1934, as amended (Communications Act). The Communications Act generally obligates us not to charge unjust or unreasonable rates nor engage in unreasonable discrimination when we are providing services as a common carrier, and regulates some of the rates, terms and conditions under which we provide certain services. The FCC also has adopted regulations governing various aspects of our business, such as the following: (i) use and disclosure of customer proprietary network information; (ii) telemarketing; (iii) assignment of telephone numbers to customers; (iv) provision to law enforcement agencies of the capability to obtain call identifying information and call content information from calls pursuant to lawful process; (v) accessibility of services and equipment to individuals with disabilities if readily achievable; (vi) interconnection with the networks of other carriers; and (vii) customers' ability to keep (or "port") their telephone numbers when switching to another carrier. In addition, we pay various fees to support other FCC programs, such as the universal service program discussed below. Changes to these mandates, or the adoption of additional mandates, could require us to make changes to our operations or otherwise increase our costs of compliance.

#### *Broadband*

The FCC has adopted a series of orders that recognize the competitive nature of the broadband market, and impose lesser regulatory requirements on broadband services and facilities than apply to narrowband. With respect to facilities, the FCC has determined that certain unbundling requirements that apply to narrowband facilities do not apply to broadband facilities such as fiber to the premise loops and packet switches. With respect to services, the FCC has concluded that broadband Internet access services offered by telephone companies and their affiliates qualify as largely deregulated information services. The same order also concluded that telephone companies may offer the underlying broadband transmission services that are used as an input to Internet access services through private carriage arrangements on negotiated commercial terms. In addition, a Verizon petition asking the FCC to forbear from applying common carrier regulation to certain broadband services sold primarily to larger business customers when those services are not used for Internet access was deemed granted by operation of law on March 19, 2006 when the FCC did not deny the petition by the statutory deadline. Both the FCC's order addressing the appropriate regulatory treatment of broadband Internet access services and the relief obtained through the forbearance petition are the subject of pending appeals.

#### *Video*

The FCC has a body of rules that apply to cable operators under Title VI of the Communications Act, and these rules also generally apply to telephone companies that provide cable services over their networks. In addition, companies that provide cable service over a cable system generally must obtain a local cable franchise. On December 21, 2006, the FCC announced the adoption of rules under Section 621 of the Communications Act to set parameters consistent with federal law, on the timing and scope of franchise negotiations by local franchising authorities.

#### *Interstate Access Charges and Intercarrier Compensation*

The current framework for interstate access rates was established in the Coalition for Affordable Local and Long Distance Services (CALLS) plan, which the FCC adopted on May 31, 2000. The CALLS plan has three main components. First, it establishes portable interstate access universal service support of \$650 million for the industry that replaces implicit support previously 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. Third, the plan set 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. As a result of tariff adjustments which became effective in July 2003, virtually all of our switched access lines reached the \$.0055 benchmark.

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The FCC currently is conducting a broad rulemaking proceeding to consider new rules governing intercarrier compensation including, but not limited to, access charges, compensation for Internet traffic, and reciprocal compensation for local traffic. The FCC has sought comments about intercarrier compensation in general, and has requested input on several specific reform proposals.

The FCC also has pending before it issues relating to intercarrier compensation for dial-up Internet-bound traffic. The FCC previously found that this traffic is not subject to reciprocal compensation under Section 251(b)(5) of the Telecommunications Act of 1996. 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 at the same rate as they are required to pay on Internet-bound traffic. 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. The FCC subsequently denied a petition to discontinue the \$.0007 rate cap on this traffic, but removed the caps on the total minutes of Internet-bound traffic subject to compensation. That decision has been upheld on appeal. 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 conducting a rulemaking proceeding to address the regulation of services that use Internet protocol, including whether access charges should apply to voice or other Internet protocol services. The FCC also considered several petitions asking whether, and under what circumstances, services that employ Internet protocol are subject to access charges. The FCC previously has held 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, while a service that utilizes Internet protocol for only one intermediate part of a call's transmission is a telecommunications service that is subject to access charges. Another petition asking the FCC to forbear from applying access charges to voice over Internet protocol services that are terminated on switched local exchange networks was withdrawn by the carrier that filed that petition. The FCC also declared the services offered by one provider of a voice over Internet protocol service to be jurisdictionally interstate on the grounds that it was impossible to separate that carrier's Internet protocol service into interstate and intrastate components. The FCC also stated that its conclusion would apply to other services with similar characteristics. That order has been appealed.

The FCC also 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. More than half of special access revenues are now removed from price regulation. The FCC currently has a rulemaking proceeding underway to evaluate experience under its pricing flexibility rules, and to determine whether any changes to those rules are warranted.

#### *Universal Service*

The FCC also has a body of rules implementing the universal service provisions of the Telecommunications Act of 1996, including rules governing support to rural and non-rural high-cost areas, support for low income subscribers, and support for schools, libraries and rural health care. The FCC's current rules for support to high-cost areas served by larger "non-rural" local telephone companies were previously remanded by U.S. Court of Appeals for the Tenth Circuit, which had found that the FCC had not adequately justified these rules. The FCC has initiated a rulemaking proceeding in response to the court's remand, but its rules remain in effect pending the results of the rulemaking. The FCC also has proceedings underway to evaluate possible changes to its current rules for assessing contributions to the universal service fund. As an interim step, in June 2006, the FCC ordered that providers of VoIP services are subject to federal universal service obligations. The FCC also increased the percentage of revenues subject to federal universal service obligations that wireless providers may use as a safe harbor. These decisions are the subject of a pending appeal. Any further change in the current assessment mechanism could result in a change in the contribution that local telephone companies, wireless carriers or others must make and that would have to be collected from customers.

#### *Unbundling of Network Elements*

Under Section 251 of the Telecommunications Act of 1996, incumbent local exchange carriers were required to provide competing carriers with access to components of their network on an unbundled basis, known as UNEs, where certain statutory standards are satisfied. The Telecommunications Act of 1996 also adopted a cost-based pricing standard for these UNEs, which the FCC interpreted as allowing it to impose a pricing standard known as "total element long run incremental cost" or "TELRIC." The FCC's rules defining the unbundled network elements that must be made available at TELRIC prices have been overturned on multiple occasions by the courts. In its most recent order issued in response to these court decisions, 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. This decision has been upheld on appeal.

As noted above, the FCC has concluded that the requirement under Section 251 of the Telecommunications Act of 1996 to provide unbundled network elements at TELRIC prices generally does not apply with respect to broadband facilities, such as fiber to the premises loops, the

packet-switched capabilities of hybrid loops and packet switching. The FCC also has held that any separate unbundling obligations that may be imposed by Section 271 of the Telecommunications Act of 1996 do not apply to these same facilities. The decision with respect to Section 271 has been upheld on appeal and a petition for rehearing of that appellate order was denied.

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## *Wireless Services*

The FCC regulates the licensing, construction, operation, acquisition and transfer of wireless communications systems, including the systems that Verizon Wireless operates, pursuant to the Communications Act, other legislation, and the FCC's rules. The FCC and Congress continuously consider changes to these laws and rules. Adoption of new laws or rules may raise the cost of providing service or require modification of Verizon Wireless's business plans or operations.

To use the radio frequency spectrum, wireless communications systems must be licensed by the FCC to operate the wireless network and mobile devices in assigned spectrum segments. Verizon Wireless holds FCC licenses to operate in several different radio services, including the cellular radiotelephone service, personal communications service, advanced wireless service, and point-to-point radio service. The technical and service rules, the specific radio frequencies and amounts of spectrum we hold, and the sizes of the geographic areas we are authorized to operate in, vary for each of these services. However, all of the licenses Verizon Wireless holds allow it to use spectrum to provide a wide range of mobile and fixed communications services, including both voice and data services, and Verizon Wireless operates a seamless network that utilizes those licenses to provide services to customers. Because the FCC issues licenses for only a fixed time, generally 10 years, Verizon Wireless must periodically seek renewal of those licenses. Although the FCC has routinely renewed all of Verizon Wireless's licenses that have come up for renewal to date, challenges could be brought against the licenses in the future. If a wireless license were revoked or not renewed upon expiration, Verizon Wireless would not be permitted to provide services on the licensed spectrum in the area covered by that license.

The FCC has also imposed specific mandates on carriers that operate wireless communications systems, which increase Verizon Wireless's costs. These mandates include requirements that Verizon Wireless: (i) meet specific construction and geographic coverage requirements during the license term; (ii) meet technical operating standards that, among other things, limit the radio frequency radiation from mobile devices and antennas; (iii) deploy "Enhanced 911" wireless services that provide the wireless caller's number, location and other information upon request by a state or local public safety agency that handles 911 calls; and (iv) comply with regulations for the construction of transmitters and towers that, among other things, restrict siting of towers in environmentally sensitive locations and in places where the towers would affect a site listed or eligible for listing on the National Register of Historic Places. Changes to these mandates could require Verizon Wireless to make changes to operations or increase its costs of compliance.

The Communications Act imposes restrictions on foreign ownership of U.S. wireless systems. The FCC has approved the interest that Vodafone Group Plc holds, through various of its subsidiaries, in Verizon Wireless. The FCC may need to approve any increase in Vodafone's interest or the acquisition of an ownership interest by other foreign entities. In addition, as part of the FCC's approval of Vodafone's ownership interest, Verizon Wireless, Verizon and Vodafone entered into an agreement with the U.S. Department of Defense, Department of Justice and Federal Bureau of Investigation which imposes national security and law enforcement-related obligations on the ways in which Verizon Wireless stores information and otherwise conducts its business.

Verizon Wireless anticipates that it will need additional spectrum to meet future demand. It can meet spectrum needs by purchasing licenses or leasing spectrum from other licensees, or by acquiring new spectrum licenses from the FCC. Under the Communications Act, before Verizon Wireless can acquire a license from another licensee in order to expand its coverage or its spectrum capacity in a particular area, it must file an application with the FCC, and the FCC can grant the application only after a period for public notice and comment. This review process can delay acquisition of spectrum needed to expand services. The Communications Act also requires the FCC to award new licenses for most commercial wireless services through a competitive bidding process in which spectrum is awarded to bidders in an auction. Verizon Wireless has participated in spectrum auctions to acquire licenses in the personal communication service and most recently the advanced wireless service. However, the timing of future auctions, and the spectrum being sold, may not match Verizon Wireless's needs, and the company may not be able to secure the spectrum in the auction.

The FCC is also conducting several proceedings to explore whether and how to use spectrum more intensively by, for example, allowing unlicensed wireless devices to operate in licensed spectrum bands. These proceedings could increase radio interference to Verizon Wireless's operations from other spectrum users, or allow other users to share its spectrum. These changes may adversely impact the ways in which it uses spectrum, the capacity of that spectrum to carry traffic, and the value of that spectrum.

## **State Regulation and Local Approvals**

### *Telephone Operations*

State public utility commissions regulate our telephone operations with respect to certain telecommunications intrastate rates and services and other matters. Our competitive local exchange carrier and long distance operations are generally classified as nondominant and lightly regulated the same as other similarly situated carriers. Our incumbent local exchange operations are generally classified as dominant. These latter operations predominantly are subject to alternative forms of regulation (AFORs) in the various states, although they remain subject to rate of return regulation in a few states. Arizona, Illinois, Nevada, New Hampshire, Oregon and Washington are rate of return regulated with various levels of pricing flexibility for competitive services. California, Connecticut, Delaware, the District of Columbia, Florida, Indiana, Maryland, Michigan, Maine, Massachusetts, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, South Carolina, Texas, Vermont, Virginia, West Virginia and Wisconsin are under AFORs with various levels of pricing flexibility, detariffing, and service

quality standards. None of the AFORs include earnings regulation. In Idaho, Verizon has made the election under a recent statutory amendment into a deregulatory regime that phases out all price regulation.

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## *Video*

Companies that provide cable service over a cable system are typically subject to state and/or local cable television rules and regulations. As noted above, cable operators generally must obtain a local cable franchise from each local unit of government prior to providing cable service in that local area. Some states have recently enacted legislation that enables cable operators to apply for, and obtain, a single cable franchise at the state, rather than local, level. To date, Verizon has applied for and received state-issued franchises in Indiana, New Jersey and Texas. California has enacted statewide franchise reform legislation, but has not yet finalized implementing rules.

## *Wireless Services*

The rapid growth of the wireless industry has led to an increase in efforts by some state legislatures and state public utility commissions to regulate the industry in ways that may impose additional costs on Verizon Wireless. The Communications Act generally preempts regulation by state and local governments of the entry of, or the rates charged by, wireless carriers. Although a state may petition the FCC to allow it to impose rate regulation, no state has done so. In addition, the Communications Act does not prohibit the states from regulating the other “terms and conditions” of wireless service. While numerous state commissions do not currently have jurisdiction over wireless services, state legislatures may decide to grant them such jurisdiction, and those commissions that already have authority to impose regulations on wireless carriers may adopt new rules.

State efforts to regulate wireless services have included proposals to regulate customer billing, termination of service, trial periods for service, advertising, network outages, the use of handsets while driving, and the provision of emergency or alert services. Over the past several years, only a few states have imposed regulation in one or more of these areas, and in 2006 a federal appellate court struck down one such state statute, but Verizon Wireless expects these efforts to continue. Some states also impose their own universal service support regimes on wireless and other telecommunications carriers, and other states are considering whether to create such regimes.

Verizon Wireless (as well as AT&T (formerly Cingular) and Sprint-Nextel) is a party to an Assurance of Voluntary Compliance (“AVC”) with 33 State Attorneys General. The AVC, which generally reflected Verizon Wireless’s practices at the time it was entered into in July 2004, obligates the company to disclose certain rates and terms during a sales transaction, to provide maps depicting coverage, and to comply with various requirements regarding advertising, billing, and other practices.

At the state and local level, wireless facilities are subject to zoning and land use regulation. Under the Communications Act, neither state nor local governments may categorically prohibit the construction of wireless facilities in any community or take actions, such as indefinite moratoria, which have the effect of prohibiting service. Nonetheless, securing state and local government approvals for new tower sites has been and is likely to continue to be a difficult, lengthy and expensive process. Finally, state and local governments continue to impose new or higher fees and taxes on wireless carriers.

## **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, including disruption of our suppliers’ provisioning of critical products or services;
- 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;
- 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;

- 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;
- the timing of the sales of our Latin American and Caribbean properties; and
- the extent and timing of our ability to obtain revenue enhancements and cost savings following our business combination with MCI, Inc.

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## Report of Management on Internal Control Over Financial Reporting

We, the management of Verizon Communications Inc., are responsible for establishing and maintaining adequate internal control over financial reporting of the company. Management has evaluated internal control over financial reporting of the company using the criteria for effective internal control established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Management has assessed the effectiveness of the company's internal control over financial reporting as of December 31, 2006. Based on this assessment, we believe that the internal control over financial reporting of the company is effective as of December 31, 2006. In connection with this assessment, there were no material weaknesses in the company's internal control over financial reporting identified by management.

The company's financial statements included in this annual report have been audited by Ernst & Young LLP, independent registered public accounting firm. Ernst & Young LLP has also issued an attestation report on management's assessment of the company's internal control over financial reporting.

/s/ Ivan G. Seidenberg

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**Ivan G. Seidenberg**  
Chairman and Chief Executive Officer

/s/ Doreen A. Toben

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**Doreen A. Toben**  
Executive Vice President and Chief Financial Officer

/s/ Thomas A. Bartlett

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**Thomas A. Bartlett**  
Senior Vice President and Controller

**To The Board of Directors and Shareowners of Verizon Communications Inc.:**

We have audited management's assessment, included in the accompanying Report of Management on Internal Control Over Financial Reporting, that Verizon Communications Inc. and subsidiaries (Verizon) maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Verizon'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.

In our opinion, management's assessment that Verizon maintained effective internal control over financial reporting, as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Verizon maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Verizon as of December 31, 2006 and 2005, 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, 2006 of Verizon and our report dated February 23, 2007 expressed an unqualified opinion thereon.

Ernst & Young LLP

**Ernst & Young LLP**  
New York, New York

February 23, 2007

**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, 2006 and 2005, 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, 2006. 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 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Verizon at December 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, Verizon changed its methods of accounting for stock-based compensation effective January 1, 2006 and pension and other post-retirement obligations effective December 31, 2006.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Verizon's internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 23, 2007 expressed an unqualified opinion thereon.

Ernst & Young LLP

**Ernst & Young LLP**  
New York, New York

February 23, 2007

**Consolidated Statements of Income** Verizon Communications Inc. and Subsidiaries

| Years Ended December 31,  | (dollars in millions, except per share amounts) |                  |                  |
|---|---|------------------|------------------|
|   | 2006  | 2005             | 2004             |
| <b>Operating Revenues</b>   | <b>\$ 88,144</b>                                | <b>\$ 69,518</b> | <b>\$ 65,751</b> |
| <b>Operating Expenses</b>   |   |                  |                  |
| Cost of services and sales (exclusive of items shown below)   | 34,994  | 24,200           | 22,032           |
| Selling, general & administrative expense   | 25,232  | 19,652           | 19,346           |
| Depreciation and amortization expense   | 14,545  | 13,615           | 13,503           |
| Sales of businesses, net  | —   | (530)            | —                |
| <b>Total Operating Expenses</b>   | <b>74,771</b>                                   | <b>56,937</b>    | <b>54,881</b>    |
| <b>Operating Income</b>   | <b>13,373</b>                                   | <b>12,581</b>    | <b>10,870</b>    |
| Equity in earnings of unconsolidated businesses   | 773   | 686              | 1,690            |
| Other income and (expense), net   | 395   | 311              | 82               |
| Interest expense  | (2,349)   | (2,129)          | (2,336)          |
| Minority interest   | (4,038)   | (3,001)          | (2,329)          |
| <b>Income Before Provision for Income Taxes, Discontinued Operations and Cumulative Effect of Accounting Change</b> | <b>8,154</b>                                    | <b>8,448</b>     | <b>7,977</b>     |
| Provision for income taxes  | (2,674)   | (2,421)          | (2,078)          |
| <b>Income Before Discontinued Operations and Cumulative Effect of Accounting Change</b>                             | <b>5,480</b>                                    | <b>6,027</b>     | <b>5,899</b>     |
| Income on discontinued operations, net of tax   | 759   | 1,370            | 1,932            |
| Cumulative effect of accounting change, net of tax  | (42)  | —                | —                |
| <b>Net Income</b>   | <b>\$ 6,197</b>                                 | <b>\$ 7,397</b>  | <b>\$ 7,831</b>  |
| <b>Basic Earnings Per Common Share <sup>(1)</sup></b>   |   |                  |                  |
| Income before discontinued operations and cumulative effect of accounting change                                    | \$ 1.88   | \$ 2.18          | \$ 2.13          |
| Income on discontinued operations, net of tax   | .26   | .50              | .70              |
| Cumulative effect of accounting change, net of tax  | (.01)   | —                | —                |
| <b>Net Income</b>   | <b>\$ 2.13</b>                                  | <b>\$ 2.67</b>   | <b>\$ 2.83</b>   |
| Weighted-average shares outstanding (in millions)   | 2,912   | 2,766            | 2,770            |
| <b>Diluted Earnings Per Common Share <sup>(1)</sup></b>   |   |                  |                  |
| Income before discontinued operations and cumulative effect of accounting change                                    | \$ 1.88   | \$ 2.16          | \$ 2.11          |
| Income on discontinued operations, net of tax   | .26   | .49              | .68              |
| Cumulative effect of accounting change, net of tax  | (.01)   | —                | —                |
| <b>Net Income</b>   | <b>\$ 2.12</b>                                  | <b>\$ 2.65</b>   | <b>\$ 2.79</b>   |
| Weighted-average shares outstanding (in millions)   | 2,938   | 2,817            | 2,831            |

(1) Total per share amounts may not add due to rounding.

See Notes to Consolidated Financial Statements.

