

# **Verizon New England Inc.**

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Financial Statements  
As of December 31, 2005 and 2004  
and for the years then ended

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**REPORT OF INDEPENDENT AUDITORS**

To The Board of Directors and Shareowner  
Verizon New England Inc.:

We have audited the accompanying balance sheets of Verizon New England Inc. (the Company) as of December 31, 2005 and 2004, and the related statements of income, changes in shareowner's investment and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Verizon New England Inc. at December 31, 2005 and 2004, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

*Ernst & Young LLP*

New York, New York  
February 23, 2006

Verizon New England Inc.

STATEMENTS OF INCOME

(dollars in millions)

| Years Ended December 31,                                    | 2005            | 2004            |
|---|-----------------|-----------------|
| <b>Operating Revenues</b>                                   | <b>\$ 3,936</b> | <b>\$ 3,955</b> |
| <b>Operating Expenses</b>                                   |                 |                 |
| Cost of services and sales (exclusive of items shown below) | 1,744           | 1,582           |
| Selling, general and administrative expense                 | 879             | 1,017           |
| Depreciation and amortization expense                       | 1,005           | 1,065           |
| <b>Total Operating Expenses</b>                             | <b>3,628</b>    | <b>3,664</b>    |
| <b>Operating Income (Loss)</b>                              | <b>308</b>      | <b>291</b>      |
| Other income and (expense), net                             | 19              | 67              |
| Interest expense  | (172)           | (165)           |
| <b>Income Before Provision for Income Taxes</b>             | <b>155</b>      | <b>193</b>      |
| Income tax (provision) benefit                              | (40)            | (50)            |
| <b>Net Income</b>   | <b>\$ 115</b>   | <b>\$ 143</b>   |

See Notes to Financial Statements.

Verizon New England Inc.

**BALANCE SHEETS**

**ASSETS**

| <b>At December 31,</b>  | <b>(dollars in millions)</b> |                 |
|---|------------------------------|-----------------|
|   | <b>2005</b>                  | <b>2004</b>     |
| Current assets  |                              |                 |
| Short-term investments  | \$ 216                       | \$ 187          |
| Accounts receivable:  |                              |                 |
| Trade and other, net of allowances for uncollectibles of \$91 and \$149 | 658                          | 731             |
| Affiliates  | 252                          | 181             |
| Material and supplies   | 26                           | 26              |
| Prepaid expenses  | 30                           | 17              |
| Deferred income taxes   | ---                          | 3               |
| Other   | 110                          | 106             |
| Total current assets  | <u>1,292</u>                 | <u>1,251</u>    |
| Plant, property and equipment   | 17,832                       | 17,605          |
| Less accumulated depreciation   | <u>11,686</u>                | <u>11,222</u>   |
|   | <u>6,146</u>                 | <u>6,383</u>    |
| Intangible assets, net  | 39                           | 62              |
| Prepaid pension asset   | 102                          | 101             |
| Other assets  | <u>447</u>                   | <u>502</u>      |
| Total assets  | <u>\$ 8,026</u>              | <u>\$ 8,299</u> |

See Notes to Financial Statements.

Verizon New England Inc.

BALANCE SHEETS

LIABILITIES AND SHAREOWNER'S INVESTMENT

| At December 31,                               | (dollars in millions) |                 |
|---|-----------------------|-----------------|
|   | 2005                  | 2004            |
| Current liabilities                           |                       |                 |
| Debt maturing within one year:                |                       |                 |
| Note payable to affiliate                     | \$ 470                | \$ 168          |
| Other   | 1                     | ---             |
| Accounts payable and accrued liabilities:     |                       |                 |
| Affiliates                                    | 478                   | 580             |
| Other   | 396                   | 463             |
| Current deferred income tax liabilities       | 3                     | ---             |
| Other current liabilities                     | 172                   | 174             |
| Total current liabilities                     | <u>1,520</u>          | <u>1,385</u>    |
| Long-term debt                                |                       |                 |
| Note payable to affiliate                     | 220                   | 220             |
| Other   | 2,482                 | 2,746           |
| Employee benefit obligations                  | 1,892                 | 1,940           |
| Deferred credits and other liabilities        |                       |                 |
| Deferred income taxes                         | 519                   | 571             |
| Unamortized investment tax credits            | 18                    | 20              |
| Other   | 147                   | 233             |
|   | <u>684</u>            | <u>824</u>      |
| Shareowner's investment                       |                       |                 |
| Common stock – one share, without par value   | 1                     | 1               |
| Contributed capital                           | 1,239                 | 1,290           |
| Reinvested earnings                           | 167                   | 112             |
| Accumulated other comprehensive loss          | (179)                 | (219)           |
| Total shareowner's investment                 | <u>1,228</u>          | <u>1,184</u>    |
| Total liabilities and shareowner's investment | <u>\$ 8,026</u>       | <u>\$ 8,299</u> |