**Consolidated Balance Sheets** Verizon Communications Inc. and Subsidiaries

(dollars in millions, except per share amounts)

| At December 31,  | 2006              | 2005              |
|--|-------------------|-------------------|
| <b>Assets</b>  |                   |                   |
| <b>Current assets</b>  |                   |                   |
| Cash and cash equivalents  | \$ 3,219          | \$ 760            |
| Short-term investments   | 2,434             | 2,146             |
| Accounts receivable, net of allowances of \$1,139 and \$1,100                        | 10,891            | 8,534             |
| Inventories  | 1,514             | 1,522             |
| Assets held for sale   | 2,592             | 4,233             |
| Prepaid expenses and other   | 1,888             | 2,125             |
| <b>Total current assets</b>  | <b>22,538</b>     | <b>19,320</b>     |
| Plant, property and equipment  | 204,109           | 187,761           |
| Less accumulated depreciation  | 121,753           | 114,774           |
|  | <b>82,356</b>     | <b>72,987</b>     |
| Investments in unconsolidated businesses   | 4,868             | 4,602             |
| Wireless licenses  | 50,959            | 47,781            |
| Goodwill   | 5,655             | 315               |
| Other intangible assets, net   | 5,140             | 4,068             |
| Other assets   | 17,288            | 19,057            |
| <b>Total assets</b>  | <b>\$ 188,804</b> | <b>\$ 168,130</b> |
| <b>Liabilities and Shareowners' Investment</b>                                       |                   |                   |
| <b>Current liabilities</b>   |                   |                   |
| Debt maturing within one year  | \$ 7,715          | \$ 6,688          |
| Accounts payable and accrued liabilities   | 14,320            | 11,747            |
| Liabilities related to assets held for sale  | 2,154             | 2,870             |
| Other  | 8,091             | 5,395             |
| <b>Total current liabilities</b>   | <b>32,280</b>     | <b>26,700</b>     |
| Long-term debt   | 28,646            | 31,569            |
| Employee benefit obligations   | 30,779            | 17,693            |
| Deferred income taxes  | 16,270            | 22,831            |
| Other liabilities  | 3,957             | 3,224             |
| Minority interest  | 28,337            | 26,433            |
| <b>Shareowners' investment</b>   |                   |                   |
| Series preferred stock (\$.10 par value; none issued)                                | -                 | -                 |
| Common stock (\$.10 par value; 2,967,652,438 shares and 2,774,865,381 shares issued) | 297               | 277               |
| Contributed capital  | 40,124            | 25,369            |
| Reinvested earnings  | 17,324            | 15,905            |
| Accumulated other comprehensive loss   | (7,530)           | (1,783)           |
| Common stock in treasury, at cost  | (1,871)           | (353)             |
| Deferred compensation-employee stock ownership plans and other                       | 191               | 265               |
| <b>Total shareowners' investment</b>   | <b>48,535</b>     | <b>39,680</b>     |
| <b>Total liabilities and shareowners' investment</b>                                 | <b>\$ 188,804</b> | <b>\$ 168,130</b> |

See Notes to Consolidated Financial Statements.

**Consolidated Statements of Cash Flows** Verizon Communications Inc. and Subsidiaries

| Years Ended December 31,  | (dollars in millions) |          |          |
|---|-----------------------|----------|----------|
|   | 2006                  | 2005     | 2004     |
| <b>Cash Flows from Operating Activities</b>   |                       |          |          |
| Net Income  | \$ 6,197              | \$ 7,397 | \$ 7,831 |
| Adjustments to reconcile net income to net cash provided by operating activities:                     |                       |          |          |
| Depreciation and amortization expense   | 14,545                | 13,615   | 13,503   |
| Sales of businesses, net  | –                     | (530)    | –        |
| (Gain) loss on sale of discontinued operations  | 541                   | –        | –        |
| Employee retirement benefits  | 1,923                 | 1,695    | 1,836    |
| Deferred income taxes   | (252)                 | (1,093)  | 1,721    |
| Provision for uncollectible accounts  | 1,034                 | 1,076    | 890      |
| Equity in earnings of unconsolidated businesses   | (773)                 | (686)    | (1,690)  |
| Cumulative effect of accounting change, net of tax  | 42                    | –        | –        |
| Changes in current assets and liabilities, net of effects from acquisition/disposition of businesses: |                       |          |          |
| Accounts receivable   | (1,312)               | (788)    | (1,293)  |
| Inventories   | 8                     | (236)    | (226)    |
| Other assets  | 52                    | (176)    | 539      |
| Accounts payable and accrued liabilities  | (383)                 | (899)    | (1,820)  |
| Other, net  | 1,408                 | 1,069    | (1,115)  |
| Net cash provided by operating activities – continuing operations                                     | 23,030                | 20,444   | 20,176   |
| Net cash provided by operating activities – discontinued operations                                   | 1,076                 | 1,581    | 1,615    |
| Net cash provided by operating activities   | 24,106                | 22,025   | 21,791   |
| <b>Cash Flows from Investing Activities</b>   |                       |          |          |
| Capital expenditures (including capitalized software)   | (17,101)              | (14,964) | (12,794) |
| Acquisitions, net of cash acquired, and investments   | (1,422)               | (4,684)  | (1,196)  |
| Proceeds from disposition of businesses   | –                     | 1,326    | 117      |
| Net change in short-term and other current investments  | 290                   | (346)    | (90)     |
| Other, net  | 811                   | 532      | 2,474    |
| Net cash used in investing activities – continuing operations   | (17,422)              | (18,136) | (11,489) |
| Net cash provided by (used in) investing activities – discontinued operations                         | 1,806                 | (356)    | 1,146    |
| Net cash used in investing activities   | (15,616)              | (18,492) | (10,343) |
| <b>Cash Flows from Financing Activities</b>   |                       |          |          |
| Proceeds from long-term borrowings  | 3,983                 | 1,487    | 514      |
| Repayments of long-term borrowings and capital lease obligations                                      | (11,233)              | (3,825)  | (5,168)  |
| Increase (decrease) in short-term obligations, excluding current maturities                           | 7,944                 | 2,098    | (747)    |
| Dividends paid  | (4,719)               | (4,427)  | (4,262)  |
| Proceeds from sale of common stock  | 174                   | 37       | 320      |
| Purchase of common stock for treasury   | (1,700)               | (271)    | (370)    |
| Other, net  | (201)                 | (57)     | (125)    |
| Net cash used in financing activities – continuing operations   | (5,752)               | (4,958)  | (9,838)  |
| Net cash used in financing activities – discontinued operations                                       | (279)                 | (76)     | (18)     |
| Net cash used in financing activities   | (6,031)               | (5,034)  | (9,856)  |
| Increase (decrease) in cash and cash equivalents  | 2,459                 | (1,501)  | 1,592    |
| Cash and cash equivalents, beginning of year  | 760                   | 2,261    | 669      |
| Cash and cash equivalents, end of year  | \$ 3,219              | \$ 760   | \$ 2,261 |

See Notes to Consolidated Financial Statements.

**Consolidated Statements of Changes in Shareowners' Investment** Verizon Communications Inc. and Subsidiaries

(dollars in millions, except per share amounts, and shares in thousands)

| Years Ended December 31,                                 | 2006      |         | 2005      |         | 2004      |         |
|--|-----------|---------|-----------|---------|-----------|---------|
|  | Shares    | Amount  | Shares    | Amount  | Shares    | Amount  |
| <b>Common Stock</b>                                      |           |         |           |         |           |         |
| Balance at beginning of year                             | 2,774,865 | \$ 277  | 2,774,865 | \$ 277  | 2,772,314 | \$ 277  |
| Shares issued  |           |         |           |         |           |         |
| Employee plans   | –         | –       | –         | –       | 2,501     | –       |
| Shareowner plans   | –         | –       | –         | –       | 50        | –       |
| Shares issued MCI/Price acquisitions                     | 192,787   | 20      | –         | –       | –         | –       |
| Balance at end of year                                   | 2,967,652 | 297     | 2,774,865 | 277     | 2,774,865 | 277     |
| <b>Contributed Capital</b>                               |           |         |           |         |           |         |
| Balance at beginning of year                             |           | 25,369  |           | 25,404  |           | 25,363  |
| Shares issued-employee and shareowner plans              |           | –       |           | (24)    |           | 2       |
| Shares issued-MCI/Price acquisitions                     |           | 6,009   |           | –       |           | –       |
| Net tax benefit from employee stock compensation         |           | (2)     |           | –       |           | 41      |
| Idearc Inc. spin-off                                     |           | 8,695   |           | –       |           | –       |
| Other  |           | 53      |           | (11)    |           | (2)     |
| Balance at end of year                                   |           | 40,124  |           | 25,369  |           | 25,404  |
| <b>Reinvested Earnings</b>                               |           |         |           |         |           |         |
| Balance at beginning of year                             |           | 15,905  |           | 12,984  |           | 9,409   |
| Net income   |           | 6,197   |           | 7,397   |           | 7,831   |
| Dividends declared (\$1.62, \$1.62 and \$1.54 per share) |           | (4,781) |           | (4,479) |           | (4,265) |
| Other  |           | 3       |           | 3       |           | 9       |
| Balance at end of year                                   |           | 17,324  |           | 15,905  |           | 12,984  |
| <b>Accumulated Other Comprehensive Loss</b>              |           |         |           |         |           |         |
| Balance at beginning of year                             |           | (1,783) |           | (1,053) |           | (1,250) |
| Foreign currency translation adjustment                  |           | 1,196   |           | (755)   |           | 548     |
| Unrealized gains on net investment hedges                |           | –       |           | 2       |           | –       |
| Unrealized gains (losses) on marketable securities       |           | 54      |           | (21)    |           | 7       |
| Unrealized gains on cash flow hedges                     |           | 14      |           | 10      |           | 17      |
| Minimum pension liability adjustment                     |           | 788     |           | 51      |           | (332)   |
| Adoption of SFAS No. 158                                 |           | (7,671) |           | –       |           | –       |
| Other  |           | (128)   |           | (17)    |           | (43)    |
| Other comprehensive income (loss)                        |           | (5,747) |           | (730)   |           | 197     |
| Balance at end of year                                   |           | (7,530) |           | (1,783) |           | (1,053) |
| <b>Treasury Stock</b>                                    |           |         |           |         |           |         |
| Balance at beginning of year                             | (11,456)  | (353)   | (5,213)   | (142)   | (4,554)   | (115)   |
| Shares purchased   | (50,066)  | (1,700) | (7,859)   | (271)   | (9,540)   | (370)   |
| Shares distributed                                       |           |         |           |         |           |         |
| Employee plans   | 5,355     | 181     | 1,594     | 59      | 8,881     | 343     |
| Shareowner plans   | 20        | 1       | 22        | 1       | –         | –       |
| Balance at end of year                                   | (56,147)  | (1,871) | (11,456)  | (353)   | (5,213)   | (142)   |
| <b>Deferred Compensation – ESOPs and Other</b>           |           |         |           |         |           |         |
| Balance at beginning of year                             |           | 265     |           | 90      |           | (218)   |
| Amortization   |           | (74)    |           | 174     |           | 301     |

|  |                  |                  |                  |
|--|------------------|------------------|------------------|
| Other  | -                | 1                | 7                |
| Balance at end of year                         | <b>191</b>       | 265              | 90               |
| <b>Total Shareowners' Investment</b>           | <b>\$ 48,535</b> | <b>\$ 39,680</b> | <b>\$ 37,560</b> |
| <b>Comprehensive Income</b>                    |                  |                  |                  |
| Net income                                     | <b>\$6,197</b>   | \$7,397          | \$7,831          |
| Other comprehensive income (loss)<br>per above | <b>(5,747)</b>   | (730)            | 197              |
| <b>Total Comprehensive Income<br/>(Loss)</b>   | <b>\$ 450</b>    | <b>\$ 6,667</b>  | <b>\$ 8,028</b>  |

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. Our wireline business provides telephone services, including voice, broadband video and data, network access, nationwide long-distance and other communications products and services, and also owns and operates one of the most expansive end-to-end global Internet Protocol (IP) networks. We continue to deploy advanced broadband network technology, with our fiber-to-the-premises network (FiOS) creating a platform with sufficient bandwidth and capabilities to meet customers' current and future needs. FiOS allows Verizon to offer our customers a wide array of broadband services including advanced data and television offerings. Our IP network includes over 446,000 route miles of fiber optic cable and provides access to over 150 countries across six continents, enabling us to provide next-generation IP network products and Information Technology (IT) services to medium and large businesses and government customers worldwide.

Verizon's domestic wireless business, operating as Verizon Wireless, provides wireless voice and data products and other value added services and equipment across the United States using one of the most extensive wireless networks. Verizon Wireless continues to expand our wireless data, messaging and multi-media offerings for both consumer and business customers. NationalAccess is our national wireless Internet service that offers customers access to the internet, email and business applications with a laptop computer. VCAST is a consumer wireless broadband multimedia service that brings high-quality video, 3D games and music to a wide array of new phones.

We have two reportable segments, Wireline and Domestic Wireless, which we operate and manage as strategic business units and organize by products and services. 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 the Financial Accounting Standards Board (FASB) 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, Assets Held for Sale, and Sales of Businesses and Investments**

We classify as discontinued operations for all periods presented 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 of significant components of our business not classified as discontinued operations are reported as either Sales of Businesses, Net, Equity in Earnings of Unconsolidated Businesses or Other Income and (Expense), Net 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 plant, property and equipment, intangible assets and other long-lived assets, valuation allowances on tax assets and pension and postretirement benefit assumptions.

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## **Revenue Recognition**

### *Wireline*

Our Wireline segment earns revenue based upon usage of our network and facilities and contract fees. In general, fixed monthly 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 services that are not fixed in amount and are based on usage are 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 revenue. In general, access revenue is billed one month in advance and recognized when earned. Access revenue, usage revenue and roaming revenue are recognized when 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 customers at a discount and are recorded as equipment sales revenue.

## **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 period. Diluted earnings per common share include the dilutive effect of shares issuable under our stock-based compensation plans, an exchangeable equity interest (see Note 9), and the zero-coupon convertible notes (see Note 11), which represent the only potentially dilutive common shares. As of December 31, 2006, the exchangeable equity interest and zero-coupon convertible notes are no longer outstanding.

## **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 local 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 local 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 Wireline operations are presented in the following table:

| Average Lives (in years)      |         |
|-------------------------------|---------|
| Buildings                     | 15 - 42 |
| Central office equipment      | 5 - 11  |
| Outside communications plant  |         |
| Copper cable                  | 13 - 18 |
| Fiber cable                   | 11 - 20 |
| Microwave towers              | 30      |
| Poles and conduit             | 30 - 50 |
| Furniture, vehicles and other | 3 - 20  |

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

Plant, property and equipment of our other subsidiaries are generally depreciated on a straight-line basis over the following estimated useful lives: buildings, 8 to 40 years; plant equipment, 3 to 15 years; and other equipment, 3 to 5 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 along with related plant assets. We also capitalize interest associated with the acquisition or construction of network-related assets. Capitalized interest is reported as part of the cost of the network-related assets and as a reduction in interest expense.

In connection with our ongoing review of the estimated remaining useful lives of plant, property and equipment and associated depreciation rates, we determined that, effective January 1, 2005, the remaining useful lives of three categories of telephone assets would be shortened by 1 to 2 years. These changes in asset lives were based on Verizon's plans, and progress to date on those plans, to deploy fiber optic cable to homes, replacing copper cable. While the timing and extent of current deployment plans are subject to modification, Verizon management believes that current estimates of reductions in impacted asset lives is reasonable and subject to ongoing analysis as deployment of fiber optic lines continues. The asset categories impacted and useful life changes are as follows:

| Average Lives (in years) | From    | To      |
|--------------------------|---------|---------|
| Central office equipment |         |         |
| Digital switches         | 12      | 11      |
| Circuit equipment        | 9       | 8 - 9   |
| Outside plant            |         |         |
| Copper cable             | 15 - 19 | 13 - 18 |

In connection with our ongoing review noted above, we determined that, effective January 1, 2006, the remaining useful lives of circuit equipment would be shortened from 8-9 years to 8 years.

## 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 1 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.

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## Goodwill and Other Intangible Assets

### *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 annually, and more frequently if indications of impairment exist. The impairment test for goodwill uses a two-step approach, which is performed at the reporting unit level. We have determined that, in our case, the reporting units are our operating segments since that is the lowest level at which discrete, reliable financial and cash flow information is available. 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 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, *Goodwill and Other Intangible Assets* (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.

We test our Domestic Wireless licenses for impairment annually, and more frequently if indications of impairment exist. Beginning in 2005, we began using a direct value approach in performing our annual impairment test on our Domestic Wireless licenses. The direct value approach determines fair value using estimates of future cash flows associated specifically with the licenses. Previously, we used a residual method, which determined the fair value of the wireless licenses 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 began using the direct value approach in 2005 in accordance with a September 29, 2004 Staff Announcement from the staff of the Securities and Exchange Commission (SEC), "Use of the Residual Method to Value Acquired Assets Other Than Goodwill." Under either the direct method or the residual method, if the fair value of the aggregated wireless licenses is less than the aggregated carrying amount of the licenses, an impairment is 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, whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. If any indications were present, we would test for recoverability by comparing the carrying amount of the asset to the net undiscounted cash flows expected to be generated from the asset. If those net undiscounted cash flows do not exceed the carrying amount (i.e., the asset is not recoverable), we would perform the next step which is to determine the fair value of the asset and record an impairment, if any. 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.

## Income Taxes

Verizon and its domestic subsidiaries file a consolidated federal income tax return.

## Stock-Based Compensation

Effective January 1, 2006, we adopted SFAS No. 123(R), *Share-Based Payment* utilizing the modified prospective method. SFAS No. 123(R) requires the measurement of stock-based compensation expense based on the fair value of the award on the date of grant. Under the modified prospective method, the provisions of SFAS No. 123(R) apply to all awards granted or modified after the date of adoption. The impact to Verizon primarily resulted from Verizon Wireless, for which we recorded a \$42 million cumulative effect of accounting change as of January 1, 2006, net of taxes and after minority interest, to recognize the effect of initially measuring the outstanding liability for Value Appreciation Rights (VARs) granted to Domestic Wireless employees at fair value utilizing a Black-Scholes model. We have been expensing stock options since adopting SFAS No. 123, *Accounting for Stock-Based Compensation* effective January 1, 2003.

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## Foreign Currency Translation

The functional currency for all of our foreign operations is generally 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.

## 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.

As of July 1, 2006, Verizon management employees no longer earn pension benefits or earn service towards the company retiree medical subsidy (See Note 15).

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106, and 132(R)* (SFAS No. 158). SFAS No. 158 requires the recognition of a defined benefit postretirement plan's funded status as either an asset or liability on the balance sheet. SFAS No. 158 also requires the immediate recognition of the unrecognized actuarial gains and losses and prior service costs and credits that arise during the period as a component of other accumulated comprehensive income, net of applicable income taxes. Additionally, the fair value of plan assets must be determined as of the company's year-end. We adopted SFAS No. 158 effective December 31, 2006, which resulted in a net decrease to shareowners' investment of \$6,883 million (see Note 15).

## 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 and collars, equity options, interest rate swap agreements and interest rate locks. We do not hold derivatives for trading purposes.

In accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS No. 133) 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.

## Other Recent Accounting Pronouncements

### *Uncertainty in Income Taxes*

In July 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48). FIN 48 requires the use of a two-step approach for recognizing and measuring tax benefits taken or expected to be taken in a tax return and disclosures regarding uncertainties in income tax positions. We are required to adopt FIN 48 effective January 1, 2007. The cumulative effect of initially adopting FIN 48 will be recorded as an adjustment to opening retained earnings (or to goodwill, in certain cases for a prior acquisition) in the year of adoption and will be presented separately. Only tax positions that meet the more likely than not recognition threshold at the effective date may be recognized upon adoption of FIN 48. We anticipate that as a result of the adoption of FIN 48, we will record an adjustment to our opening retained earnings. We are also reviewing the potential impact of FIN 48 on prior purchase accounting. Any such purchase accounting adjustment will not impact retained earnings or current earnings. We are reviewing the final impact of the adoption of FIN 48. We anticipate that any required adjustment under the adoption of FIN 48 will not be material.

### *Leveraged Leases*

In July 2006, the FASB issued Staff Position No. FAS 13-2, "Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction" (FSP 13-2). FSP 13-2 requires that changes in the projected timing of income tax cash flows generated by a leveraged lease transaction be recognized as a gain or loss in the year in which change occurs. We are required to adopt FSP 13-2 effective January 1, 2007. The cumulative effect of initially adopting this FSP will be recorded as an adjustment to opening retained earnings in the year of adoption and will be presented separately. We anticipate that any required adjustment under the adoption of FSP 13-2 will not be material.

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## *Fair Value Measurements*

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurement* (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, establishes a hierarchy that categorizes and prioritizes the sources to be used to estimate fair value and expands disclosures about fair value measurements. We are required to adopt SFAS No. 157 effective January 1, 2008 on a prospective basis. We are currently evaluating the impact this new standard will have on our future results of operations and financial position.

### Note 2

#### Acquisitions

#### **Completion of Merger with MCI**

On February 14, 2005, Verizon announced that it agreed to acquire 100% of the outstanding common stock of MCI, Inc. (MCI) for a combination of Verizon common shares and cash. MCI was a global communications company that provided Internet, data and voice communication services to businesses and government entities throughout the world and consumers in the United States. After receiving the required state, federal and international regulatory approvals, Verizon and MCI closed the merger on January 6, 2006.

On April 9, 2005, Verizon entered into a stock purchase agreement with eight entities affiliated with Carlos Slim Helú to purchase 43.4 million shares of MCI common stock for \$25.72 per share in cash plus an additional cash amount of 3% per annum from April 9, 2005, until the closing of the purchase of those shares. The transaction closed on May 17, 2005. The total cash payment was \$1,121 million and the investment was accounted for as a cost investment. No payments were made under a provision that required Verizon to pay an additional amount at the end of one year to the extent that the price of Verizon's common stock exceeded \$35.52 per share. We received the special dividend of \$5.60 per MCI share on these 43.4 million MCI shares, or \$243 million, on October 27, 2005.

Under the terms of the merger agreement, MCI shareholders received .5743 shares of Verizon common stock (\$5,050 million in the aggregate) and cash of \$2.738 (\$779 million in the aggregate) for each of their MCI shares. The merger consideration was equal to \$20.40 per MCI share, excluding the \$5.60 per share special dividend paid by MCI to its shareholders on October 27, 2005. There was no purchase price adjustment.