See Notes to Financial Statements.

STATEMENTS OF CHANGES IN SHAREOWNER'S INVESTMENT

| Years Ended December 31,  | (dollars in millions) |                |
|---|-----------------------|----------------|
|   | 2005                  | 2004           |
| <b>Common Stock</b>   |                       |                |
| Balance at beginning of year  | \$ 1                  | \$ 1           |
| Balance at end of year  | 1                     | 1              |
| <b>Contributed Capital</b>  |                       |                |
| Balance at beginning of year  | 1,290                 | 1,587          |
| Capital (return)/contribution (with parent)                                   | (51)                  | (301)          |
| Tax benefit from exercise of stock options                                    | ---                   | 4              |
| Balance at end of year  | 1,239                 | 1,290          |
| <b>Reinvested Earnings</b>  |                       |                |
| Balance at beginning of year  | 112                   | 106            |
| Net income  | 115                   | 143            |
| Dividends declared  | (60)                  | (137)          |
| Balance at end of year  | 167                   | 112            |
| <b>Accumulated Other Comprehensive Loss</b>                                   |                       |                |
| Balance at beginning of year  | (219)                 | (145)          |
| Minimum pension liability adjustment (net of income taxes of \$27 and \$(49)) | 40                    | (74)           |
| Balance at end of year  | (179)                 | (219)          |
| <b>Total Shareowner's Investment</b>  | <b>\$ 1,228</b>       | <b>\$1,184</b> |
| <b>Comprehensive Income</b>   |                       |                |
| Net income  | \$ 115                | \$ 143         |
| Minimum pension liability adjustment (net of income taxes of \$27 and \$(49)) | 40                    | (74)           |
| <b>Total Comprehensive Income</b>   | <b>\$ 155</b>         | <b>\$ 69</b>   |

See Notes to Financial Statements.

## STATEMENTS OF CASH FLOWS

|  | (dollars in millions) |        |
|--|-----------------------|--------|
| Years Ended December 31,   | 2005                  | 2004   |
| <b>Net Cash Provided by Operating Activities</b>   |                       |        |
| Income (loss) before cumulative effect of accounting change  | \$ 115                | \$ 143 |
| Adjustments to reconcile income (loss) before cumulative effect of accounting change to net cash provided by operating activities: |                       |        |
| Depreciation and amortization  | 1,004                 | 1,065  |
| Employee retirement benefits   | 297                   | 266    |
| Deferred income taxes, net   | (74)                  | 144    |
| Provision for uncollectible accounts   | 34                    | 128    |
| Equity loss (income) from affiliates   | (23)                  | (59)   |
| Dividends received from equity affiliates  | 31                    | 37     |
| Changes in current assets and liabilities:   |                       |        |
| Accounts receivable  | (64)                  | 46     |
| Other current assets   | (25)                  | 123    |
| Accounts payable and accrued liabilities   | (174)                 | (474)  |
| Other current liabilities  | (3)                   | (15)   |
| Other, net   | (287)                 | (184)  |
| Net cash provided by operating activities  | 831                   | 1,220  |
| <b>Cash Flows from Investing Activities</b>  |                       |        |
| Capital expenditures (including capitalized network and non-network software)  | (755)                 | (667)  |
| Purchases of short-term investments  | (216)                 | (187)  |
| Proceeds from sale of short-term investments   | 187                   | 200    |
| Other, net   | ---                   | (1)    |
| Net cash used in investing activities  | (784)                 | (655)  |
| <b>Cash Flows from Financing Activities</b>  |                       |        |
| Proceeds from borrowings   | 2                     | 220    |
| Early extinguishment of debt   | (250)                 | ---    |
| Principal repayments of borrowings and capital lease obligations   | 4                     | ---    |
| Net change in note payable to affiliate  | 302                   | (344)  |
| Dividends paid   | (60)                  | (137)  |
| Return of capital to parent  | (51)                  | (301)  |
| Net change in outstanding checks drawn on controlled disbursement accounts   | 6                     | (2)    |
| Other, net   | ---                   | (1)    |
| Net cash used in financing activities  | (47)                  | (565)  |
| Net change in cash   | ---                   | ---    |
| Cash, beginning of year  | ---                   | ---    |
| Cash, end of year  | \$ ---                | \$ --- |

See Notes to Financial Statements.



## NOTES TO FINANCIAL STATEMENTS

### 1. DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Description of Business

Verizon New England Inc. is a wholly owned subsidiary of NYNEX Corporation (NYNEX), which is a wholly owned subsidiary of Verizon Communications Inc. (Verizon). We presently serve a territory consisting of Local Access and Transport Areas (LATAs) in Maine, Massachusetts, New Hampshire, Rhode Island and Vermont. We have one reportable segment which provides domestic wireline telecommunications services. We currently provide two basic types of telecommunications services:

- *Exchange telecommunication service* is the transmission of telecommunications among customers located within a local calling area within a LATA. Examples of exchange telecommunications services include switched local residential and business services, local private line voice and data services and Centrex services. We also provide toll services within a LATA (intraLATA long distance).
- *Exchange access service* links a customer's premises and the transmission facilities of other telecommunications carriers, generally interLATA carriers. Examples of exchange access services include switched access and special access services.

The communications services we provide are subject to regulation by the state regulatory commissions of Maine, Massachusetts, New Hampshire, Rhode Island and Vermont with respect to intrastate rates and services and other matters. The Federal Communications Commission (FCC) regulates rates that we charge long distance carriers and end-user subscribers for interstate access services.

On April 16, 2001, February 22, 2002, April 17, 2002, June 19, 2002, and September 25, 2002, the FCC released orders approving our applications for permission to enter the in-region long distance markets in Massachusetts, Rhode Island, Vermont, Maine and New Hampshire, respectively. The United States Court of Appeals for the District of Columbia has remanded the Massachusetts order to the FCC for further explanation on one issue, but left our long distance authority in effect. Since April 26, 2001, March 7, 2002, April 30, 2002, July 1, 2002 and October 23, 2002 in-region long distance service is being offered in Massachusetts, Rhode Island, Vermont, Maine and New Hampshire, respectively, by a separate non-regulated subsidiary of Verizon as required by law.

#### Basis of Presentation

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

We have a 33-1/3% ownership interest in Telesector Resources Group, Inc. (d/b/a Verizon Services Group) and share voting rights equally with the other owner, Verizon New York Inc. (Verizon New York), which is a wholly owned subsidiary of NYNEX. Verizon Services Group operates in conjunction with Verizon Services Corp. and Verizon Corporate Services Group Inc. (collectively known as Verizon Services) to provide various centralized services on behalf of Verizon's subsidiaries. We use the equity method of accounting for our investment in Verizon Services Group.

We also have a 4.57% ownership interest in SMS/800, a venture that is jointly owned by the Bell Operating Companies. SMS/800 administers the centralized national database system associated with toll free numbers. We use the equity method of accounting for our investment in SMS/800.

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

#### Revenue Recognition

We recognize service revenues based upon usage of our local exchange network and facilities and contract fees. In general, fixed fees for local telephone, long distance and certain other services are billed one month in advance and recognized the following month when earned. Revenue from other products that are not fixed fee or that exceed contracted amounts is recognized when such services are provided.

We recognize 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.