The merger was accounted for using the purchase method in accordance with the SFAS No. 141, *Business Combinations* (SFAS No. 141), and the aggregate transaction value was \$6,890 million, consisting of the cash and common stock issued at closing (\$5,829 million), the consideration for the shares acquired from the Carlos Slim Helú entities, net of the portion of the special dividend paid by MCI that was treated as a return of our investment (\$973 million) and closing and other direct merger-related costs. The number of shares issued was based on the "Average Parent Stock Price," as defined in the merger agreement. The consolidated financial statements include the results of MCI's operations from the date of the close of the merger.

Prior to the merger, there were commercial transactions between us and the former MCI entities for telecommunications services at rates comparable to similar transactions with other third parties. Subsequent to the merger, these transactions are eliminated in consolidation.

#### *Reasons for the Merger*

We believe that the merger will make us a more efficient competitor in providing a broad range of communications services and will result in several significant strategic benefits to us, including the following:

- **Strategic Position.** Following the merger, it is expected that our core strengths in communication services will be enhanced by MCI's employee and business customer base, portfolio of advanced data and IP services and network assets.
- **Growth Platform.** MCI's presence in the U.S. and international enterprise sector and its long haul fiber network infrastructure are expected to provide us with a stronger platform from which we can market our products and services.
- **Operational Benefits.** We believe that we will achieve operational benefits through, among other things, eliminating duplicative staff and information and operating systems and to a lesser extent overlapping network facilities; reducing procurement costs; using the existing networks more efficiently; reducing line support functions; reducing general and administrative expenses; improving information systems; optimizing traffic flow; eliminating planned or potential Verizon capital expenditures for new long-haul network capability; and offering wireless capabilities to MCI's customers.

### Allocation of the cost of the merger

In accordance with SFAS No. 141, the cost of the merger was allocated to the assets acquired and liabilities assumed based on their fair values as of the close of the merger, with the amounts exceeding the fair value being recorded as goodwill. The process to identify and record the fair value of assets acquired and liabilities assumed included an analysis of the acquired fixed assets, including real and personal property; various contracts, including leases, contractual commitments, and other business contracts; customer relationships; investments; and contingencies.

The fair values of the assets acquired and liabilities assumed were determined using one or more of three valuation approaches: market, income and cost. The selection of a particular method for a given asset depended on the reliability of available data and the nature of the asset, among other considerations. The market approach, which indicates value for a subject asset based on available market pricing for comparable assets, was utilized for certain acquired real property and investments. The income approach, which indicates value for a subject asset based on the present value of cash flow projected to be generated by the asset, was used for certain intangible assets such as customer relationships, as well as for favorable/unfavorable contracts. Projected cash flow is discounted at a required rate of return that reflects the relative risk of achieving the cash flow and the time value of money. Projected cash flows for each asset considered multiple factors, including current revenue from existing customers; distinct analysis of expected price, volume, and attrition trends; reasonable contract renewal assumptions from the perspective of a marketplace participant; expected profit margins giving consideration to marketplace synergies; and required returns to contributory assets. The cost approach, which estimates value by determining the current cost of replacing an asset with another of equivalent economic utility, was used for the majority of personal property. The cost to replace a given asset reflects the estimated reproduction or replacement cost for the property, less an allowance for loss in value due to depreciation or obsolescence, with specific consideration given to economic obsolescence if indicated.

The following table summarizes the allocation of the cost of the merger to the assets acquired, including cash of \$2,361 million, and liabilities assumed as of the close of the merger. Certain of the amounts in the following table have been revised since the initial allocation to reflect information that has since become available.

|   | (dollars in millions) |
|---|-----------------------|
| Assets acquired   |                       |
| Current assets  | \$ 6,001              |
| Property, plant & equipment                             | 6,453                 |
| Intangible assets subject to amortization               |                       |
| Customer relationships                                  | 1,162                 |
| Rights of way and other                                 | 176                   |
| Deferred income taxes and other assets                  | 1,995                 |
| Goodwill  | 5,085                 |
| Total assets acquired                                   | \$ 20,872             |
| Liabilities assumed                                     |                       |
| Current liabilities                                     | \$ 6,093              |
| Long-term debt  | 6,169                 |
| Deferred income taxes and other non-current liabilities | 1,720                 |
| Total liabilities assumed                               | 13,982                |
| Purchase price  | \$ 6,890              |

The goodwill resulting from the merger with MCI was assigned to the Wireline segment, which includes the operations of the former MCI. The customer relationships are being amortized on a straight-line basis over 3-8 years based on whether the relationship is with a consumer or a business customer since this correlates to the pattern in which the economic benefits are expected to be realized.

In connection with the merger, we recorded \$193 million of severance and severance-related costs and \$427 million of contract termination costs in the above allocation of the cost of the merger in accordance with the Emerging Issues Task Force Issue (EITF) No. 95-3, "Recognition of Liabilities in Connection with a Purchase Business Combination." We paid \$116 million of the severance and severance-related costs in 2006 with the remaining costs to be paid in 2007. We paid \$128 million of contract termination costs in 2006 and the remaining costs will be paid over the remaining contract periods through 2009. The following table summarizes the obligations recognized in connection with the MCI merger and the activity to date:

|  | Initial<br>Allocation | Other<br>Increases | Payments | Ending Balance |
|--|-----------------------|--------------------|----------|----------------|
| Severance costs and contract termination costs | \$ 459                | \$ 161             | \$ (244) | \$ 376         |

## Pro Forma Information

The following unaudited pro forma consolidated results of operations assume that the MCI merger was completed as of January 1 for the periods shown below:

| Years Ended December 31,   | (dollars in millions, except per share amounts) |           |
|--|---|-----------|
|  | 2006  | 2005      |
| Revenues   | \$ 88,371                                       | \$ 85,739 |
| Income before discontinued operations and cumulative effect of accounting change | 5,480   | 6,724     |
| Net income   | 6,197   | 8,176     |
| Basic earnings per common share:   |   |           |
| Income before discontinued operations and cumulative effect of accounting change | 1.88  | 2.30      |
| Net income   | 2.13  | 2.79      |
| Diluted earnings per common share:   |   |           |
| Income before discontinued operations and cumulative effect of accounting change | 1.88  | 2.28      |
| Net income   | 2.12  | 2.76      |

The unaudited pro forma information presents the combined operating results of Verizon and the former MCI, with the results prior to the acquisition date adjusted to include the pro forma impact of: the elimination of transactions between Verizon and the former MCI; the adjustment of amortization of intangible assets and depreciation of fixed assets based on the purchase price allocation; the elimination of merger expenses incurred by the former MCI; the elimination of the loss on the early redemption of MCI's debt; the adjustment of interest expense reflecting the redemption of all of MCI's debt and the replacement of that debt with \$4 billion of new debt issued in February 2006 at Verizon's weighted average borrowing rate; and to reflect the impact of income taxes on the pro forma adjustments utilizing Verizon's statutory tax rate of 40%. The unaudited pro forma results for 2005 include \$82 million for discontinued operations that were sold by MCI during the first quarter of 2005. The unaudited pro forma results for 2005 include approximately \$300 million of net tax benefits resulting from tax reserve adjustments recognized by the former MCI primarily during the third and fourth quarters of 2005, including audit settlements and other activity.

The unaudited pro forma consolidated basic and diluted earnings per share for 2006 and 2005 are based on the consolidated basic and diluted weighted average shares of Verizon and the former MCI. The historical basic and diluted weighted average shares of the former MCI were converted for the actual number of shares issued upon the closing of the merger.

The unaudited pro forma results are presented for illustrative purposes only and do not reflect the realization of potential cost savings, or any related integration costs. Certain cost savings may result from the merger; however, there can be no assurance that these cost savings will be achieved. Cost savings, if achieved, could result from, among other things, the reduction of overhead expenses, including employee levels and the elimination of duplicate facilities and capital expenditures. These pro forma results do not purport to be indicative of the results that would have actually been obtained if the merger occurred as of the beginning of each of the periods presented, nor does the pro forma data intend to be a projection of results that may be obtained in the future.

### Other Acquisitions

In August 2002, Verizon Wireless and Price Communications Corp. (Price) combined Price's wireless business with a portion of Verizon Wireless. The resulting limited partnership, Verizon Wireless of the East LP (VZ East), is controlled and managed by Verizon Wireless. In exchange for its contributed assets, Price received a limited partnership interest in the new partnership which was exchangeable into the common stock of Verizon Wireless if an initial public offering of that stock occurred, or into the common stock of Verizon on the fourth anniversary of the asset contribution date. On August 15, 2006, Verizon delivered 29.5 million shares of newly-issued Verizon common stock to Price valued at \$1,007 million in exchange for Price's limited partnership interest in VZ East. As a result of acquiring Price's limited partnership interest, Verizon recorded goodwill of \$345 million in the third quarter of 2006 attributable to its Domestic Wireless segment.

On November 29, 2006, we were granted thirteen 20MHz licenses we won in an FCC auction that concluded on September 18, 2006. We paid a total of \$2,809 million for the licenses, which cover a population of nearly 200 million.

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**Note 3****Discontinued Operations and Sales of Businesses, Net**

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*Verizon Information Services*

In October, 2006, we announced our intention to spin-off our domestic print and Internet yellow pages directories publishing operations, which have been organized into a newly formed company known as Idearc Inc. (Idearc). On October 18, 2006, the Verizon Board of Directors declared a dividend consisting of 1 share of Idearc for each 20 shares of Verizon owned. In making its determination to effect the spin-off, Verizon's Board of Directors considered, among other things, that the spin-off may allow each company to separately focus on its core business, which may facilitate the potential expansion and growth of Verizon and Idearc, and allow each company to determine its own capital structure.

On November 17, 2006, we completed the spin-off of Idearc. Cash was paid for fractional shares. The distribution of Idearc common stock to our shareholders is considered a tax free transaction for us and for our shareowners, except for the cash payments for fractional shares which are generally taxable.

At the time of the spin-off, the exercise price of and number of shares of Verizon common stock underlying options to purchase shares of Verizon common stock, restricted stock units (RSU's) and performance stock units (PSU's) were adjusted pursuant to the terms of the applicable Verizon equity incentive plans, taking into account the change in the value of Verizon common stock as a result of the spin-off.

In connection with the spin-off, Verizon received approximately \$2.0 billion in cash from the proceeds of loans under an Idearc term loan facility and transferred to Idearc debt obligations in the aggregate principal amount of approximately \$7.1 billion thereby reducing Verizon's outstanding debt at that time. We incurred pretax charges of approximately \$117 million (\$101 million after-tax), including debt retirement costs, costs associated with accumulated vesting benefits of Idearc employees, investment banking fees and other transaction costs related to the spin-off, which are included in discontinued operations.

In connection with the spin-off, we named Idearc the exclusive official publisher of Verizon print directories of wireline listings in markets where Verizon is the current incumbent local exchange carrier. We also entered into other agreements that defined responsibility for obligations arising before or that may arise after the spin-off, including, among others, obligations relating to Idearc employees, certain transition services and taxes. In general, the agreements governing the exchange of services between us and Idearc are for specified periods at cost-based or commercial rates.

*Verizon Dominicana C. por A., Telecomunicaciones de Puerto Rico, Inc. and Compañía Anónima Nacional Teléfonos de Venezuela*

During the second quarter of 2006, we reached definitive agreements to sell our interests in our Caribbean and Latin American telecommunications operations in three separate transactions to América Móvil, S.A. de C.V. (América Móvil), a wireless service provider throughout Latin America, and a company owned jointly by Teléfonos de México, S.A. de C.V. (Telmex) and América Móvil. We agreed to sell our 100 percent indirect interest in Verizon Dominicana C. por A. (Verizon Dominicana) and our 52 percent interest in Telecomunicaciones de Puerto Rico, Inc. (TELPRI) to América Móvil. An entity jointly owned by América Móvil and Telmex agreed to purchase our indirect 28.5 percent interest in Compañía Anónima Nacional Teléfonos de Venezuela (CANTV).

In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," (SFAS No. 144) we have classified the results of operations of Verizon Dominicana and TELPRI as discontinued operations. CANTV continues to be accounted for as an equity method investment.

On December 1, 2006, we closed the sale of Verizon Dominicana. The transaction resulted in net pretax cash proceeds of \$2,042 million, net of a purchase price adjustment of \$373 million. The U.S. taxes that became payable and were recognized at the time the transaction closed exceeded the \$30 million pretax gain resulting in an after-tax loss of \$541 million.

We expect to close the sale of our interest in TELPRI in 2007 subject to the receipt of regulatory approvals and in accordance with the terms of the definitive agreement. We expect that the sale will result in approximately \$900 million in net pretax cash proceeds.

During the second quarter of 2006, we entered into a definitive agreement to sell our indirect 28.5% interest in CANTV to an entity jointly owned by América Móvil and Telmex for estimated pretax proceeds of \$677 million. Regulatory authorities in Venezuela never commenced the formal review of that transaction and the related tender offers for the remaining equity securities of CANTV. On February 8, 2007, after two prior extensions, the parties terminated the stock purchase agreement because the parties mutually concluded that the regulatory approvals would not be granted by the Government.

In January 2007, the Bolivarian Republic of Venezuela (the Republic) declared its intent to nationalize certain companies, including CANTV. On February 12, 2007, we entered into a Memorandum of Understanding (MOU) with the Republic. The MOU provides that the Republic will offer to purchase all of the equity securities of CANTV through public tender offers in Venezuela and the United States at a price equivalent to \$17.85 per ADS. If the tender offers are completed, the aggregate purchase price for Verizon's shares would be \$572 million. If the 2007

dividend that has been recommended by the CANTV Board is approved by shareholders and paid prior to the closing of the tender offers, this amount will be reduced by the amount of the dividend. Verizon has agreed to tender its shares if the offers are commenced. The Republic has

agreed to commence the offers within forty-five days assuming the satisfactory completion of its due diligence investigation of CANTV. The tender offers are subject to certain conditions including that a majority of the outstanding shares are tendered to the Government and receipt of regulatory approvals. Based upon the terms of the MOU and our current investment balance in CANTV, we expect that we will record a loss on our investment in the first quarter of 2007. The ultimate amount of the loss depends on a variety of factors, including the successful completion of the tender offer and the satisfaction of other terms in the MOU.

#### *Verizon Information Services Canada*

During 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 closed during the fourth quarter of 2004 and resulted in a gain of \$1,017 million (\$516 million after-tax).

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS No. 144), we have classified the results of operation of the U.S. print and Internet yellow pages directories business, Verizon Dominicana and Verizon Information Services Canada as discontinued operations in the consolidated statements of income for all years presented through the date of the spin-off or sale. We have also classified the results of operations of TELPRI, which we continued to own at December 31, 2006, as discontinued operations in the consolidated statements of income. Our investment in CANTV continues to be accounted for as an equity method investment in continuing operations.

The assets and liabilities of the U.S. print and Internet yellow pages directories business, Verizon Information Services Canada, Verizon Dominicana and TELPRI are disclosed as current assets and current liabilities held for sale in the consolidated balance sheets for all years presented through the date of their spin-off or divestiture. Additional detail related to those assets and liabilities are as follows:

|                                    | At December 31, 2006 | (dollars in millions)<br>At December 31, 2005 |
|------------------------------------|----------------------|---|
| Current assets                     | \$ 303               | \$ 995  |
| Plant, property and equipment, net | 1,436                | 2,318   |
| Other non-current assets           | 853                  | 920   |
| Total assets                       | <u>\$ 2,592</u>      | <u>\$ 4,233</u>                               |
| Current liabilities                | \$ 181               | \$ 1,369                                      |
| Long-term debt                     | 575                  | 300   |
| Other non-current liabilities      | 1,398                | 1,201   |
| Total liabilities                  | <u>\$ 2,154</u>      | <u>\$ 2,870</u>                               |

Related to the assets and liabilities above is \$241 million and \$898 million included as Accumulated Other Comprehensive Loss in the condensed consolidated balance sheets as of December 31, 2006 and December 31, 2005, respectively.

Income from discontinued operations, net of tax presented in the consolidated statements of income included the following:

| Years Ended December 31,                      | (dollars in millions) |                 |                 |
|---|-----------------------|-----------------|-----------------|
|   | 2006                  | 2005            | 2004            |
| Operating Revenues                            | \$ 5,077              | \$ 5,595        | \$ 5,812        |
| Income before provision for income taxes      | 2,041                 | 2,159           | 3,251           |
| Provision for income taxes                    | (1,282)               | (789)           | (1,319)         |
| Income on discontinued operations, net of tax | <u>\$ 759</u>         | <u>\$ 1,370</u> | <u>\$ 1,932</u> |

#### *Verizon Hawaii Inc.*

During the second quarter of 2004, we entered into an agreement to sell our wireline and directory businesses in Hawaii, including Verizon Hawaii Inc. which operated approximately 700,000 switched access lines, as well as the services and assets of Verizon Long Distance, Verizon Online, Verizon Information Services and Verizon Select Services Inc. in Hawaii, to an affiliate of The Carlyle Group. This transaction closed during the second quarter of 2005. In connection with this sale, we received net proceeds of \$1,326 million and recorded a net pretax gain of \$530 million (\$336 million after-tax).

**Other Strategic Actions****Spin-off Transaction Charges**

In 2006, we recorded pretax charges of \$117 million (\$101 million after-tax) for costs related to the spin-off of Idearc. These costs primarily consisted of banking and legal fees; as well as filing fees, printing and mailing costs. There were no similar charges in 2005 and 2004.

**Merger Integration Costs**

In 2006, we recorded pretax charges of \$232 million (\$146 million after-tax) related to integration costs associated with the MCI acquisition that closed on January 6, 2006. These costs are primarily comprised of advertising and other costs related to re-branding initiatives and systems integration activities. There were no similar charges incurred in 2005 and 2004.

**Facility and Employee-Related Items**

During 2006, we recorded pretax charges of \$184 million (\$118 million after-tax) in connection with the continued relocation of employees and business operations to Verizon Center located in Basking Ridge, New Jersey. During 2005, we recorded a net pretax gain of \$18 million (\$8 million after-tax) in connection with this relocation of our new operations center, Verizon Center, including a pretax gain of \$120 million (\$72 million after-tax) related to the sale of a New York City office building, partially offset by a pretax charge of \$102 million (\$64 million after-tax) primarily associated with relocation, employee severance and related activities. There were no similar charges incurred in 2004.

During 2006, we recorded net pretax severance, pension and benefits charges of \$425 million (\$258 million after-tax, including \$3 million of income recorded to discontinued operations). These charges included net pretax pension settlement losses of \$56 million (\$26 million after-tax) related to employees that received lump-sum distributions primarily resulting from our separation plans. 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* (SFAS No. 88), which requires that settlement losses be recorded once prescribed payment thresholds have been reached. Also included are pretax charges of \$369 million (\$228 million after-tax), for employee severance and severance-related costs in connection with the involuntary separation of approximately 4,100 employees. In addition, during 2005 we recorded a charge of \$59 million (\$36 million after-tax) associated with employee severance costs and severance-related activities in connection with the voluntary separation program for surplus union-represented employees.

During 2005, we recorded a net pretax charge of \$98 million (\$59 million after-tax) related to the restructuring of the Verizon management retirement benefit plans. This pretax charge was recorded in accordance with SFAS No. 88, and SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions* (SFAS No. 106) and includes the unamortized cost of prior pension enhancements of \$430 million offset partially by a pretax curtailment gain of \$332 million related to retiree medical benefits. In connection with this restructuring, management employees: no longer earn pension benefits or earn service towards the company retiree medical subsidy after June 30, 2006; received an 18-month enhancement of the value of their pension and retiree medical subsidy; and receive a higher savings plan matching contribution.

During 2004, we recorded pretax pension settlement losses of \$805 million (\$492 million after-tax) related to employees that received lump-sum distributions during 2004 in connection with the 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. In addition, we recorded a \$7 million after-tax charge in income from discontinued operations, related to the 2003 separation plan.

**Tax Matters**

During 2005, we recorded a tax benefit of \$336 million in connection with capital gains and prior year investment losses. As a result of the capital gain realized in 2005 in connection with the sale of our Hawaii businesses, we recorded a tax benefit of \$242 million related to capital losses incurred in previous years. The investment losses pertain to Iusacell, CTI Holdings, S.A. (CTI) and TelecomAsia.

Also during 2005, we recorded a net tax provision of \$206 million related to the repatriation of foreign earnings under the provisions of the American Jobs Creation Act of 2004, for two of our foreign investments.

As a result of the capital gain realized in 2004 in connection with the sale of Verizon Information Services Canada, we recorded tax benefits of \$234 million in the fourth quarter of 2004 pertaining to prior year investment impairments. The investment impairments primarily related to debt and equity investments in CTI, Cable & Wireless plc and NTL Incorporated.

## Other Charges and Special Items

During 2006, we recorded pretax charges of \$26 million (\$16 million after-tax) resulting from the extinguishment of debt assumed in connection with the completion of the MCI merger.

During 2006, we recorded after-tax charges of \$42 million to recognize the adoption of SFAS No. 123 (R).