### **Maintenance and Repairs**

We charge the cost of maintenance and repairs, including the cost of replacing minor items not constituting substantial betterments, to Cost of Services and Sales as these costs are incurred.

### **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 of cash equivalents held in trust to pay for certain employee benefits. Short-term investments are stated at cost, which approximates market value.

### **Trade and Other Accounts Receivable**

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

### **Material and Supplies**

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

### **Plant and Depreciation**

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

The asset lives used are presented in the following table:

| <b>Average Lives (in years)</b> |       |
|---------------------------------|-------|
| Buildings                       | 25-42 |
| Central office equipment        | 5-11  |
| Outside communications plant    |       |
| Copper cable                    | 13-18 |
| Fiber cable                     | 20    |
| Poles and conduit               | 30-50 |
| Furniture, vehicles and other   | 3-15  |

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

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

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:

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

### Impairment of Long-Lived Assets

Our plant, property, and equipment and intangible assets subject to amortization are reviewed for impairment in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which we adopted effective January 1, 2002. Under SFAS No. 144, these assets are tested for recoverability whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. An impairment charge is recognized for the amount (if any) by which the carrying value of the asset exceeds its fair value.

### Computer Software Costs

We capitalize the cost of internal-use network 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 computer software costs are amortized using the straight-line method over a period of 3 to 5 years.

## Goodwill and Other Intangible Assets

Effective January 1, 2002, we adopted SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142 no longer permits the amortization of goodwill and indefinite-lived intangible assets. Instead, these assets must be reviewed annually (or more frequently under prescribed conditions) for impairment in accordance with this statement. Intangible assets that do not have indefinite lives are amortized over their useful lives. The adoption of SFAS No. 142 did not impact our results of operations or financial position because we had no goodwill or indefinite-lived intangible assets at December 31, 2005 and 2004.

Our other intangible assets consist of non-network internal-use software as follows:

|  | At December 31, 2005  |                          | (dollars in millions)<br>At December 31, 2004 |                          |
|--|-----------------------|--------------------------|---|--------------------------|
|  | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount                         | Accumulated Amortization |
| Non-network internal-use software (3 to 5 years) | \$ 148                | \$ 109                   | \$ 180  | \$ 119                   |

Intangible asset amortization expense was \$22 million in 2005 and \$30 million in 2004. Amortization expense is estimated to be \$19 million in 2006, \$12 million in 2007, \$7 million in 2008, \$1 million in 2009 and \$--- in 2010 related to our non-network internal-use software.

## Advertising Costs

We expense advertising costs as they are incurred.

## Stock-Based Compensation

We participate in employee compensation plans sponsored by Verizon with awards of Verizon common stock. The structure of Verizon's stock incentive plans does not provide for the separate determination of certain disclosures for our company. The required information is provided on a consolidated basis in Verizon's Annual Report on Form 10-K for the year ended December 31, 2005.

Prior to 2003, Verizon accounted for stock-based employee compensation under Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations, and followed the disclosure-only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation."

Effective January 1, 2003, Verizon adopted the fair value recognition provisions of SFAS No. 123, using the prospective method (as permitted under SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure") to all new awards granted, modified or settled after January 1, 2003. Under the prospective method, employee compensation expense in the first year will be recognized for new awards granted, modified, or settled. The options generally vest over a term of three years, therefore the expenses related to stock-based employee compensation included in the determination of net income for 2005 and 2004 are less than what would have been recorded if the fair value method was also applied to previously issued awards.

The effect on net income if the fair value method had been applied to all outstanding and unvested options in 2005 and 2004 was not material.

After-tax compensation expense for other stock-based compensation included in net income as reported for the years ended December 31, 2005 and 2004 was not material.

For additional information on assumptions used to determine the pro forma amounts as well as other information related to our stock-based compensation plans, see Verizon's Annual Report on Form 10-K for the year ended December 31, 2005.

## **Employee Benefit Plans**

We participate in the Verizon benefit plans. Under these 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.

In December 2005, we announced that Verizon management employees will no longer earn pension benefits or earn service towards the company retiree medical subsidy after June 30, 2006. 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 will receive an increased company match on their savings plan contributions. See Note 6 for additional information.

## **Income Taxes**

Verizon and its domestic subsidiaries, including us, file a consolidated federal income tax return. We participate in a tax sharing agreement with Verizon and remit tax payments to Verizon based on the respective tax liability on a separate company basis. Current and deferred tax expense is determined by applying the provisions of SFAS No. 109, "Accounting for Income Taxes," to each subsidiary as if it were a separate taxpayer.

We use the deferral method of accounting for investment tax credits earned prior to the repeal of investment tax credits by the Tax Reform Act of 1986. We also defer certain transitional credits earned after the repeal. We amortize these credits over the estimated service lives of the related assets as a reduction to the Provision for income taxes.

## **Derivative Instruments**

We employ risk management strategies to manage our exposure to fluctuations in interest rates. We do not hold derivatives for trading purposes.

In accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" and related amendments and interpretations, we measure all derivatives, including derivatives embedded in other financial instruments, at fair value and recognize them as either assets or liabilities on our 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.

## **Recent Accounting Pronouncements**

### *Stock-Based Compensation*

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123(R), "Share-Based Payment," which revises 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, Verizon adopted the fair value recognition provisions of SFAS No. 123. Verizon plans to adopt SFAS No. 123(R) effective January 1, 2006, using the modified prospective method and we expect that any impact will not be material on our results of operations or financial position.

## 2. PLANT, PROPERTY AND EQUIPMENT

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

|  | (dollars in millions) |                 |
|--|-----------------------|-----------------|
| <b>At December 31,</b>                       | <b>2005</b>           | <b>2004</b>     |
| Land   | \$ 37                 | \$ 37           |
| Buildings                                    | 1,122                 | 1,107           |
| Central office equipment                     | 7,785                 | 7,866           |
| Outside communications plant                 | 7,725                 | 7,401           |
| Furniture, vehicles and other work equipment | 747                   | 748             |
| Construction-in-progress                     | 236                   | 204             |
| Other  | 180                   | 242             |
|  | <b>17,832</b>         | <b>17,605</b>   |
| Accumulated depreciation                     | <b>(11,686)</b>       | <b>(11,222)</b> |
| Total  | <b>\$ 6,146</b>       | <b>\$ 6,383</b> |

## 3. LEASES

We lease certain facilities and equipment for use in our operations under both capital and operating leases. We did not incur any initial capital lease obligations in 2005 and 2004.

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

|                          | (dollars in millions) |             |
|--------------------------|-----------------------|-------------|
| <b>At December 31,</b>   | <b>2005</b>           | <b>2004</b> |
| Capital leases           | \$ 5                  | \$ 1        |
| Accumulated amortization | ---                   | ---         |
| Total                    | <b>\$ 5</b>           | <b>\$ 1</b> |

Total rent expense amounted to \$200 million in 2005 and \$208 million in 2004. Of these amounts, \$128 million in 2005 and \$134 million in 2004 were lease payments to affiliated companies for land and buildings.

This table displays the aggregate minimum rental commitments under noncancelable leases for the periods shown at December 31, 2005:

|   | (dollars in millions) |                         |
|---|-----------------------|-------------------------|
| <b>Years</b>                              | <b>Capital Leases</b> | <b>Operating Leases</b> |
| 2006                                      | \$ 1                  | \$ 44                   |
| 2007                                      | 1                     | 40                      |
| 2008                                      | 1                     | 33                      |
| 2009                                      | 1                     | 30                      |
| 2010                                      | 1                     | 23                      |
| Thereafter                                | 2                     | 23                      |
| Total minimum rental commitments          | 7                     | \$ 193                  |
| Less interest and executory costs         | (3)                   |                         |
| Present value of minimum lease payments   | 4                     |                         |
| Less current installments                 | ---                   |                         |
| Long-term obligation at December 31, 2005 | <b>\$ 4</b>           |                         |