During 2005, we recorded pretax charges of \$139 million (\$133 million after-tax) including a pretax impairment charge of \$125 million pertaining to aircraft leased to airlines involved in bankruptcy proceedings and a pretax charge of \$14 million (\$8 million after-tax) in connection with the early extinguishment of debt.

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 that were recovered upon the emergence of MCI from bankruptcy.

Also during 2004, we recorded an impairment charge of \$113 million (\$87 million after-tax) related to our international long distance and data network. In addition, we recorded pretax charges of \$55 million (\$34 million after-tax) in connection with the early extinguishment of debt.

During 2004, we recorded a pretax gain of \$787 million (\$565 million after-tax) on the sale of our 20.5% interest in TELUS in an underwritten public offering in the U.S. and Canada. In connection with this sale transaction, Verizon recorded a contribution of \$100 million to Verizon Foundation to fund its charitable activities and increase its self-sufficiency. Consequently, we recorded a net gain of \$500 million after taxes related to this transaction and the accrual of the Verizon Foundation contribution.

### Note 5

#### Marketable Securities and Other Investments

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 Short-Term Investments, 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 Other Income and Expense, Net 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. As of December 31, 2006, no impairments were determined to exist.

The following table shows certain summarized information related to our investments in marketable securities:

|  | (dollars in millions) |                              |                               |                 |
|--|-----------------------|------------------------------|-------------------------------|-----------------|
|  | Cost                  | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value   |
| <b>At December 31, 2006</b>              |                       |                              |                               |                 |
| Short-term investments                   | \$ 616                | \$ 28                        | \$ –                          | \$ 644          |
| Investments in unconsolidated businesses | 259                   | 38                           | (2)                           | 295             |
| Other assets                             | 594                   | 31                           | –                             | 625             |
|  | <b>\$ 1,469</b>       | <b>\$ 97</b>                 | <b>\$ (2)</b>                 | <b>\$ 1,564</b> |
| <b>At December 31, 2005</b>              |                       |                              |                               |                 |
| Short-term investments                   | \$ 373                | \$ 9                         | \$ –                          | \$ 382          |
| Investments in unconsolidated businesses | 215                   | 13                           | (3)                           | 225             |
| Other assets                             | 548                   | 19                           | –                             | 567             |
|  | <b>\$ 1,136</b>       | <b>\$ 41</b>                 | <b>\$ (3)</b>                 | <b>\$ 1,174</b> |

Our investments in marketable securities are primarily bonds and mutual funds.

During 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 Other Income and Expense, Net in the consolidated statements of income. The preferred stock was received in 2000 in connection with the sale of access lines in Iowa.

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. The carrying values for investments not adjusted to market value were \$12 million at December 31, 2006 and \$5 million at December 31, 2005.

**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,                                 | (dollars in millions) |                  |
|---|-----------------------|------------------|
|   | 2006                  | 2005             |
| Land  | \$ 959                | \$ 706           |
| Buildings and equipment                         | 19,207                | 16,312           |
| Network equipment                               | 163,580               | 152,409          |
| Furniture, office and data processing equipment | 12,789                | 12,272           |
| Work in progress                                | 2,315                 | 1,475            |
| Leasehold improvements                          | 3,061                 | 2,297            |
| Other   | 2,198                 | 2,290            |
|   | <b>204,109</b>        | <b>187,761</b>   |
| Accumulated depreciation                        | <b>(121,753)</b>      | <b>(114,774)</b> |
| Total   | <b>\$ 82,356</b>      | <b>\$ 72,987</b> |

**Note 7****Goodwill and Other Intangible Assets****Goodwill**

Changes in the carrying amount of goodwill are as follows:

|  | (dollars in millions) |                   |                 |
|--|-----------------------|-------------------|-----------------|
|  | Wireline              | Domestic Wireless | Total           |
| <b>Balance at December 31, 2004 and 2005</b> | \$ 315                | \$ –              | \$ 315          |
| Acquisitions                                 | 5,085                 | 345               | 5,430           |
| Goodwill reclassifications and other         | (90)                  | –                 | (90)            |
| <b>Balance at December 31, 2006</b>          | <b>\$ 5,310</b>       | <b>\$ 345</b>     | <b>\$ 5,655</b> |

**Other Intangible Assets**

The following table displays the details of other intangible assets:

|  | At December 31, 2006 |                          | At December 31, 2005 |                          |
|--|----------------------|--------------------------|----------------------|--------------------------|
|  | Gross Amount         | Accumulated Amortization | Gross Amount         | Accumulated Amortization |
| Finite-lived intangible assets:                  |                      |                          |                      |                          |
| Customer lists (3 to 8 years)                    | \$ 1,278             | \$ 270                   | \$ 3,436             | \$ 3,279                 |
| Non-network internal-use software (1 to 7 years) | 7,777                | 3,826                    | 7,081                | 3,193                    |
| Other (1 to 25 years)                            | 204                  | 23                       | 26                   | 3                        |
| Total  | <b>\$ 9,259</b>      | <b>\$ 4,119</b>          | <b>\$ 10,543</b>     | <b>\$ 6,475</b>          |
| Indefinite-lived intangible assets:              |                      |                          |                      |                          |
| Wireless licenses                                | <b>\$ 50,959</b>     |                          | <b>\$ 47,781</b>     |                          |

Customer lists of \$1,278 million includes \$1,162 million related to the MCI acquisition. Customer lists of \$3,313 million at Domestic Wireless became fully amortized and were written off during 2006. Intangible asset amortization expense was \$1,423 million, \$1,444 million, and \$1,334 million for the years ended December 31, 2006, 2005 and 2004, respectively. It is estimated to be \$1,201 million in 2007, \$1,047 million in 2008, \$856 million in 2009, \$633 million in 2010 and \$483 million in 2011, 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:

| At December 31,                                | Ownership | (dollars in millions) |                    |
|--|-----------|-----------------------|--------------------|
|  |           | 2006<br>Investment    | 2005<br>Investment |
| <b>Equity Investees</b>                        |           |                       |                    |
| CANTV  | 28.5%     | \$ 230                | \$ 152             |
| Vodafone Omnitel                               | 23.1      | 3,624                 | 2,591              |
| Other  | Various   | 744                   | 770                |
| Total equity investees                         |           | <u>4,598</u>          | <u>3,513</u>       |
| <b>Cost Investees</b>                          | Various   | 270                   | 1,089              |
| Total investments in unconsolidated businesses |           | <u>\$ 4,868</u>       | <u>\$ 4,602</u>    |

Dividends and repatriations of foreign earnings received from investees amounted to \$42 million in 2006, \$2,335 million in 2005 and \$162 million in 2004, respectively, and are reported in Other, Net operating activities in the consolidated statements of cash flows.

**Equity Investees***CANTV*

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. Our \$230 million investment in CANTV is net of approximately \$400 million of foreign currency translation adjustments that are included in Accumulated Other Comprehensive Loss.

In the second quarter of 2006, we reached a definitive agreement to sell our indirect 28.5% interest in CANTV to an entity jointly owned by América Móvil and Telmex. That agreement was terminated on February 8, 2007. On February 12, 2007, we announced our intention to participate in the Venezuelan government's offer to purchase our shares in CANTV through public tender offers in Venezuela and the U.S. (See Note 23).

*Vodafone Omnitel*

Vodafone Omnitel N.V. (Vodafone Omnitel) is an Italian digital cellular telecommunications company. It is the second largest wireless provider in Italy. At December 31, 2006 and 2005, our investment in Vodafone Omnitel included goodwill of \$1,044 million and \$937 million, respectively.

During 2005, we repatriated \$2,202 million of Vodafone Omnitel's earnings through the repurchase of issued and outstanding shares of its equity. Vodafone Omnitel's owners, Verizon and Vodafone Group Plc (Vodafone), participated on a pro rata basis; consequently, Verizon's ownership interest after the share repurchase remained at 23.1%.

*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, 2006 and 2005, Verizon had equity investments in these partnerships of \$659 million and \$652 million, respectively. Verizon currently adjusts the carrying value of these investments for any losses incurred by the limited partnerships through earnings.

The remaining investments include wireless partnerships in the U.S., and other smaller domestic and international investments.

**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. Our cost investments include a variety of domestic and international investments primarily involved in providing communication services.

Our cost investments in unconsolidated businesses included 43.4 million of shares of MCI common stock that were converted upon the closing of the MCI merger (see Note 2).

**Note 9****Minority Interest**

Minority interests in equity of subsidiaries were as follows:

| At December 31,                                   | (dollars in millions) |                  |
|---|-----------------------|------------------|
|   | 2006                  | 2005             |
| Minority interests in consolidated subsidiaries*: |                       |                  |
| Wireless joint venture (55%)                      | \$ 27,854             | \$ 24,683        |
| Cellular partnerships and other (various)         | 483                   | 1,650            |
| Preferred securities issued by subsidiaries       | –                     | 100              |
|   | <b>\$ 28,337</b>      | <b>\$ 26,433</b> |

\* 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. 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 had the right to require Verizon Wireless to purchase up to an aggregate of \$20 billion worth of Vodafone's interest in Verizon Wireless at designated times (put windows) at its then fair market value, not to exceed \$10 billion in any one put window. Vodafone had the right to require the purchase of up to \$10 billion during a 61-day period which opened on June 10 and closed on August 9 in 2006, and did not exercise that right. As of December 31, 2006, Vodafone only has the right to require the purchase of up to \$10 billion worth of its interest, during a 61-day period opening on June 10 and closing on August 9 in 2007, under its one remaining put window. 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. In the event Vodafone exercises its one remaining put right, we (instead of Verizon Wireless) have the right, exercisable at our sole discretion, to purchase up to \$2.5 billion of Vodafone's interest for cash or Verizon stock at our option.

**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. The resulting limited partnership, Verizon Wireless of the East LP (VZ East), is controlled and managed by Verizon Wireless. In exchange for its contributed assets, Price received a limited partnership interest in the new partnership which was exchangeable into the common stock of Verizon Wireless if an initial public offering of that stock occurred, or into the common stock of Verizon on the fourth anniversary of the asset contribution date. On August 15, 2006, Verizon delivered 29.5 million shares of newly-issued Verizon common stock to Price valued at \$1,007 million in exchange for Price's limited partnership interest in VZ East.

**Preferred Securities Issued By Subsidiaries**

On January 15, 2006, Verizon redeemed \$100 million Verizon International Holdings Ltd. Series A variable term voting cumulative preferred stock at the redemption price per share of \$100,000, plus accrued and unpaid dividends.

**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 up to 49 years as of December 31, 2006. 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 information on 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:

| At December 31,                   | 2006             |                       |                 | (dollars in millions)<br>2005 |                       |                 |
|-----------------------------------|------------------|-----------------------|-----------------|-------------------------------|-----------------------|-----------------|
|                                   | Leveraged Leases | Direct Finance Leases | Total           | Leveraged Leases              | Direct Finance Leases | Total           |
| Minimum lease payments receivable | \$ 3,311         | \$ 128                | \$ 3,439        | \$ 3,847                      | \$ 123                | \$ 3,970        |
| Estimated residual value          | 1,637            | 18                    | 1,655           | 1,937                         | 9                     | 1,946           |
| Unearned income                   | (1,895)          | (22)                  | (1,917)         | (2,260)                       | (11)                  | (2,271)         |
|                                   | <b>\$ 3,053</b>  | <b>\$ 124</b>         | <b>3,177</b>    | <b>\$ 3,524</b>               | <b>\$ 121</b>         | <b>3,645</b>    |
| Allowance for doubtful accounts   |                  |                       | (175)           |                               |                       | (375)           |
| Finance lease receivables, net    |                  |                       | <b>\$ 3,002</b> |                               |                       | <b>\$ 3,270</b> |
| Current                           |                  |                       | <b>\$ 40</b>    |                               |                       | <b>\$ 30</b>    |
| Noncurrent                        |                  |                       | <b>\$ 2,962</b> |                               |                       | <b>\$ 3,240</b> |

Accumulated deferred taxes arising from leveraged leases, which are included in Deferred Income Taxes, amounted to \$2,674 million at December 31, 2006 and \$3,049 million at December 31, 2005.

The following table is a summary of the components of income from leveraged leases:

| Years Ended December 31,     | (dollars in millions) |        |       |
|------------------------------|-----------------------|--------|-------|
|                              | 2006                  | 2005   | 2004  |
| Pretax lease income          | \$ 96                 | \$ 119 | \$ 63 |
| Income tax expense/(benefit) | 57                    | (25)   | (52)  |
| Investment tax credits       | 4                     | 4      | 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, 2006, are as follows:

| Years      | (dollars in millions) |                  |
|------------|-----------------------|------------------|
|            | Capital Leases        | Operating Leases |
| 2007       | \$ 128                | \$ 32            |
| 2008       | 92                    | 18               |
| 2009       | 153                   | 14               |
| 2010       | 132                   | 11               |
| 2011       | 114                   | 8                |
| Thereafter | 2,820                 | 24               |
| Total      | <b>\$ 3,439</b>       | <b>\$ 107</b>    |

#### 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 \$1,608 million in 2006, \$1,458 million in 2005 and \$1,278 million in 2004.

Capital lease amounts included in plant, property and equipment are as follows:

| At December 31,          | (dollars in millions) |               |
|--------------------------|-----------------------|---------------|
|                          | 2006                  | 2005          |
| Capital leases           | \$ 359                | \$ 313        |
| Accumulated amortization | (160)                 | (137)         |
| Total                    | <b>\$ 199</b>         | <b>\$ 176</b> |

The aggregate minimum rental commitments under noncancelable leases for the periods shown at December 31, 2006, are as follows:

| Years                                     | (dollars in millions) |                  |
|---|-----------------------|------------------|
|   | Capital Leases        | Operating Leases |
| 2007                                      | \$ 80                 | \$ 1,739         |
| 2008                                      | 69                    | 1,194            |
| 2009                                      | 64                    | 998              |
| 2010                                      | 55                    | 724              |
| 2011                                      | 51                    | 459              |
| Thereafter                                | 161                   | 1,729            |
| Total minimum rental commitments          | 480                   | \$ 6,843         |
| Less interest and executory costs         | (120)                 |                  |
| Present value of minimum lease payments   | 360                   |                  |
| Less current installments                 | (55)                  |                  |
| Long-term obligation at December 31, 2006 | \$ 305                |                  |

As of December 31, 2006, the total minimum sublease rentals to be received in the future under noncancelable operating and capital subleases were \$124 million and \$0.9 million, respectively.

## Note 11

### Debt

#### Debt Maturing Within One Year

Debt maturing within one year is as follows:

| At December 31,                         | (dollars in millions) |          |
|---|-----------------------|----------|
|   | 2006                  | 2005     |
| Long-term debt maturing within one year | \$ 4,139              | \$ 4,526 |
| Commercial paper                        | 3,576                 | 2,152    |
| Other short-term debt                   | –                     | 10       |
| Total debt maturing within one year     | \$ 7,715              | \$ 6,688 |

The weighted average interest rate for our commercial paper at year-end December 31, 2006 and December 31, 2005 was 5.3% and 4.3%, respectively.

Capital expenditures (primarily acquisition and construction of network assets) are partially financed, pending long-term financing, through bank loans and the issuance of commercial paper payable within 12 months.

At December 31, 2006, we had approximately \$6.2 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  | (dollars in millions) |           |
|---|------------------|-------------|-----------------------|-----------|
|   |                  |             | 2006                  | 2005      |
| Notes payable   | 4.00 – 8.25      | 2007 – 2035 | \$ 14,805             | \$ 15,610 |
| Telephone subsidiaries – debentures and first/refunding mortgage bonds      | 4.63 – 7.00      | 2007 – 2042 | 11,703                | 11,869    |
|   | 7.15 – 7.65      | 2007 – 2032 | 1,275                 | 1,725     |
|   | 7.85 – 8.75      | 2010 – 2031 | 1,679                 | 1,926     |
| Other subsidiaries – debentures and other                                   | 4.25 – 10.75     | 2007 – 2028 | 2,977                 | 3,410     |
| Zero-coupon convertible notes, net of unamortized discount of \$– and \$790 | –                | –           | –                     | 1,360     |
| Employee stock ownership plan loans:  |                  |             |                       |           |
| NYNEX debentures  | 9.55             | 2010        | 92                    | 113       |
| Capital lease obligations (average rate 8.0% and 11.9%)                     | –                | –           | 360                   | 112       |
| Property sale holdbacks held in escrow, vendor financing and other          |                  |             | –                     | 13        |
| Unamortized discount, net of premium  |                  |             | (106)                 | (43)      |

|  |                  |                  |
|--|------------------|------------------|
| Total long-term debt, including current maturities | 32,785           | 36,095           |
| Less: debt maturing within one year                | (4,139)          | (4,526)          |
| Total long-term debt                               | <u>\$ 28,646</u> | <u>\$ 31,569</u> |

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### *Telephone Subsidiaries' Debt*

Our first mortgage bonds of \$100 million are secured by certain telephone operations assets.

See Note 20 for additional information about guarantees of operating subsidiary debt.

### *Redemption of Debt Assumed in Merger*

On January 17, 2006, Verizon announced offers to purchase two series of MCI senior notes, MCI \$1,983 million aggregate principal amount of 6.688% Senior Notes Due 2009 and MCI \$1,699 million aggregate principal amount of 7.735% Senior Notes Due 2014, at 101% of their par value. Due to the change in control of MCI that occurred in connection with the merger with Verizon on January 6, 2006, Verizon was required to make this offer to noteholders within 30 days of the closing of the merger. Noteholders tendered \$165 million of the 6.688% Senior Notes. Separately, Verizon notified noteholders that MCI was exercising its right to redeem both series of Senior Notes prior to maturity under the optional redemption procedures provided in the indentures. The 6.688% Notes were redeemed on March 1, 2006, and the 7.735% Notes were redeemed on February 16, 2006.

In addition, on January 20, 2006, Verizon announced an offer to repurchase MCI \$1,983 million aggregate principal amount of 5.908% Senior Notes Due 2007 at 101% of their par value. On February 21, 2006, \$1,804 million of these notes were redeemed by Verizon. Verizon satisfied and discharged the indenture governing this series of notes shortly after the close of the offer for those noteholders who did not accept this offer.

### *Other Debt Redemptions/Prepayments*

During the second quarter of 2006, we redeemed/prepaid several debt issuances, including: Verizon North Inc. \$200 million 7.625% Series C debentures due May 15, 2026; Verizon Northwest Inc. \$175 million 7.875% Series B debentures due June 1, 2026; Verizon South Inc. \$250 million 7.5% Series D debentures due March 15, 2026; Verizon California Inc. \$25 million 9.41% Series W first mortgage bonds due 2014; Verizon California Inc. \$30 million 9.44% Series X first mortgage bonds due 2015; Verizon Northwest Inc. \$3 million 9.67% Series HH first mortgage bonds due 2010 and Contel of the South Inc. \$14 million 8.159% Series GG first mortgage bonds due 2018. The gain/(loss) from these retirements was immaterial.

During the third quarter of 2005, we redeemed Verizon New England Inc. \$250 million 6.875% debentures due October 1, 2023 resulting in a pretax charge of \$10 million (\$6 million after-tax) in connection with the early extinguishment of the debt.

### *Zero-Coupon Convertible Notes*

Previously in May 2001, 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 were 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 exceeded specified levels or in other specified circumstances. The conversion price increased by at least 3% a year. The initial conversion price represented a 25% premium over the May 8, 2001 closing price of \$55.60 per share. The notes were 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. In addition, the zero-coupon convertible notes were callable by Verizon on or after May 15, 2006. On May 16, 2006, we redeemed the remaining \$1,375 million accreted principal of the remaining outstanding zero-coupon convertible principal. The total payment on the date of redemption was \$1,377 million.

### *Support Agreements*

All of Verizon Global Funding's debt had the benefit of Support Agreements between us and Verizon Global Funding, which gave holders of Verizon Global Funding debt the right to proceed directly against us for payment of interest, premium (if any) and principal outstanding should

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Verizon Global Funding fail to pay. The holders of Verizon Global Funding debt did not have recourse to the stock or assets of most of our telephone operations; however, they did have recourse to dividends paid to us by any of our consolidated subsidiaries as well as assets not covered by the exclusion. On February 1, 2006, Verizon announced the merger of Verizon Global Funding into Verizon. As a result of the merger all of Verizon Global Funding's debt has been assumed by Verizon by operation of law.

In addition, Verizon Global Funding had 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. In connection with the merger of Verizon Global Funding into Verizon, Verizon has assumed this guarantee. As of December 31, 2006, \$2,950 million principal amount of these obligations remained outstanding.

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 December 31, 2006, \$92 million principal amount of this obligation remained outstanding. NYNEX and GTE no longer issue public debt or file SEC reports. See Note 20 for information on guarantees of operating subsidiary debt listed on the New York Stock Exchange.

#### *Debt Covenants*

We and our consolidated subsidiaries are in compliance with all of our debt covenants.

#### *Maturities of Long-Term Debt*

Maturities of long-term debt outstanding at December 31, 2006 are \$4.1 billion in 2007, \$2.5 billion in 2008, \$1.4 billion in 2009, \$2.8 billion in 2010, \$2.6 billion in 2011 and \$19.4 billion thereafter.

### 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 period 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.

#### *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 recorded as gains in the consolidated statements of income of \$4 million for the year ended December 31, 2004.

We also enter into interest rate derivatives to limit our exposure to interest rate changes. In accordance with the provisions of SFAS No. 133, changes in fair value of these cash flow hedges due to interest rate fluctuations are recognized in Accumulated Other Comprehensive Loss. We recorded Other Comprehensive Income (Loss) of \$14 million and \$10 million related to these interest rate cash flow hedges for the years ended December 31, 2006 and 2005, respectively.

#### *Foreign Exchange Risk Management*

From time to time, our foreign exchange risk management has included 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. There were no foreign currency contracts outstanding as of December 31, 2006 and 2005. 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 Accumulated Other Comprehensive Loss. We have recorded net unrealized gains of \$17 million in Other Comprehensive Income (Loss) for the year ended December 31, 2004.

#### *Net Investment Hedges*

During 2005, we entered into zero cost euro collars to hedge a portion of our net investment in Vodafone Omnitel. In accordance with the provisions of SFAS No. 133 and related amendments and interpretations, changes in fair value of these contracts due to exchange rate fluctuations were recognized in Accumulated Other Comprehensive Loss and offset the impact of foreign currency changes on the value of our net investment. During 2005, our positions in the zero cost euro collars were settled. As of December 31, 2006 and 2005, Accumulated Other Comprehensive Loss includes unrecognized gains of \$2 million related to these hedge contracts, which along with the unrealized foreign currency translation balance of the investment hedged, remains unless the investment is sold.

During 2004, we entered into foreign currency forward contracts to hedge our net investment in our Canadian operations. In accordance with the provisions of SFAS No. 133, changes in the fair value of these contracts due to exchange rate fluctuations were recognized in Accumulated Other Comprehensive Loss and offset the impact of foreign currency changes on the value of our net investment. During 2004, we sold our Canadian operations and the unrealized losses on these net investment hedge contracts were recognized in net income along with the corresponding foreign currency translation balance. We recorded realized losses of \$106 million (\$58 million after-tax) related to these hedge contracts.

#### *Other Derivatives*

On May 17, 2005, we purchased 43.4 million shares of MCI common stock under a stock purchase agreement that contained a provision for the payment of an additional cash amount determined immediately prior to April 9, 2006 based on the market price of Verizon's common stock. (See Note 2). Under SFAS No. 133, this additional cash payment was an embedded derivative which we carried at fair value and was subject to changes in the market price of Verizon stock. Since this derivative did not qualify for hedge accounting under SFAS No. 133, changes in its fair value were recorded in the consolidated statements of income in Other Income and (Expense), Net. During 2006 and 2005, we recorded pretax income of \$4 million and \$57 million, respectively, in connection with this embedded derivative. As of December 31, 2006, this embedded derivative has expired with no requirement for an additional cash payment made under the stock purchase agreement.

#### **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 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:

| <b>Financial Instrument</b>   | <b>Valuation Method</b>  |
|---|--|
| Cash and cash equivalents and short-term investments  | Carrying amounts   |
| Short- and long-term debt (excluding capital leases)  | Market quotes for similar terms and maturities or future cash flows discounted at current rates                |
| Cost investments in unconsolidated businesses, derivative assets and liabilities and notes receivable | Future cash flows discounted at current rates, market quotes for similar instruments or other valuation models |

| <b>At December 31,</b>                        | (dollars in millions) |            |                    |            |
|---|-----------------------|------------|--------------------|------------|
|   | <b>2006</b>           |            | 2005               |            |
|   | Carrying<br>Amount    | Fair Value | Carrying<br>Amount | Fair Value |
| Short- and long-term debt                     | \$ 36,000             | \$ 37,165  | \$ 38,145          | \$ 39,549  |
| Cost investments in unconsolidated businesses | 270                   | 270        | 1,089              | 1,089      |
| Short- and long-term derivative assets        | 31                    | 31         | 62                 | 62         |
| Short- and long-term derivative liabilities   | 10                    | 10         | 21                 | 21         |

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 common share:

| Years Ended December 31,   | (dollars and shares in millions, except per share amounts) |                 |                 |
|--|--|-----------------|-----------------|
|  | 2006   | 2005            | 2004            |
| <b>Net Income Used For Basic Earnings Per Common Share</b>   |  |                 |                 |
| Income before discontinued operations and cumulative effect of accounting change   | \$ 5,480   | \$ 6,027        | \$ 5,899        |
| Income on discontinued operations, net of tax  | 759  | 1,370           | 1,932           |
| Cumulative effect of accounting change, net of tax   | (42)   | –               | –               |
| Net income   | <b>\$ 6,197</b>  | <b>\$ 7,397</b> | <b>\$ 7,831</b> |
| <b>Net Income Used For Diluted Earnings Per Common Share</b>   |  |                 |                 |
| Income before discontinued operations and cumulative effect of accounting change   | \$ 5,480   | \$ 6,027        | \$ 5,899        |
| After-tax minority interest expense related to exchangeable equity interest  | 20   | 32              | 27              |
| After-tax interest expense related to zero-coupon convertible notes  | 11   | 28              | 41              |
| Income before discontinued operations and cumulative effect of accounting change – after assumed conversion of dilutive securities | 5,511  | 6,087           | 5,967           |
| Income on discontinued operations, net of tax  | 759  | 1,370           | 1,932           |
| Cumulative effect of accounting change, net of tax   | (42)   | –               | –               |
| Net income – after assumed conversion of dilutive securities   | <b>\$ 6,228</b>  | <b>\$ 7,457</b> | <b>\$ 7,899</b> |
| <b>Basic Earnings Per Common Share <sup>(1)</sup></b>  |  |                 |                 |
| Weighted-average shares outstanding – basic  | 2,912  | 2,766           | 2,770           |
| Income before discontinued operations and cumulative effect of accounting change   | \$ 1.88  | \$ 2.18         | \$ 2.13         |
| Income on discontinued operations, net of tax  | .26  | .50             | .70             |
| Cumulative effect of accounting change, net of tax   | (.01)  | –               | –               |
| Net income   | <b>\$ 2.13</b>   | <b>\$ 2.67</b>  | <b>\$ 2.83</b>  |
| <b>Diluted Earnings Per Common Share <sup>(1)</sup></b>  |  |                 |                 |
| Weighted-average shares outstanding  | 2,912  | 2,766           | 2,770           |
| Effect of dilutive securities:   |  |                 |                 |
| Stock options  | 1  | 5               | 5               |
| Exchangeable equity interest   | 18   | 29              | 29              |
| Zero-coupon convertible notes  | 7  | 17              | 27              |
| Weighted-average shares – diluted  | <b>2,938</b>   | <b>2,817</b>    | <b>2,831</b>    |
| Income before discontinued operations and cumulative effect of accounting change   | \$ 1.88  | \$ 2.16         | \$ 2.11         |
| Income on discontinued operations, net of tax  | .26  | .49             | .68             |
| Cumulative effect of accounting change, net of tax   | (.01)  | –               | –               |
| Net income   | <b>\$ 2.12</b>   | <b>\$ 2.65</b>  | <b>\$ 2.79</b>  |

(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 228 million shares during 2006, 250 million shares during 2005 and 262 million shares during 2004.

The zero-coupon convertible notes were retired on May 15, 2006. (see Note 11).

The exchangeable equity interest was converted on August 15, 2006 by issuing 29.5 million Verizon shares (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 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. We repurchased 7.9 million and 9.5 million common shares during 2005 and 2004, respectively.

On January 19, 2006, the Board of Directors determined that no additional common shares may be purchased under the previously authorized program and gave authorization to repurchase of up to 100 million common shares terminating no later than the close of business on February 28, 2008. We repurchased approximately 50 million common shares under this authorization during 2006.

## Note 14

### Stock-Based Compensation

Effective January 1, 2006, we adopted SFAS No. 123(R) utilizing the modified prospective method. SFAS No. 123(R) requires the measurement of stock-based compensation expense based on the fair value of the award on the date of grant. Under the modified prospective method, the provisions of SFAS No. 123(R) apply to all awards granted or modified after the date of adoption. The impact to Verizon primarily resulted from Verizon Wireless, for which we recorded a \$42 million cumulative effect of accounting change, net of taxes and after minority interest, to recognize the effect of initially measuring the outstanding liability for awards granted to Domestic Wireless employees at fair value utilizing a Black-Scholes model.

Previously, 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*) for all new awards granted, modified or settled after January 1, 2003.

#### *Verizon Communications Long Term Incentive Plan*

The Verizon Communications Long Term Incentive Plan (the "Plan"), permits the grant of nonqualified stock options, incentive stock options, restricted stock, restricted stock units, performance shares, performance share units and other awards. The maximum number of shares for awards is 200 million.

#### *Restricted Stock Units*

The Plan provides for grants of restricted stock units (RSUs) that vest at the end of the third year after the grant. The RSUs are classified as liability awards because the RSUs are paid in cash upon vesting. The RSU award liability is measured at its fair value at the end of each reporting period and, therefore, will fluctuate based on the performance of Verizon's stock.

The following table summarizes Verizon's Restricted Stock Unit activity.

| (Shares in thousands)          | Restricted Stock<br>Units | Weighted Average<br>Grant-Date Fair<br>Value |
|--------------------------------|---------------------------|--|
| Outstanding, January 1, 2004   | –                         | \$ –   |
| Granted                        | 532                       | 36.75  |
| Cancelled/Forfeited            | (7)                       | 36.75  |
| Outstanding, December 31, 2004 | 525                       | 36.75  |
| Granted                        | 6,410                     | 36.06  |
| Cancelled/Forfeited            | (66)                      | 36.07  |
| Outstanding, December 31, 2005 | 6,869                     | 36.12  |
| Granted                        | 9,116                     | 31.88  |
| Cancelled/Forfeited            | (392)                     | 35.01  |
| Outstanding, December 31, 2006 | <b>15,593</b>             | <b>33.67</b>                                 |

### Performance Share Units

The Plan also provides for grants of performance share units (PSUs) that vest at the end of the third year after the grant. The 2006, 2005 and 2004 performance share units will be paid in cash upon vesting. The 2003 PSUs were paid out in February 2006 in Verizon shares.

The target award is determined at the beginning of the period and can increase (to a maximum 200% of the target) or decrease (to zero) based on a key performance measure, Total Shareholder Return (TSR). At the end of the period, the PSU payment is determined by comparing Verizon's TSR to the TSR of a predetermined peer group and the S&P 500 companies. All payments are subject to approval by the Board's Human Resources Committee. The PSUs are classified as liability awards because the PSU awards are paid in cash upon vesting. The PSU award liability is measured at its fair value at the end of each reporting period and, therefore, will fluctuate based on the performance of Verizon's stock as well as Verizon's TSR relative to the peer group's TSR and S&P 500 TSR.

The following table summarizes Verizon's Performance Share Unit activity.

| (Shares in thousands)          | Performance Share<br>Units | Weighted Average<br>Grant-Date Fair<br>Value |
|--------------------------------|----------------------------|--|
| Outstanding, January 1, 2004   | 4,219                      | \$ 38.54                                     |
| Granted                        | 6,477                      | 36.81  |
| Cancelled/Forfeited            | (617)                      | 37.40  |
| Outstanding, December 31, 2004 | 10,079                     | 37.50  |
| Granted                        | 9,300                      | 36.13  |
| Cancelled/Forfeited            | (288)                      | 36.91  |
| Outstanding, December 31, 2005 | 19,091                     | 36.84  |
| Granted                        | <b>14,166</b>              | <b>32.05</b>                                 |
| Payments                       | <b>(3,607)</b>             | <b>38.54</b>                                 |
| Cancelled/Forfeited            | <b>(1,227)</b>             | <b>37.25</b>                                 |
| Outstanding, December 31, 2006 | <b>28,423</b>              | <b>34.22</b>                                 |

As of December 31, 2006, unrecognized compensation expense related to the unvested portion of Verizon's RSUs and PSUs was approximately \$392 million and is expected to be recognized over the next two years.

### MCI Restricted Stock Plan

MCI's Management Restricted Stock Plan (MRSP) provides for the granting of stock-based compensation to management. Following the acquisition by Verizon on January 6, 2006, awards outstanding under the MRSP were converted into Verizon common stock in accordance with the Merger Agreement. MCI has not issued new MRSPs since February 2005.

The following table summarizes MRSP's restricted stock activity.

| (Shares in thousands)          | Restricted<br>Stock | Weighted Average<br>Grant-Date Fair<br>Value |
|--------------------------------|---------------------|--|
| Outstanding, January 1, 2006   | —                   | \$ —   |
| Acquisition by Verizon         | <b>3,456</b>        | 30.75  |
| Payments                       | <b>(2,756)</b>      | 30.75  |
| Cancellations/Forfeitures      | <b>(53)</b>         | 30.75  |
| Outstanding, December 31, 2006 | <b>647</b>          | <b>30.75</b>                                 |

As of December 31, 2006, unrecognized compensation expense related to the unvested portion of the MRSP restricted stock was approximately \$9 million and is expected to be recognized over the next year.

### Verizon Wireless Long-Term Incentive Plan

The 2000 Verizon Wireless Long-Term Incentive Plan (the "Wireless Plan") provides compensation opportunities to eligible employees and other participating affiliates of the Cellco Partnership, d.b.a. Verizon Wireless (the "Partnership"). The Wireless Plan provides rewards that are tied to the long-term performance of the Partnership. Under the Wireless Plan, VARs are granted to eligible employees. The aggregate number of VARs that may be issued under the Wireless Plan is approximately 343 million.

VARs reflect the change in the value of the Partnership, as defined in the Wireless Plan, similar to stock options. Once VARs become vested, employees can exercise their VARs and receive a payment that is equal to the difference between the VAR price on the date of grant and the VAR price on the date of exercise, less applicable taxes. VARs are fully exercisable three years from the date of grant with a maximum term of

10 years. All VARs are granted at a price equal to the estimated fair value of the Partnership, as defined in the Wireless Plan, at the date of the grant.

With the adoption of SFAS No. 123(R), the Partnership began estimating the fair value of VARs granted using a Black-Scholes option valuation model. The following table summarizes the assumptions used in the model during 2006:

|                          | Ranges        |
|--------------------------|---------------|
| Risk-free interest rate  | 4.6% - 5.2%   |
| Expected term (in years) | 1.0 - 3.5     |
| Expected volatility      | 17.6% - 22.3% |
| Expected dividend yield  | n/a           |

The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of the measurement date. The expected term of the VARs granted was estimated using a combination of the simplified method as prescribed in Staff Accounting Bulletin (SAB) No. 107, "Share Based Payments," (SAB No. 107) historical experience, and management judgment. Expected volatility was based on a blend of the historical and implied volatility of publicly traded peer companies for a period equal to the VARs expected life, ending on the measurement date, and calculated on a monthly basis.

The following table summarizes the VARs activity.

| (Shares in thousands)                 | VARs          | Weighted Average<br>Grant-Date Fair<br>Value |
|---------------------------------------|---------------|--|
| Outstanding rights, January 1, 2004   | 119,809       | \$ 16.31                                     |
| Granted                               | 48,999        | 13.89  |
| Exercised                             | (2,144)       | 16.39  |
| Cancelled/Forfeited                   | (6,003)       | 14.65  |
| Outstanding rights, December 31, 2004 | 160,661       | 15.63  |
| Granted                               | 10            | 14.85  |
| Exercised                             | (47,964)      | 12.27  |
| Cancelled/Forfeited                   | (3,784)       | 15.17  |
| Outstanding rights, December 31, 2005 | 108,923       | 17.12  |
| Exercised                             | (7,448)       | 13.00  |
| Cancelled/Forfeited                   | (7,008)       | 23.25  |
| Outstanding rights, December 31, 2006 | <b>94,467</b> | <b>16.99</b>                                 |

As of December 31, 2006, unrecognized compensation expense related to the unvested portion of the VARs was approximately \$50 million and is expected to be recognized within one year.

#### *Stock-Based Compensation Expense*

After-tax compensation expense for stock based compensation related to RSUs, PSUs, MRSPs and VARs described above included in net income as reported was \$535 million, \$359 million and \$248 million for 2006, 2005 and 2004, respectively.

#### *Stock Options*

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

We determined stock-option related employee compensation expense for the 2004 grant using the Black-Scholes option-pricing model based on the following weighted-average assumptions:

|   | 2004    |
|---|---------|
| Dividend yield                            | 4.2%    |
| Expected volatility                       | 31.3%   |
| Risk-free interest rate                   | 3.3%    |
| Expected lives (in years)                 | 6       |
| Weighted average value of options granted | \$ 7.61 |

The following table summarizes Verizon's stock option activity.

| (Shares in thousands)                  | Stock<br>Options | Weighted<br>Average<br>Exercise Price |
|--|------------------|---------------------------------------|
| Outstanding, January 1, 2004           | 280,581          | \$ 46.24                              |
| Granted                                | 17,413           | 35.51                                 |
| Exercised                              | (10,519)         | 28.89                                 |
| Cancelled/forfeited                    | (6,586)          | 48.01                                 |
| Outstanding, December 31, 2004         | 280,889          | 46.18                                 |
| Exercised                              | (1,133)          | 28.73                                 |
| Cancelled/forfeited                    | (19,996)         | 49.62                                 |
| Outstanding, December 31, 2005         | 259,760          | 46.01                                 |
| Exercised                              | (3,371)          | 32.12                                 |
| Cancelled/forfeited                    | (27,025)         | 43.72                                 |
| Options outstanding, December 31, 2006 | <b>229,364</b>   | <b>46.48</b>                          |
| Options exercisable, December 31,      |                  |                                       |
| 2004                                   | 247,461          | 47.26                                 |
| 2005                                   | 244,424          | 46.64                                 |
| 2006                                   | <b>225,067</b>   | <b>46.69</b>                          |

The following table summarizes information about Verizon's stock options outstanding as of December 31, 2006:

| Range of Exercise Prices | Stock Options Outstanding |                                    |                                    | Stock Options Exercisable |                                    |
|--------------------------|---------------------------|------------------------------------|------------------------------------|---------------------------|------------------------------------|
|                          | Shares (in thousands)     | Weighted-Average<br>Remaining Life | Weighted-Average<br>Exercise Price | Shares (in thousands)     | Weighted-Average<br>Exercise Price |
| \$ 20.00 – 29.99         | 73                        | 3.4 years                          | \$ 28.50                           | 73                        | \$ 28.50                           |
| 30.00 – 39.99            | 44,874                    | 5.5                                | 36.36                              | 40,577                    | 36.45                              |
| 40.00 – 49.99            | 96,154                    | 3.7                                | 43.92                              | 96,154                    | 43.92                              |
| 50.00 – 59.99            | 87,687                    | 3.1                                | 54.40                              | 87,687                    | 54.40                              |
| 60.00 – 69.99            | 576                       | 2.8                                | 60.93                              | 576                       | 60.93                              |
| Total                    | <b>229,364</b>            |                                    | 46.48                              | <b>225,067</b>            | 46.69                              |

The weighted average remaining contractual term was 3.8 years for stock options outstanding and exercisable as of December 31, 2006. The total intrinsic value was approximately \$44 million and \$37 million for stock options outstanding and exercisable, respectively, as of December 31, 2006. The total intrinsic value for stock options exercised was \$10 million, \$6 million and \$97 million, during 2006, 2005 and 2004, respectively.

The amount of cash received from the exercise of stock options was approximately \$101 million, \$34 million and \$306 million for 2006, 2005 and 2004, respectively.

The after-tax compensation expense for stock options was \$28 million, \$53 million and \$50 million for 2006, 2005 and 2004, respectively. As of December 31, 2006, unrecognized compensation expense related to the unvested portion of stock options was approximately \$3 million.

#### Note 15

##### Employee Benefits

We maintain noncontributory defined benefit pension plans for many of our employees. The postretirement health care and life insurance plans for our retirees and their dependents are both contributory and noncontributory and include a limit on 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 our pension and postretirement health care and life insurance plans.

In September 2006, the FASB issued SFAS No. 158. SFAS No. 158 requires the recognition of a defined benefit postretirement plan's funded status as either an asset or liability on the balance sheet. SFAS No. 158 also requires the immediate recognition of the unrecognized actuarial gains and losses and prior service costs and credits that arise during the period as a component of other accumulated comprehensive income, net

of applicable income taxes. Additionally, the fair value of plan assets must be determined as of the company's year-end. We adopted SFAS No. 158 effective December 31, 2006 which resulted in a net decrease to shareowners' investment of \$6,883 million. This included a net increase in pension obligations of \$2,403 million, an increase in Other Postretirement Benefits Obligations of \$10,828 million and an increase in Other Employee Benefit Obligations of \$31 million, partially offset by a net decrease of \$1,205 million to reverse the Additional Minimum Pension Liability and an increase in deferred taxes of \$5,174 million. If we had recorded an Additional Minimum Pension Liability at December 31, 2006, it would have been \$396 million, (\$262 million after-tax).

### 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.

As of June 30, 2006, Verizon management employees no longer earned pension benefits or earned service towards the company retiree medical subsidy. In addition, new management employees hired after December 31, 2005 are not eligible for pension benefits and managers with less than 13.5 years of service as of June 30, 2006 are not eligible for company-subsidized retiree healthcare or retiree life insurance benefits. Beginning July 1, 2006, management employees receive an increased company match on their savings plan contributions.

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

| At December 31,   | Pension   |           | Health Care and Life |             |
|---|-----------|-----------|----------------------|-------------|
|   | 2006      | 2005      | 2006                 | 2005        |
| (dollars in millions)   |           |           |                      |             |
| <b>Change in Benefit Obligation</b>                                 |           |           |                      |             |
| Beginning of year   | \$ 35,540 | \$ 35,479 | \$ 26,783            | \$ 26,181   |
| Service cost  | 581       | 675       | 356                  | 358         |
| Interest cost   | 1,995     | 1,959     | 1,499                | 1,467       |
| Plan amendments   | –         | 149       | 50                   | 69          |
| Actuarial (gain) loss, net  | (282)     | 327       | 152                  | 403         |
| Benefits paid   | (2,762)   | (2,831)   | (1,564)              | (1,662)     |
| Termination benefits  | 47        | 11        | 14                   | 1           |
| Acquisitions and divestitures, net                                  | 477       | (194)     | 40                   | (34)        |
| Settlements   | (1,437)   | (35)      | –                    | –           |
| End of year   | \$ 34,159 | \$ 35,540 | \$ 27,330            | \$ 26,783   |
| <b>Change in Plan Assets</b>  |           |           |                      |             |
| Beginning of year   | 39,227    | 37,461    | 4,275                | 4,549       |
| Actual return on plan assets  | 5,536     | 4,136     | 493                  | 348         |
| Company contributions   | 568       | 698       | 1,099                | 1,040       |
| Benefits paid   | (2,762)   | (2,831)   | (1,564)              | (1,662)     |
| Settlements   | (1,437)   | (35)      | –                    | –           |
| Acquisitions and divestitures, net                                  | 377       | (202)     | –                    | –           |
| End of year   | \$ 41,509 | \$ 39,227 | \$ 4,303             | \$ 4,275    |
| <b>Funded Status</b>  |           |           |                      |             |
| End of year   | 7,350     | 3,687     | (23,027)             | (22,508)    |
| Unrecognized  |           |           |                      |             |
| Actuarial loss, net   | –         | 4,685     | –                    | 7,056       |
| Prior service cost  | –         | 1,018     | –                    | 4,339       |
| Net amount recognized   | \$ 7,350  | \$ 9,390  | \$ (23,027)          | \$ (11,113) |
| <b>Amounts recognized on the balance sheet</b>                      |           |           |                      |             |
| Prepaid pension cost (in Other Assets)                              | \$ 12,058 | \$ 12,704 | \$ –                 | \$ –        |
| Other assets  | –         | 458       | –                    | –           |
| Employee benefit obligation   | (4,708)   | (4,977)   | (23,027)             | (11,113)    |
| Accumulated other comprehensive loss                                | –         | 1,205     | –                    | –           |
| Net amount recognized   | \$ 7,350  | \$ 9,390  | \$ (23,027)          | \$ (11,113) |
| <b>Amounts recognized in Accumulated Other Comprehensive Income</b> |           |           |                      |             |
| Actuarial loss, net   | \$ 1,428  |           | \$ 6,799             |             |
| Prior service cost  | 975       |           | 4,029                |             |

|   |                 |                  |
|---|-----------------|------------------|
| Total   | <u>\$ 2,403</u> | <u>\$ 10,828</u> |
| <b>Estimated amounts to be amortized from Accumulated</b> |                 |                  |
| <b>Other</b>  |                 |                  |
| <b>Comprehensive Income during 2007 fiscal year</b>       |                 |                  |
| Actuarial (gain) loss, net                                | \$ 98           | \$ 316           |
| Prior service cost  | 43              | 393              |
| Total   | <u>\$ 141</u>   | <u>\$ 709</u>    |

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

In 2005, as a result of changes in management retiree benefits, we recorded pretax expense of \$430 million for pension curtailments and pretax income of \$332 million for retiree medical curtailments (see Note 4 for additional information).

The accumulated benefit obligation for all defined benefit pension plans was \$32,724 million and \$34,232 million at December 31, 2006 and 2005, respectively.

Information for pension plans with an accumulated benefit obligation in excess of plan assets follows:

| At December 31,                | (dollars in millions) |           |
|--------------------------------|-----------------------|-----------|
|                                | 2006                  | 2005      |
| Projected benefit obligation   | \$ 11,495             | \$ 11,567 |
| Accumulated benefit obligation | 11,072                | 11,165    |
| Fair value of plan assets      | 8,288                 | 7,500     |

### Net Periodic Cost

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

| Years Ended December 31,               | (dollars in millions) |         |         |                      |          |          |
|--|-----------------------|---------|---------|----------------------|----------|----------|
|  | Pension               |         |         | Health Care and Life |          |          |
|  | 2006                  | 2005    | 2004    | 2006                 | 2005     | 2004     |
| Service cost                           | \$ 581                | \$ 675  | \$ 666  | \$ 356               | \$ 358   | \$ 269   |
| Interest cost                          | 1,995                 | 1,959   | 2,144   | 1,499                | 1,467    | 1,422    |
| Expected return on plan assets         | (3,173)               | (3,231) | (3,565) | (328)                | (349)    | (409)    |
| Amortization of transition asset       | –                     | –       | (4)     | –                    | –        | –        |
| Amortization of prior service cost     | 44                    | 42      | 57      | 360                  | 290      | 236      |
| Actuarial loss, net                    | 182                   | 124     | 45      | 290                  | 258      | 169      |
| Net periodic benefit (income) cost     | (371)                 | (431)   | (657)   | 2,177                | 2,024    | 1,687    |
| Termination benefits                   | 47                    | 11      | 1       | 14                   | 1        | –        |
| Settlement loss                        | 56                    | 80      | 805     | –                    | –        | –        |
| Curtailment (gain) loss and other, net | –                     | 436     | –       | –                    | (332)    | –        |
| Subtotal                               | 103                   | 527     | 806     | 14                   | (331)    | –        |
| Total cost                             | \$ (268)              | \$ 96   | \$ 149  | \$ 2,191             | \$ 1,693 | \$ 1,687 |

Termination benefits and settlement and curtailment losses of \$94 million pertaining to the sale of Hawaii operations in 2005 were recorded in the consolidated statements of income in Sales of Businesses, Net.

## Additional Information

As a result of the adoption of SFAS No. 158, we no longer record an additional minimum pension liability. In prior years, 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 number of plans, as indicated below. The adjustment in the liability was recorded as a charge or (credit) to Accumulated Other Comprehensive Loss, net of tax, in shareowners' investment in the consolidated balance sheets.

| Years Ended December 31,  | (dollars in millions) |         |        |
|---|-----------------------|---------|--------|
|   | 2006                  | 2005    | 2004   |
| Increase (decrease) in minimum liability included in other comprehensive income, net of tax | \$ (788)              | \$ (51) | \$ 332 |

## Assumptions

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

| At December 31,                          | Pension |       | Health Care and Life |       |
|--|---------|-------|----------------------|-------|
|  | 2006    | 2005  | 2006                 | 2005  |
| Discount rate                            | 6.00%   | 5.75% | 6.00%                | 5.75% |
| Rate of future increases in compensation | 4.00    | 4.00  | 4.00                 | 4.00  |

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

| Years Ended December 31,       | Pension |       |       | Health Care and Life |       |       |
|--------------------------------|---------|-------|-------|----------------------|-------|-------|
|                                | 2006    | 2005  | 2004  | 2006                 | 2005  | 2004  |
| Discount rate                  | 5.75%   | 5.75% | 6.25% | 5.75%                | 5.75% | 6.25% |
| Expected return on plan assets | 8.50    | 8.50  | 8.50  | 8.25                 | 7.75  | 8.50  |
| Rate of compensation increase  | 4.00    | 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: current market interest rates and valuation levels, consensus earnings expectations, historical long-term risk premiums and value-added. To determine the aggregate return for the pension trust, the projected return of each individual asset class is then weighted according to the allocation to that investment area in the trust's long-term asset allocation policy.

The assumed Health Care Cost Trend Rates follow:

| At December 31,  | Health Care and Life |        |        |
|--|----------------------|--------|--------|
|  | 2006                 | 2005   | 2004   |
| Health care cost trend rate assumed for next year              | 10.00%               | 10.00% | 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 | 2011                 | 2010   | 2009   |

A one-percentage-point change in the assumed health care cost trend rate would have the following effects:

| One-Percentage-Point  | (dollars in millions) |          |
|---|-----------------------|----------|
|   | Increase              | Decrease |
| Effect on 2006 service and interest cost                            | \$ 282                | \$ (223) |
| Effect on postretirement benefit obligation as of December 31, 2006 | 3,339                 | (2,731)  |

## Plan Assets

### Pension Plans

The weighted-average asset allocations for the pension plans by asset category follow:

| At December 31,       | 2006          | 2005          |
|-----------------------|---------------|---------------|
| <b>Asset Category</b> |               |               |
| Equity securities     | 62.5%         | 63.4%         |
| Debt securities       | 16.3          | 17.5          |
| Real estate           | 4.5           | 3.2           |
| Other                 | 16.7          | 15.9          |
| <b>Total</b>          | <b>100.0%</b> | <b>100.0%</b> |

Equity securities include Verizon common stock of \$95 million and \$72 million at December 31, 2006 and 2005, respectively. Other assets include cash and cash equivalents (primarily held for the payment of benefits), private equity and investments in absolute return strategies.

### Health Care and Life Plans

The weighted-average asset allocations for the other postretirement benefit plans by asset category follow:

| At December 31,       | 2006          | 2005          |
|-----------------------|---------------|---------------|
| <b>Asset Category</b> |               |               |
| Equity securities     | 72.1%         | 71.9%         |
| Debt securities       | 20.4          | 22.1          |
| Real estate           | 0.1           | 0.1           |
| Other                 | 7.4           | 5.9           |
| <b>Total</b>          | <b>100.0%</b> | <b>100.0%</b> |

Equity securities include Verizon common stock of \$4 million at December 31, 2005. There was no Verizon common stock held at the end of 2006.

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.

### Cash Flows

In 2006, we contributed \$451 million to our qualified pension trusts, \$117 million to our nonqualified pension plans and \$1,099 million to our other postretirement benefit plans. We estimate required qualified pension trust contributions for 2007 to be approximately \$510 million. We also anticipate \$120 million in contributions to our non-qualified pension plans and \$1,210 million to our other postretirement benefit plans in 2007.

### Estimated Future Benefit Payments

The benefit payments to retirees, which reflect expected future service, are expected to be paid as follows:

|             | Pension Benefits | Health Care and Life<br>Prior to Medicare<br>Prescription<br>Drug Subsidy | Expected Medicare<br>Prescription<br>Drug Subsidy |
|-------------|------------------|---|---|
| 2007        | \$ 2,491         | \$ 1,717  | \$ 91   |
| 2008        | 2,552            | 1,806   | 97  |
| 2009        | 2,749            | 1,869   | 102   |
| 2010        | 3,042            | 1,936   | 108   |
| 2011        | 3,503            | 1,991   | 112   |
| 2012 – 2016 | 16,472           | 9,983   | 589   |

(dollars in millions)

### Savings Plan and Employee Stock Ownership Plans

We maintain four leveraged employee stock ownership plans (ESOP), only one plan currently has unallocated shares. Under this plan, we match a certain percentage of eligible employee contributions to the savings plans with shares of our common stock from this ESOP. Common stock is allocated from the leveraged ESOP trust 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. The final debt service payments and related share allocations for two of our leveraged ESOPs were made in 2004. At December 31, 2006, the number of unallocated and allocated shares of common stock was 5 million and 77 million, respectively. All leveraged ESOP shares are included in earnings per share computations.

Total savings plan costs were \$669 million, \$499 million, and \$501 million in 2006, 2005 and 2004 respectively. A portion of these costs were funded through a leveraged ESOP. We recognize leveraged ESOP costs based on the shares allocated method.

Leveraged ESOP costs and trust activity consist of the following:

| Years Ended December 31, | (dollars in millions) |              |               |
|--------------------------|-----------------------|--------------|---------------|
|                          | 2006                  | 2005         | 2004          |
| Compensation             | \$ 24                 | \$ 39        | \$ 159        |
| Interest incurred        | —                     | —            | 12            |
| Dividends                | (9)                   | (16)         | (16)          |
| Net leveraged ESOP cost  | <u>\$ 15</u>          | <u>\$ 23</u> | <u>\$ 155</u> |

### Severance Benefits

The following table provides an analysis of our severance liability recorded in accordance with SFAS Nos. 112 and 146:

| Year        | (dollars in millions) |                    |              |           |             |
|-------------|-----------------------|--------------------|--------------|-----------|-------------|
|             | Beginning of Year     | Charged to Expense | Payments     | Other     | End of Year |
| 2004        | \$ 2,150              | \$(40)             | \$(1,356)    | \$(1)     | \$753       |
| 2005        | 753                   | 99                 | (251)        | (5)       | 596         |
| <b>2006</b> | <b>596</b>            | <b>343</b>         | <b>(383)</b> | <b>88</b> | <b>644</b>  |

The remaining severance liability includes future contractual payments to employees separated as of December 31, 2006. The 2006 expense includes charges for the involuntary separation of 4,100 employees (see Note 4).

### Note 16

#### Income Taxes

The components of Income Before Provision for Income Taxes, Discontinued Operations and Cumulative Effect of Accounting Change are as follows:

| Years Ended December 31, | (dollars in millions) |                 |                 |
|--------------------------|-----------------------|-----------------|-----------------|
|                          | 2006                  | 2005            | 2004            |
| Domestic                 | \$ 6,682              | \$ 7,496        | \$ 6,186        |
| Foreign                  | 1,472                 | 952             | 1,791           |
|                          | <u>\$ 8,154</u>       | <u>\$ 8,448</u> | <u>\$ 7,977</u> |

The components of the provision for income taxes from continuing operations are as follows:

| Years Ended December 31, | (dollars in millions) |                 |                 |
|--------------------------|-----------------------|-----------------|-----------------|
|                          | 2006                  | 2005            | 2004            |
| <b>Current</b>           |                       |                 |                 |
| Federal                  | \$ 2,364              | \$ 2,772        | \$ (162)        |
| Foreign                  | 141                   | 81              | 249             |
| State and local          | 420                   | 661             | 271             |
|                          | <u>2,925</u>          | <u>3,514</u>    | <u>358</u>      |
| <b>Deferred</b>          |                       |                 |                 |
| Federal                  | (9)                   | (844)           | 1,580           |
| Foreign                  | (45)                  | (55)            | 53              |
| State and local          | (190)                 | (187)           | 95              |
|                          | <u>(244)</u>          | <u>(1,086)</u>  | <u>1,728</u>    |
| Investment tax credits   | (7)                   | (7)             | (8)             |
| Total income tax expense | <u>\$ 2,674</u>       | <u>\$ 2,421</u> | <u>\$ 2,078</u> |

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,                                | 2006  | 2005  | 2004  |
|---|-------|-------|-------|
| Statutory federal income tax rate                       | 35.0% | 35.0% | 35.0% |
| State and local income tax, net of federal tax benefits | 1.8   | 3.6   | 3.0   |
| Tax benefits from investment losses                     | (.9)  | (4.5) | (3.7) |
| Equity in earnings from unconsolidated businesses       | (3.8) | (3.5) | (8.0) |
| Other, net  | .7    | (1.9) | (.2)  |
| Effective income tax rate                               | 32.8% | 28.7% | 26.1% |

The favorable impact on our 2006 effective income tax rate was primarily driven by earnings from our unconsolidated businesses and tax benefits from valuation allowance reversals. These favorable impacts to the 2006 effective tax rate were partially offset by the unfavorable impact of tax reserve adjustments which is included in the Other, net line above. During 2006, we recorded a tax benefit of \$80 million in connection with capital gains and prior year investment losses.

During 2005, we recorded a tax benefit of \$336 million in connection with capital gains and prior year investment losses. As a result of the capital gain realized in 2005 in connection with the sale of our Hawaii businesses, we recorded a tax benefit of \$242 million related to prior year investment losses. Also during 2005, we recorded a net tax provision of \$206 million related to the repatriation of foreign earnings under the provisions of the American Jobs Creation Act of 2004, which provides for a favorable federal income tax rate in connection with the repatriation of foreign earnings, provided the criteria described in the law is met. Two of our foreign investments repatriated earnings resulting in income taxes of \$332 million, partially offset by a tax benefit of \$126 million.

The favorable impact on our 2004 effective income tax rate was primarily driven by increased earnings from our unconsolidated businesses and tax benefits from valuation allowance reversals.

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,  | 2006                  | 2005       |
|--|-----------------------|------------|
|  | (dollars in millions) |            |
| Employee benefits  | \$ (7,788)            | \$ (1,778) |
| Loss on investments  | (124)                 | (369)      |
| Former MCI tax loss carry forwards                                       | (2,026)               | –          |
| Uncollectible accounts receivable  | (455)                 | (375)      |
|  | (10,393)              | (2,522)    |
| Valuation allowance  | 2,600                 | 815        |
| Deferred tax assets  | (7,793)               | (1,707)    |
| Former MCI intercompany accounts receivable basis difference             | 2,003                 | –          |
| Depreciation   | 7,617                 | 9,676      |
| Leasing activity   | 2,638                 | 3,001      |
| Wireless joint venture including wireless licenses                       | 12,177                | 11,786     |
| Other – net  | 782                   | (370)      |
| Deferred tax liabilities   | 25,217                | 24,093     |
| Net deferred tax liability   | \$ 17,424             | \$ 22,386  |
| Net long-term deferred tax liabilities                                   | \$ 16,270             | \$ 22,831  |
| Plus net current deferred tax liabilities (in Other current liabilities) | 1,154                 | –          |
| Less net current deferred tax assets (in Prepaid expenses and other)     | –                     | 445        |
| Net deferred tax liability   | \$ 17,424             | \$ 22,386  |

At December 31, 2006, employee benefits deferred tax assets include \$5,174 million as a result of the adoption of SFAS No. 158 (see Note 15).

At December 31, 2006, undistributed earnings of our foreign subsidiaries amounted to approximately \$3 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 foreign and state net operating loss carry forwards, capital loss carry forwards and other deferred tax assets which may expire without being utilized. During 2006, the valuation allowance increased \$1,785 million. This increase was primarily due to the addition of former MCI valuation allowances. This increase was offset by valuation allowance reversals relating to utilizing prior year investment losses to offset the capital gains realized on the sale of various businesses including Verizon Dominicana.

Former MCI tax loss carry forwards include federal, state and foreign net operating loss tax carry forwards as well as capital loss tax carry forwards. As a result of the MCI Bankruptcy and the application of the related tax attribute reduction rules, MCI reduced the tax basis in intercompany accounts receivables. This reduction in tax basis results in a deferred tax liability as reflected above.

## Note 17

### Segment Information

#### Reportable Segments

On November 17, 2006, we completed the spin-off of our U.S. print and Internet yellow pages directories to our shareowners, which was included in the Information Services segment. The spin-off resulted in a new company, named Idearc Inc. In addition, we reached definitive agreements to sell our interests in TELPRI and Verizon Dominicana, each of which were included in the International segment. The operations of our U.S. print and Internet yellow pages directories business, Verizon Dominicana and TELPRI are reported as discontinued operations and assets held for sale. Accordingly we have two 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. Corporate, eliminations and other includes unallocated corporate expenses, intersegment eliminations recorded in consolidation, the results of other businesses such as our investments in unconsolidated businesses, primarily Omnitel and CANTV, lease financing, and asset impairments and expenses that are not allocated in assessing segment performance due to their non-recurring nature. These 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.

Our segments and their principal activities consist of the following:

| Segment                  | Description   |
|--------------------------|---|
| <b>Wireline</b>          | Wireline provides communications services including voice, broadband video and data, next generation IP network services, network access, long distance and other services to consumers, carriers, business and government customers both domestically and globally in 150 countries. |
| <b>Domestic Wireless</b> | Domestic wireless products and services include wireless voice and data products and other value added services and equipment sales across the United States.   |

The following table provides operating financial information for our two reportable segments:

| 2006  | (dollars in millions) |                   |                |
|---|-----------------------|-------------------|----------------|
|   | Wireline              | Domestic Wireless | Total Segments |
| External revenues                               | \$ 49,621             | \$ 37,930         | \$ 87,551      |
| Intersegment revenues                           | 1,173                 | 113               | 1,286          |
| Total operating revenues                        | 50,794                | 38,043            | 88,837         |
| Cost of services and sales                      | 24,522                | 11,491            | 36,013         |
| Selling, general & administrative expense       | 12,116                | 12,039            | 24,155         |
| Depreciation & amortization expense             | 9,590                 | 4,913             | 14,503         |
| Total operating expenses                        | 46,228                | 28,443            | 74,671         |
| Operating income                                | 4,566                 | 9,600             | 14,166         |
| Equity in earnings of unconsolidated businesses | -                     | 19                | 19             |
| Other income and (expense), net                 | 250                   | 4                 | 254            |
| Interest expense                                | (2,062)               | (452)             | (2,514)        |
| Minority interest                               | -                     | (4,038)           | (4,038)        |
| Provision for income taxes                      | (1,120)               | (2,157)           | (3,277)        |
| Segment income                                  | \$ 1,634              | \$ 2,976          | \$ 4,610       |
| Assets  | \$ 92,274             | \$ 81,989         | \$ 174,263     |
| Investments in unconsolidated businesses        | 28                    | 87                | 115            |
| Plant, property and equipment, net              | 57,031                | 24,659            | 81,690         |
| Capital expenditures                            | 10,259                | 6,618             | 16,877         |

| 2005  | (dollars in millions) |                   |                |
|---|-----------------------|-------------------|----------------|
|   | Wireline              | Domestic Wireless | Total Segments |
| External revenues                               | \$ 36,628             | \$ 32,219         | \$ 68,847      |
| Intersegment revenues                           | 988                   | 82                | 1,070          |
| Total operating revenues                        | 37,616                | 32,301            | 69,917         |
| Cost of services and sales                      | 15,604                | 9,393             | 24,997         |
| Selling, general & administrative expense       | 8,419                 | 10,768            | 19,187         |
| Depreciation & amortization expense             | 8,801                 | 4,760             | 13,561         |
| Total operating expenses                        | 32,824                | 24,921            | 57,745         |
| Operating income                                | 4,792                 | 7,380             | 12,172         |
| Equity in earnings of unconsolidated businesses | –                     | 27                | 27             |
| Other income and (expense), net                 | 79                    | 6                 | 85             |
| Interest expense                                | (1,701)               | (601)             | (2,302)        |
| Minority interest                               | –                     | (2,995)           | (2,995)        |
| Provision for income taxes                      | (1,264)               | (1,598)           | (2,862)        |
| Segment income                                  | \$ 1,906              | \$ 2,219          | \$ 4,125       |
| Assets  | \$ 75,188             | \$ 76,729         | \$ 151,917     |
| Investments in unconsolidated businesses        | 2                     | 154               | 156            |
| Plant, property and equipment, net              | 49,618                | 22,790            | 72,408         |
| Capital expenditures                            | 8,267                 | 6,484             | 14,751         |

| 2004  | (dollars in millions) |                   |                |
|---|-----------------------|-------------------|----------------|
|   | Wireline              | Domestic Wireless | Total Segments |
| External revenues                               | \$ 37,160             | \$ 27,586         | \$ 64,746      |
| Intersegment revenues                           | 861                   | 76                | 937            |
| Total operating revenues                        | 38,021                | 27,662            | 65,683         |
| Cost of services and sales                      | 14,830                | 7,747             | 22,577         |
| Selling, general & administrative expense       | 8,621                 | 9,591             | 18,212         |
| Depreciation & amortization expense             | 8,910                 | 4,486             | 13,396         |
| Total operating expenses                        | 32,361                | 21,824            | 54,185         |
| Operating income                                | 5,660                 | 5,838             | 11,498         |
| Equity in earnings of unconsolidated businesses | –                     | 45                | 45             |
| Other income and (expense), net                 | 100                   | 11                | 111            |
| Interest expense                                | (1,602)               | (661)             | (2,263)        |
| Minority interest                               | –                     | (2,323)           | (2,323)        |
| Provision for income taxes                      | (1,506)               | (1,265)           | (2,771)        |
| Segment income                                  | \$ 2,652              | \$ 1,645          | \$ 4,297       |
| Assets  | \$ 78,824             | \$ 68,027         | \$ 146,851     |
| Investments in unconsolidated businesses        | 3                     | 148               | 151            |
| Plant, property and equipment, net              | 50,608                | 20,516            | 71,124         |
| Capital expenditures                            | 7,118                 | 5,633             | 12,751         |

## 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) |                  |                  |
|--|-----------------------|------------------|------------------|
|  | 2006                  | 2005             | 2004             |
| <b>Operating Revenues</b>                  |                       |                  |                  |
| Total reportable segments                  | \$ 88,837             | \$ 69,917        | \$ 65,683        |
| Hawaii operations                          | –                     | 180              | 529              |
| Corporate, eliminations and other          | (693)                 | (579)            | (461)            |
| Consolidated operating revenues – reported | <u>\$ 88,144</u>      | <u>\$ 69,518</u> | <u>\$ 65,751</u> |

|  |                  |                  |                  |
|--|------------------|------------------|------------------|
| <b>Operating Expenses</b>  |                  |                  |                  |
| Total reportable segments  | \$ 74,671        | \$ 57,745        | \$ 54,185        |
| Merger integration costs (see Note 4)                                      | 232              | –                | –                |
| Severance, pension and benefit charges (see Note 4)                        | 425              | 157              | 805              |
| Verizon Center relocation, net (see Note 4)                                | 184              | (18)             | –                |
| Former MCI exposure, lease impairment and other special items (see Note 4) | –                | 125              | (91)             |
| Hawaii operations  | –                | 118              | 375              |
| Sales of businesses and investments, net (see Notes 3 and 5)               | –                | (530)            | 100              |
| Corporate, eliminations and other  | (741)            | (660)            | (493)            |
| Consolidated operating expenses – reported                                 | <u>\$ 74,771</u> | <u>\$ 56,937</u> | <u>\$ 54,881</u> |

|  | (dollars in millions) |                 |                 |
|--|-----------------------|-----------------|-----------------|
|  | 2006                  | 2005            | 2004            |
| <b>Net Income</b>  |                       |                 |                 |
| Segment income – reportable segments                                       | \$ 4,610              | \$ 4,125        | \$ 4,297        |
| Debt extinguishment costs (see Note 11)                                    | (16)                  | –               | –               |
| Merger integration costs (see Note 4)                                      | (146)                 | –               | –               |
| Sales of businesses and investments, net (see Notes 3 and 5)               | (541)                 | 336             | 1,059           |
| Idearc spin-off costs (see Note 4)   | (101)                 | –               | –               |
| Severance, pension and benefit charges (see Note 4)                        | (258)                 | (95)            | (499)           |
| Verizon Center relocation, net (see Note 4)                                | (118)                 | 8               | –               |
| Former MCI exposure, lease impairment and other special items (see Note 4) | –                     | (133)           | 2               |
| Tax benefits (see Note 4)  | –                     | 336             | 234             |
| Tax provision on repatriated earnings (see Note 4)                         | –                     | (206)           | –               |
| Income from discontinued operations, net of tax (see Note 3)               | 1,398                 | 1,370           | 1,423           |
| Cumulative effect of accounting change (see Note 1)                        | (42)                  | –               | –               |
| Corporate and other  | 1,411                 | 1,656           | 1,315           |
| Consolidated net income – reported   | <u>\$ 6,197</u>       | <u>\$ 7,397</u> | <u>\$ 7,831</u> |

|                           |                   |                   |                   |
|---------------------------|-------------------|-------------------|-------------------|
| <b>Assets</b>             |                   |                   |                   |
| Total reportable segments | \$ 174,263        | \$ 151,917        | \$ 146,851        |
| Reconciling items         | 14,541            | 16,213            | 19,107            |
| Consolidated assets       | <u>\$ 188,804</u> | <u>\$ 168,130</u> | <u>\$ 165,958</u> |

Financial information for Wireline excludes the effects of Hawaii access lines and directory operations sold in 2005.

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:

| Years Ended December 31, | (dollars in millions) |           |           |
|--------------------------|-----------------------|-----------|-----------|
|                          | 2006                  | 2005      | 2004      |
| <b>Domestic</b>          |                       |           |           |
| Operating revenues       | \$ 84,693             | \$ 69,327 | \$ 65,659 |
| Long-lived assets        | 82,277                | 74,813    | 72,488    |
| <b>Foreign</b>           |                       |           |           |
| Operating revenues       | 3,451                 | 191       | 92        |
| Long-lived assets        | 4,947                 | 2,776     | 4,973     |
| <b>Consolidated</b>      |                       |           |           |
| Operating revenues       | 88,144                | 69,518    | 65,751    |
| Long-lived assets        | 87,224                | 77,589    | 77,461    |

### 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:

| Years Ended December 31,  | (dollars in millions) |                 |               |
|---|-----------------------|-----------------|---------------|
|   | 2006                  | 2005            | 2004          |
| <b>Foreign Currency Translation Adjustments</b>   | <b>\$ 1,196</b>       | <b>\$ (755)</b> | <b>\$ 548</b> |
| <b>Unrealized Gains (Losses) on Net Investment Hedges</b>   |                       |                 |               |
| Unrealized gains (losses), net of taxes of \$-, \$1 and \$(48)  | -                     | 2               | (58)          |
| Less reclassification adjustments for losses realized in net income, net of taxes of \$-, \$- and \$(48)      | -                     | -               | (58)          |
| Net unrealized gains on net investment hedges   | -                     | 2               | -             |
| <b>Unrealized Derivative Gains (Losses) on Cash Flow Hedges</b>   |                       |                 |               |
| Unrealized gains (losses), net of taxes of \$(1), \$- and \$(2)   | 11                    | 4               | (9)           |
| Less reclassification adjustments for (losses) realized in net income, net of taxes of \$(1), \$(2) and \$(2) | (3)                   | (6)             | (26)          |
| Net unrealized derivative gains on cash flow hedges   | 14                    | 10              | 17            |
| <b>Unrealized Gains (Losses) on Marketable Securities</b>   |                       |                 |               |
| Unrealized gains, net of taxes of \$30, \$10 and \$4  | 79                    | 4               | 8             |
| Less reclassification adjustments for gains realized in net income, net of taxes of \$13, \$14 and \$1        | 25                    | 25              | 1             |
| Net unrealized gains (losses) on marketable securities  | 54                    | (21)            | 7             |
| <b>Minimum Pension Liability Adjustment</b> , net of taxes of \$417, \$37 and \$(185)                         | <b>788</b>            | <b>51</b>       | <b>(332)</b>  |
| <b>Defined benefit pension and postretirement plans – SFAS No. 158 adoption</b> , net of taxes of \$(5,591)   | <b>(7,671)</b>        | <b>-</b>        | <b>-</b>      |
| <b>Other</b> , net of taxes of \$(159), \$(20) and \$(53)   | <b>(128)</b>          | <b>(17)</b>     | <b>(43)</b>   |
| <b>Other Comprehensive Income (Loss)</b>  | <b>\$ (5,747)</b>     | <b>\$ (730)</b> | <b>\$ 197</b> |

The foreign currency translation adjustment in 2006 represents the realization of the cumulative foreign currency translation loss of approximately \$800 million in connection with the sale of our consolidated interest in Verizon Dominicana (see Note 3), as well as unrealized

gains from the appreciation of the functional currency on our investment in Vodafone Omnitel. The minimum pension liability adjustment in 2006 represents the adoption of SFAS No. 158.

The foreign currency translation adjustment in 2005 represents unrealized losses from the decline in the functional currencies of our investments in Vodafone Omnitel, Verizon Dominicana and CANTV. The foreign currency translation adjustment in 2004 represents unrealized gains from the appreciation of the functional currencies at Verizon Dominicana and our investment in Vodafone Omnitel as well as the realization of the cumulative foreign currency translation loss in connection with the sale of our 20.5% interest in TELUS (see Note 4), partially offset by unrealized losses from the decline in the functional currency on our investment in CANTV.

During 2005, we entered into zero cost euro collars to hedge a portion of our net investment in Vodafone Omnitel. As of December 31, 2005, our positions in the zero cost euro collars have been settled. During 2004, we entered into foreign currency forward contracts to hedge our net investment in Verizon Information Services Canada and TELUS (see Note 3). In connection with the sales of these interests in the fourth quarter of 2004, the unrealized losses on these net investment hedges were realized in net income along with the corresponding foreign currency translation balance.

As discussed in Note 15, we adopted SFAS No. 158 effective December 31, 2006, which resulted in a net decrease to shareowners' investment of \$6,883 million.

The changes in the minimum pension liability in 2005 and 2004 were required by accounting rules for certain pension plans based on their funded status (see Note 15). In connection with our adoption of SFAS No. 158 on December 31, 2006, we no longer record a minimum pension liability adjustment as a discrete component of Accumulated Other Comprehensive Loss.

The components of Accumulated Other Comprehensive Loss are as follows:

| At December 31,  | (dollars in millions) |                   |
|--|-----------------------|-------------------|
|  | 2006                  | 2005              |
| Foreign currency translation adjustments                             | \$ 329                | \$ (867)          |
| Unrealized gains on net investment hedges                            | 2                     | 2                 |
| Unrealized derivative losses on cash flow hedges                     | (13)                  | (27)              |
| Unrealized gains on marketable securities                            | 64                    | 10                |
| Minimum pension liability  | –                     | (788)             |
| Defined benefit pension and postretirement plans – SFAS 158 adoption | (7,671)               | –                 |
| Other  | (241)                 | (113)             |
| Accumulated other comprehensive loss                                 | <u>\$ (7,530)</u>     | <u>\$ (1,783)</u> |

As discussed above, the change in foreign currency translation adjustments during 2006 is due primarily to the sale of Verizon Dominicana (approximately \$800 million). Foreign currency translation adjustments at year-end 2006 is primarily comprised of unrealized gains in the functional currencies at Vodafone Omnitel, partially offset by unrealized losses of approximately \$400 million at CANTV. The reduction in our minimum pension liability adjustment balance to zero at year-end 2006 is due to the adoption of SFAS No. 158.

**Note 19****Additional Financial Information**

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

**Income Statement Information**

| Years Ended December 31, | (dollars in millions) |           |           |
|--------------------------|-----------------------|-----------|-----------|
|                          | 2006                  | 2005      | 2004      |
| Depreciation expense     | \$ 13,122             | \$ 12,171 | \$ 12,169 |
| Interest cost incurred   | 2,811                 | 2,481     | 2,513     |
| Capitalized interest     | (462)                 | (352)     | (177)     |
| Advertising expense      | 2,271                 | 1,844     | 1,617     |

**Balance Sheet Information**

| At December 31,                                 | (dollars in millions) |                  |
|---|-----------------------|------------------|
|   | 2006                  | 2005             |
| <i>Accounts Payable and Accrued Liabilities</i> |                       |                  |
| Accounts payable                                | \$ 4,392              | \$ 2,620         |
| Accrued expenses                                | 2,982                 | 2,891            |
| Accrued vacation, salaries and wages            | 3,575                 | 3,179            |
| Interest payable                                | 614                   | 573              |
| Accrued taxes                                   | 2,757                 | 2,484            |
|   | <b>\$ 14,320</b>      | <b>\$ 11,747</b> |
| <i>Other Current Liabilities</i>                |                       |                  |
| Advance billings and customer deposits          | \$ 2,226              | \$ 1,964         |
| Dividends payable                               | 1,199                 | 1,137            |
| Other   | 4,666                 | 2,294            |
|   | <b>\$ 8,091</b>       | <b>\$ 5,395</b>  |

**Cash Flow Information**

| Years Ended December 31,   | (dollars in millions) |          |        |
|--|-----------------------|----------|--------|
|  | 2006                  | 2005     | 2004   |
| <i>Cash Paid</i>   |                       |          |        |
| Income taxes, net of amounts refunded  | \$ 3,299              | \$ 4,189 | \$ 152 |
| Interest, net of amounts capitalized   | 2,103                 | 2,025    | 2,226  |
| <i>Supplemental Investing and Financing Transactions</i>                           |                       |          |        |
| Cash acquired in business combination  | 2,361                 | —        | —      |
| Assets acquired in business combinations   | 18,511                | 635      | 8      |
| Liabilities assumed in business combinations                                       | 7,813                 | 35       | —      |
| Debt assumed in business combinations  | 6,169                 | 9        | —      |
| Shares issued to Price to acquire limited partnership interest in VZ East (Note 2) | 1,007                 | —        | —      |

Note 20

**Guarantees of Operating Subsidiary Debt**

Verizon has guaranteed the obligations of two 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.

(dollars in millions)

| Condensed Consolidating Statements of Income<br>Year Ended December 31, 2006   | Parent          | Verizon<br>New England | Verizon<br>South | Other           | Adjustments       | Total           |
|--|-----------------|------------------------|------------------|-----------------|-------------------|-----------------|
| Operating revenues   | \$ –            | \$ 3,852               | \$ 858           | \$ 84,208       | \$ (774)          | \$ 88,144       |
| Operating expenses   | 164             | 3,685                  | 634              | 71,062          | (774)             | 74,771          |
| <b>Operating Income (Loss)</b>   | <b>(164)</b>    | <b>167</b>             | <b>224</b>       | <b>13,146</b>   | <b>–</b>          | <b>13,373</b>   |
| Equity in earnings of unconsolidated<br>businesses   | 6,011           | 14                     | –                | (708)           | (4,544)           | 773             |
| Other income and (expense), net  | 1,579           | 11                     | 14               | 283             | (1,492)           | 395             |
| Interest expense   | (1,185)         | (174)                  | (54)             | (961)           | 25                | (2,349)         |
| Minority interest  | –               | –                      | –                | (4,038)         | –                 | (4,038)         |
| Income (loss) before provision for<br>income taxes, discontinued<br>operations and cumulative effect of<br>accounting change | 6,241           | 18                     | 184              | 7,722           | (6,011)           | 8,154           |
| Income tax benefit (provision)   | 33              | (19)                   | (68)             | (2,620)         | –                 | (2,674)         |
| <b>Income (Loss) Before Discontinued<br/>Operations And Cumulative Effect<br/>Of Accounting Change</b>                       | <b>6,274</b>    | <b>(1)</b>             | <b>116</b>       | <b>5,102</b>    | <b>(6,011)</b>    | <b>5,480</b>    |
| Income on discontinued operations, net<br>of tax   | (77)            | –                      | –                | 836             | –                 | 759             |
| Cumulative effect of accounting<br>change, net of tax  | –               | –                      | –                | (42)            | –                 | (42)            |
| <b>Net Income</b>  | <b>\$ 6,197</b> | <b>\$ (1)</b>          | <b>\$ 116</b>    | <b>\$ 5,896</b> | <b>\$ (6,011)</b> | <b>\$ 6,197</b> |

(dollars in millions)

| Condensed Consolidating Statements of Income<br>Year Ended December 31, 2005 | Parent          | Verizon<br>New England | Verizon<br>South | Other           | Adjustments       | Total           |
|--|-----------------|------------------------|------------------|-----------------|-------------------|-----------------|
| Operating revenues   | \$ –            | \$ 3,936               | \$ 907           | \$ 65,172       | \$ (497)          | \$ 69,518       |
| Operating expenses   | 8               | 3,628                  | 684              | 53,114          | (497)             | 56,937          |
| <b>Operating Income (Loss)</b>   | <b>(8)</b>      | <b>308</b>             | <b>223</b>       | <b>12,058</b>   | <b>–</b>          | <b>12,581</b>   |
| Equity in earnings of unconsolidated<br>businesses                           | 6,698           | 23                     | –                | 273             | (6,308)           | 686             |
| Other income and (expense), net  | 537             | (4)                    | 6                | 180             | (408)             | 311             |
| Interest expense   | (58)            | (172)                  | (63)             | (1,854)         | 18                | (2,129)         |
| Minority interest  | –               | –                      | –                | (3,001)         | –                 | (3,001)         |
| Income before provision for income taxes<br>and discontinued operations      | 7,169           | 155                    | 166              | 7,656           | (6,698)           | 8,448           |
| Income tax benefit (provision)   | 228             | (40)                   | (62)             | (2,547)         | –                 | (2,421)         |
| <b>Income Before Discontinued<br/>Operations</b>                             | <b>7,397</b>    | <b>115</b>             | <b>104</b>       | <b>5,109</b>    | <b>(6,698)</b>    | <b>6,027</b>    |
| Income on discontinued operations, net of<br>tax                             | –               | –                      | –                | 1,370           | –                 | 1,370           |
| <b>Net Income</b>  | <b>\$ 7,397</b> | <b>\$ 115</b>          | <b>\$ 104</b>    | <b>\$ 6,479</b> | <b>\$ (6,698)</b> | <b>\$ 7,397</b> |

(dollars in millions)

| Condensed Consolidating Statements of Income                         |                 |                     |               |                 |                   |                 |
|--|-----------------|---------------------|---------------|-----------------|-------------------|-----------------|
| Year Ended December 31, 2004   | Parent          | Verizon New England | Verizon South | Other           | Adjustments       | Total           |
| Operating revenues   | \$ –            | \$ 3,955            | \$ 934        | \$ 61,224       | \$ (362)          | \$ 65,751       |
| Operating expenses   | 260             | 3,664               | 717           | 50,602          | (362)             | 54,881          |
| <b>Operating Income (Loss)</b>                                       | <b>(260)</b>    | <b>291</b>          | <b>217</b>    | <b>10,622</b>   | <b>–</b>          | <b>10,870</b>   |
| Equity in earnings of unconsolidated businesses                      | 7,714           | 59                  | –             | 1,437           | (7,520)           | 1,690           |
| Other income and (expense), net                                      | 171             | 8                   | 7             | 98              | (202)             | 82              |
| Interest expense   | (20)            | (165)               | (63)          | (2,096)         | 8                 | (2,336)         |
| Minority interest  | –               | –                   | –             | (2,329)         | –                 | (2,329)         |
| Income before provision for income taxes and discontinued operations | 7,605           | 193                 | 161           | 7,732           | (7,714)           | 7,977           |
| Income tax benefit (provision)                                       | 229             | (50)                | (34)          | (2,223)         | –                 | (2,078)         |
| <b>Income Before Discontinued Operations</b>                         | <b>7,834</b>    | <b>143</b>          | <b>127</b>    | <b>5,509</b>    | <b>(7,714)</b>    | <b>5,899</b>    |
| Income (loss) on discontinued operations, net of tax                 | (3)             | –                   | –             | 1,935           | –                 | 1,932           |
| <b>Net Income</b>  | <b>\$ 7,831</b> | <b>\$ 143</b>       | <b>\$ 127</b> | <b>\$ 7,444</b> | <b>\$ (7,714)</b> | <b>\$ 7,831</b> |

(dollars in millions)

| Condensed Consolidating Balance Sheets               |                  |                     |                 |                   |                    |                   |
|--|------------------|---------------------|-----------------|-------------------|--------------------|-------------------|
| At December 31, 2006                                 | Parent           | Verizon New England | Verizon South   | Other             | Adjustments        | Total             |
| Cash   | \$ –             | \$ –                | \$ –            | \$ 3,219          | \$ –               | \$ 3,219          |
| Short-term investments                               | –                | 215                 | 33              | 2,186             | –                  | 2,434             |
| Accounts receivable, net                             | 4                | 705                 | 104             | 10,999            | (921)              | 10,891            |
| Other current assets                                 | 32,680           | 134                 | 28              | 5,830             | (32,678)           | 5,994             |
| <b>Total current assets</b>                          | <b>32,684</b>    | <b>1,054</b>        | <b>165</b>      | <b>22,234</b>     | <b>(33,599)</b>    | <b>22,538</b>     |
| Plant, property and equipment, net                   | 1                | 6,165               | 1,120           | 75,070            | –                  | 82,356            |
| Investments in unconsolidated businesses             | 44,048           | 116                 | –               | 7,488             | (46,784)           | 4,868             |
| Other assets   | 5,045            | 288                 | 389             | 73,550            | (230)              | 79,042            |
| <b>Total Assets</b>                                  | <b>\$ 81,778</b> | <b>\$ 7,623</b>     | <b>\$ 1,674</b> | <b>\$ 178,342</b> | <b>\$ (80,613)</b> | <b>\$ 188,804</b> |
| Debt maturing within one year                        | \$ 6,735         | \$ 333              | \$ 232          | \$ 33,302         | \$ (32,887)        | \$ 7,715          |
| Other current liabilities                            | 2,354            | 1,032               | 182             | 21,709            | (712)              | 24,565            |
| <b>Total current liabilities</b>                     | <b>9,089</b>     | <b>1,365</b>        | <b>414</b>      | <b>55,011</b>     | <b>(33,599)</b>    | <b>32,280</b>     |
| Long-term debt                                       | 11,392           | 2,573               | 417             | 14,494            | (230)              | 28,646            |
| Employee benefit obligations                         | 12,419           | 1,625               | 259             | 16,476            | –                  | 30,779            |
| Deferred income taxes                                | 337              | 560                 | 203             | 15,170            | –                  | 16,270            |
| Other liabilities                                    | 6                | 111                 | 19              | 3,821             | –                  | 3,957             |
| Minority interest                                    | –                | –                   | –               | 28,337            | –                  | 28,337            |
| Total shareowners' investment                        | 48,535           | 1,389               | 362             | 45,033            | (46,784)           | 48,535            |
| <b>Total Liabilities and Shareowners' Investment</b> | <b>\$ 81,778</b> | <b>\$ 7,623</b>     | <b>\$ 1,674</b> | <b>\$ 178,342</b> | <b>\$ (80,613)</b> | <b>\$ 188,804</b> |

(dollars in millions)

**Condensed Consolidating Balance Sheets**

| At December 31, 2005                     | Parent           | Verizon New England | Verizon South   | Other             | Adjustments        | Total             |
|--|------------------|---------------------|-----------------|-------------------|--------------------|-------------------|
| Cash                                     | \$ –             | \$ –                | \$ –            | \$ 760            | \$ –               | \$ 760            |
| Short-term investments                   | –                | 216                 | 32              | 1,898             | –                  | 2,146             |
| Accounts receivable, net                 | 20               | 910                 | 142             | 8,792             | (1,330)            | 8,534             |
| Other current assets                     | 9,365            | 166                 | 185             | 7,661             | (9,497)            | 7,880             |
| Total current assets                     | 9,385            | 1,292               | 359             | 19,111            | (10,827)           | 19,320            |
| Plant, property and equipment, net       | 1                | 6,146               | 1,158           | 65,682            | –                  | 72,987            |
| Investments in unconsolidated businesses | 32,593           | 116                 | –               | 10,015            | (38,122)           | 4,602             |
| Other assets                             | 532              | 472                 | 390             | 70,057            | (230)              | 71,221            |
| <b>Total Assets</b>                      | <b>\$ 42,511</b> | <b>\$ 8,026</b>     | <b>\$ 1,907</b> | <b>\$ 164,865</b> | <b>\$ (49,179)</b> | <b>\$ 168,130</b> |

|  |                  |                 |                 |                   |                    |                   |
|--|------------------|-----------------|-----------------|-------------------|--------------------|-------------------|
| Debt maturing within one year                        | \$ 22            | \$ 471          | \$ –            | \$ 15,999         | \$ (9,804)         | \$ 6,688          |
| Other current liabilities                            | 2,511            | 1,049           | 176             | 17,299            | (1,023)            | 20,012            |
| Total current liabilities                            | 2,533            | 1,520           | 176             | 33,298            | (10,827)           | 26,700            |
| Long-term debt                                       | 92               | 2,702           | 901             | 28,104            | (230)              | 31,569            |
| Employee benefit obligations                         | 205              | 1,892           | 254             | 15,342            | –                  | 17,693            |
| Deferred income taxes                                | –                | 537             | 220             | 22,074            | –                  | 22,831            |
| Other liabilities                                    | 1                | 146             | 27              | 3,050             | –                  | 3,224             |
| Minority interest                                    | –                | –               | –               | 26,433            | –                  | 26,433            |
| Total shareowners' investment                        | 39,680           | 1,229           | 329             | 36,564            | (38,122)           | 39,680            |
| <b>Total Liabilities and Shareowners' Investment</b> | <b>\$ 42,511</b> | <b>\$ 8,026</b> | <b>\$ 1,907</b> | <b>\$ 164,865</b> | <b>\$ (49,179)</b> | <b>\$ 168,130</b> |

(dollars in millions)

**Condensed Consolidating Statements of Cash Flows**  
Year Ended December 31, 2006

|                                    | Parent      | Verizon New England | Verizon South | Other           | Adjustments | Total           |
|------------------------------------|-------------|---------------------|---------------|-----------------|-------------|-----------------|
| Net cash from operating activities | \$ 5,919    | \$ 1,211            | \$ 311        | \$ 22,260       | \$ (5,595)  | \$ 24,106       |
| Net cash from investing activities | (779)       | (919)               | 15            | (14,032)        | 99          | (15,616)        |
| Net cash from financing activities | (5,140)     | (292)               | (326)         | (5,769)         | 5,496       | (6,031)         |
| <b>Net Increase in Cash</b>        | <b>\$ –</b> | <b>\$ –</b>         | <b>\$ –</b>   | <b>\$ 2,459</b> | <b>\$ –</b> | <b>\$ 2,459</b> |

(dollars in millions)

**Condensed Consolidating Statements of Cash Flows**  
Year Ended December 31, 2005

|                                    | Parent      | Verizon New England | Verizon South | Other             | Adjustments | Total             |
|------------------------------------|-------------|---------------------|---------------|-------------------|-------------|-------------------|
| Net cash from operating activities | \$ 7,605    | \$ 831              | \$ 284        | \$ 20,242         | \$ (6,937)  | \$ 22,025         |
| Net cash from investing activities | (913)       | (784)               | (221)         | (16,343)          | (231)       | (18,492)          |
| Net cash from financing activities | (6,692)     | (47)                | (63)          | (5,400)           | 7,168       | (5,034)           |
| <b>Net Decrease in Cash</b>        | <b>\$ –</b> | <b>\$ –</b>         | <b>\$ –</b>   | <b>\$ (1,501)</b> | <b>\$ –</b> | <b>\$ (1,501)</b> |

(dollars in millions)

**Condensed Consolidating Statements of Cash Flows**  
Year Ended December 31, 2004

|                                    | Parent      | Verizon New England | Verizon South | Other           | Adjustments | Total           |
|------------------------------------|-------------|---------------------|---------------|-----------------|-------------|-----------------|
| Net cash from operating activities | \$ 6,650    | \$ 1,219            | \$ 282        | \$ 20,104       | \$ (6,464)  | \$ 21,791       |
| Net cash from investing activities | –           | (655)               | (75)          | (9,559)         | (54)        | (10,343)        |
| Net cash from financing activities | (6,650)     | (564)               | (207)         | (8,953)         | 6,518       | (9,856)         |
| <b>Net Increase in Cash</b>        | <b>\$ –</b> | <b>\$ –</b>         | <b>\$ –</b>   | <b>\$ 1,592</b> | <b>\$ –</b> | <b>\$ 1,592</b> |

**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 commenced at the site of a former Sylvania facility in Hicksville, New York that processed nuclear fuel rods in the 1950s and 1960s. Remediation beyond original expectations proved to be necessary and a reassessment of the anticipated remediation costs was conducted. A reassessment of costs related to remediation efforts at several other former facilities was also undertaken. In September 2005 the Army Corps of Engineers (ACE) accepted the Hicksville site into the Formerly Utilized Sites Remedial Action Program. This may result in the ACE performing some or all of the remediation effort for the Hicksville site with a corresponding decrease in costs to Verizon. To the extent that the ACE assumes responsibility for remedial work at the Hicksville site, an adjustment to a reserve previously established for the remediation may be made. Adjustments may also be made based upon actual conditions discovered during the remediation at any of the sites requiring remediation.

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.

In connection with the execution of agreements for the sales of businesses and investments, Verizon ordinarily provides representations and warranties to the purchasers pertaining to a variety of nonfinancial matters, such as ownership of the securities being sold, as well as financial losses.

Subsequent to the sale of Verizon Information Services Canada (see Note 3), we continue to provide a guarantee to publish directories, which was issued when the directory business was purchased in 2001 and had a 30-year term (before extensions). The preexisting guarantee continues, without modification, following the sale of Verizon Information Services Canada. As a result of the Idearc spin-off, we continue to be responsible for this guarantee. The possible financial impact of the guarantee, which is not expected to be adverse, cannot be reasonably estimated since a variety of the potential outcomes available under the guarantee result in costs and revenues or benefits that may offset. In addition, performance under the guarantee is not likely.

As of December 31, 2006, letters of credit totaling \$223 million had been executed in the normal course of business, which support several financing arrangements and payment obligations to third parties.

We have several commitments primarily to purchase network services, equipment and software from a variety of suppliers totaling \$812 million. Of this total amount, \$566 million, \$164 million, \$53 million, \$11 million, \$5 million and \$13 million are expected to be purchased in 2007, 2008, 2009, 2010, 2011 and thereafter, respectively.

## Note 22

### Quarterly Financial Information (Unaudited)

(dollars in millions, except per share amounts)

| Quarter Ended       | Operating Revenues | Operating Income | Income Before Discontinued Operations |                 |                   | Net Income |
|---------------------|--------------------|------------------|---------------------------------------|-----------------|-------------------|------------|
|                     |                    |                  | Amount                                | Per Share-Basic | Per Share-Diluted |            |
| <b>2006</b>         |                    |                  |                                       |                 |                   |            |
| <b>March 31</b>     | \$ 21,221          | \$ 3,175         | \$ 1,282                              | \$ .44          | \$ .44            | \$ 1,632   |
| <b>June 30</b>      | 21,876             | 3,217            | 1,263                                 | .43             | .43               | 1,611      |
| <b>September 30</b> | 22,449             | 3,537            | 1,545                                 | .53             | .53               | 1,922      |
| <b>December 31</b>  | 22,598             | 3,444            | 1,390                                 | .48             | .48               | 1,032      |
| <b>2005</b>         |                    |                  |                                       |                 |                   |            |
| March 31            | \$ 16,785          | \$ 2,828         | \$ 1,407                              | \$ .51          | \$ .50            | \$ 1,757   |
| June 30             | 17,177             | 3,561            | 1,804                                 | .65             | .65               | 2,113      |
| September 30        | 17,629             | 3,040            | 1,506                                 | .54             | .54               | 1,869      |
| December 31         | 17,927             | 3,152            | 1,310                                 | .47             | .47               | 1,658      |

- Results of operations for the first quarter of 2006 include after-tax charges of \$16 million for the early extinguishment of debt related to the MCI merger, \$28 million for costs associated with the relocation to Verizon Center, \$42 million for the impact of accounting for share based payments, and \$35 million for merger integration costs.
- Results of operations for the second quarter of 2006 include after-tax charges of \$48 million for merger integration costs, \$29 million for costs associated with the relocation to Verizon Center and \$186 million for severance, pension and benefits charges.
- Results of operations for the third quarter of 2006 include after-tax charges of \$16 million for merger integration costs, \$31 million for costs associated with the relocation to Verizon Center and \$17 million for severance, pension and benefits charges.
- Results of operations for the fourth quarter of 2006 include after-tax charges of \$47 million for merger integration costs, \$30 million for costs associated with the relocation to Verizon Center, \$55 million severance, pension and benefits charges, \$541 million for the loss on sale of Verizon Dominicana included in discontinued operations, and \$101 million for costs associated with the spin-off of our directories publishing business.

- Results of operations for the second quarter of 2005 include a \$336 million net after-tax gain on the sale of our wireline and directory businesses in Hawaii, tax benefits of \$242 million associated with prior investment losses and a net tax provision of \$206 million related to the repatriation of foreign earnings under the provisions of the American Jobs Creation Act of 2004.
- Results of operations for the third quarter of 2005 include an impairment charge of \$125 million pertaining to our leasing operations for aircraft leased to airlines experiencing financial difficulties.

Income before discontinued operations per common share is computed independently for each quarter and the sum of the quarters may not equal the annual amount.

## Note 23

### Subsequent Events

#### Disposition of Businesses and Investments

##### *Telephone Access Lines Spin-off*

On January 16, 2007, we announced a definitive agreement with FairPoint Communications, Inc. (FairPoint) that will result in Verizon establishing a separate entity for its local exchange and related business assets in Maine, New Hampshire and Vermont, spinning off that new entity to Verizon shareowners, and immediately merging it with and into FairPoint.

Upon the closing of the transaction, Verizon shareowners will own approximately 60 percent of the new company and FairPoint stockholders will own approximately 40 percent. Verizon Communications will not own any shares in FairPoint after the merger. In connection with the merger, Verizon shareowners will receive one share of FairPoint stock for approximately every 55 shares of Verizon stock held as of the record date. Both the spin-off and merger are expected to qualify as tax-free transactions, except to the extent that cash is paid to Verizon shareowners in lieu of fractional shares.

The total value to be received by Verizon and its shareowners in exchange for these operations will be approximately \$2,715 million. Verizon shareowners will receive approximately \$1,015 million of FairPoint common stock in the merger, based upon FairPoint's recent stock price and the terms of the merger agreement. Verizon will receive \$1,700 million in value through a combination of cash distributions to Verizon and debt securities issued to Verizon prior to the spin-off. Verizon may exchange these newly issued debt securities for certain debt that was previously issued by Verizon, which would have the effect of reducing Verizon's then-outstanding debt.

##### *CANTV*

During the second quarter of 2006, we entered into a definitive agreement to sell our indirect 28.5% interest in CANTV to an entity jointly owned by América Móvil and Telmex for estimated pretax proceeds of \$677 million. Regulatory authorities in Venezuela never commenced the formal review of that transaction and the related tender offers for the remaining equity securities of CANTV. On February 8, 2007, after two prior extensions, the parties terminated the stock purchase agreement because the parties mutually concluded that the regulatory approvals would not be granted by the Government.

In January 2007, the Bolivarian Republic of Venezuela (the Republic) declared its intent to nationalize certain companies, including CANTV. On February 12, 2007, we entered into a Memorandum of Understanding (MOU) with the Republic. The MOU provides that the Republic will offer to purchase all of the equity securities of CANTV through public tender offers in Venezuela and the United States at a price equivalent to \$17.85 per ADS. If the tender offers are completed, the aggregate purchase price for Verizon's shares would be \$572 million. If the 2007 dividend that has been recommended by the CANTV Board is approved by shareholders and paid prior to the closing of the tender offers, this amount will be reduced by the amount of the dividend. Verizon has agreed to tender its shares if the offers are commenced. The Republic has agreed to commence the offers within forty-five days assuming the satisfactory completion of its due diligence investigation of CANTV. The tender offers are subject to certain conditions including that a majority of the outstanding shares are tendered to the Government and receipt of regulatory approvals. Based upon the terms of the MOU and our current investment balance in CANTV, we expect that we will record a loss on our investment in the first quarter of 2007. The ultimate amount of the loss depends on a variety of factors, including the successful completion of the tender offer and the satisfaction of other terms in the MOU.

#### Redemption of Debt

On January 8, 2007, we redeemed the remaining \$1,580 million of the outstanding Verizon Communications Inc. floating rate notes due 2007. The gain/(loss) on this redemption was immaterial.

**Verizon Communications Inc. and Subsidiaries**  
Principal Subsidiaries of Registrant at December 31, 2006

| Name  | Jurisdiction of Organization |
|---|------------------------------|
| Verizon California Inc.                                 | California                   |
| Verizon Delaware LLC.                                   | Delaware                     |
| Verizon Florida LLC.                                    | Florida                      |
| Verizon Maryland Inc.                                   | Maryland                     |
| Verizon New England Inc.                                | New York                     |
| Verizon New Jersey Inc.                                 | New Jersey                   |
| Verizon New York Inc.                                   | New York                     |
| Verizon North Inc.                                      | Wisconsin                    |
| Verizon Northwest Inc.                                  | Washington                   |
| Verizon Pennsylvania Inc.                               | Pennsylvania                 |
| Verizon South Inc.                                      | Virginia                     |
| GTE Southwest Incorporated<br>(d/b/a Verizon Southwest) | Delaware                     |
| Verizon Virginia Inc.                                   | Virginia                     |
| Verizon Washington, DC Inc.                             | New York                     |
| Verizon West Virginia Inc.                              | West Virginia                |
| Cellco Partnership<br>(d/b/a Verizon Wireless)          | Delaware                     |
| Verizon Capital Corp.                                   | Delaware                     |
| Verizon Business Global LLC                             | Delaware                     |

## Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in this Annual Report (Form 10-K) of Verizon Communications Inc. (Verizon) of our reports dated February 23, 2007, with respect to the consolidated financial statements of Verizon, Verizon management's assessment of the effectiveness of internal control over financial reporting, and the effectiveness of internal control over financial reporting of Verizon, included in the 2006 Annual Report to Shareowners of Verizon.

Our audits also included the financial statement schedule of Verizon listed in Item 15(a). This schedule is the responsibility of Verizon's management. Our responsibility is to express an opinion based on our audits. In our opinion, the financial statement schedule referred to above, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also consent to the incorporation by reference in the following registration statements of Verizon and where applicable, related Prospectuses, of our reports dated February 23, 2007, with respect to the consolidated financial statements of Verizon, Verizon management's assessment of the effectiveness of internal control over financial reporting, and the effectiveness of internal control over financial reporting of Verizon, incorporated by reference in this Annual Report (Form 10-K) for the year ended December 31, 2006: Form S-8, No. 333-66459; Form S-8, No. 333-66349; Form S-4, No. 333-11573; Form S-8, No. 333-41593; Form S-8, No. 333-42801; Form S-4, No. 333-76171; Form S-8, No. 333-75553; Form S-8, No. 333-76171; Form S-8, No. 333-50146; Form S-8, No. 333-53830; Form S-4, No. 333-82408; Form S-8, No. 333-82690; Form S-3, No. 333-109028-01; Form S-3, No. 333-106750; Form S-8, No. 333-105512; Form S-8, No. 333-105511; Form S-8, No. 333-118904; Form S-8, No. 333-123374; Form S-4, No. 333-124008; Form S-8, No. 333-124008; Form S-4, No. 333-132651; Form S-8, No. 333-134846; Form S-8, No. 333-137475; and Form S-3, No. 333-138705.

Ernst & Young LLP  

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Ernst & Young LLP  
New York, New York

February 23, 2007

I, Ivan G. Seidenberg, certify that:

1. I have reviewed this annual report on Form 10-K 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)) 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 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 1, 2007

/s/ Ivan G. Seidenberg

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Ivan G. Seidenberg

Chairman and Chief Executive Officer

I, Doreen A. Toben, certify that:

1. I have reviewed this annual report on Form 10-K 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)) 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 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 1, 2007

/s/ Doreen A. Toben

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Doreen A. Toben

Executive Vice President and Chief Financial Officer

**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-K for the annual period ending December 31, 2006 (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: March 1, 2007

/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.

**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-K for the annual period ending December 31, 2006 (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: March 1, 2007

/s/ Doreen A. Toben

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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.