#### 4. DEBT

##### Debt Maturing Within One Year

Debt maturing within one year consists of the following at December 31:

|  | (dollars in millions) |               |
|--|-----------------------|---------------|
|  | 2005                  | 2004          |
| Note payable to affiliate (VNFC)   | \$ 470                | \$ 168        |
| Long-term debt maturing within one year                                  | 1                     | ---           |
| Total debt maturing within one year                                      | <u>\$ 471</u>         | <u>\$ 168</u> |
| Weighted average interest rate for notes payable outstanding at year-end | 4.39%                 | 2.2%          |

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

##### Long-Term Debt

Long-term debt consists principally of debentures and notes that we have issued. Interest rates and maturities of the amounts outstanding are as follows at December 31:

|  | (dollars in millions) |          |                 |                 |
|--|-----------------------|----------|-----------------|-----------------|
| Description  | Interest Rate         | Maturity | 2005            | 2004            |
| Ten year debenture                                       | 6 1/2%                | 2011     | \$ 1,026        | \$ 1,045        |
| Ten year debenture                                       | 4 3/4                 | 2013     | 300             | 300             |
| Thirty year debenture                                    | 6 7/8                 | 2023     | ---             | 250             |
| Forty year debenture                                     | 7 7/8                 | 2029     | 349             | 349             |
| Forty year debenture                                     | 7                     | 2042     | 480             | 480             |
| Seven year note payable                                  | 7.65                  | 2007     | 125             | 125             |
| Ten year note payable                                    | 5 7/8                 | 2009     | 200             | 200             |
|  |                       |          | <u>2,480</u>    | <u>2,749</u>    |
| Other – long-term debt                                   | 8                     | 2011     | 3               | 3               |
| Unamortized discount and premium, net                    |                       |          | (4)             | (7)             |
| Note payable with affiliate (VNSHI)                      | 4.91                  | 2009     | 220             | 220             |
| Capital lease obligations - average rate 19.36% and 6.5% |                       |          | 4               | 1               |
| Total long-term debt, including current maturities       |                       |          | <u>2,703</u>    | <u>2,966</u>    |
| Less maturing within one year                            |                       |          | (1)             | ---             |
| Total long-term debt                                     |                       |          | <u>\$ 2,702</u> | <u>\$ 2,966</u> |

The aggregate principal amount of bonds and debentures that may be issued is subject to the restrictions and provisions of our indentures. None of the securities shown above were held in sinking or other special funds or pledged by us. Debt discounts on our outstanding long-term debt are amortized over the lives of the respective issues.

We are in compliance with all of our debt covenants.

During the third quarter of 2005, we redeemed the entire outstanding principal amount of our \$250 million 6 7/8% debentures due on October 1, 2023. We recorded a pretax loss of \$10 million to other income and (expense), net due to this redemption.

On January 30, 2004, we issued a \$220 million promissory note to an affiliated company Verizon NSI Holdings Inc. (VNSHI). The note matures on January 30, 2009 and carries a floating interest rate priced at 3 month LIBOR plus 37bps, reset and paid quarterly.

Maturities of long-term debt outstanding at December 31, 2005, excluding capital lease obligations and unamortized discount and premium are as follows:

| Years                            | (dollars in millions) |
|----------------------------------|-----------------------|
| 2006                             | \$ ---                |
| 2007                             | 125                   |
| 2008                             | ---                   |
| 2009                             | 420                   |
| 2010                             | ---                   |
| Thereafter                       | 2,158                 |
| Total long-term debt outstanding | <u>\$ 2,703</u>       |

## 5. FINANCIAL INSTRUMENTS

### Derivatives

The ongoing effect of SFAS No. 133 and related amendments and interpretations on our financial statements will be determined each quarter by several factors, including the specific hedging instruments in place and their relationships to hedged items, as well as market conditions at the end of each period. For the years ended December 31, 2005 and December 31, 2004, the mark to market of our interest rate swaps did not have a material effect on our results of operations or financial position.

We have entered into domestic interest rate swaps to achieve a targeted mix of fixed and variable rate debt. 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 counterparties to the interest rate swap agreements are major financial institutions. These financial institutions have been accorded high ratings by primary rating agencies. We limit the dollar amount of contracts entered into with any one financial institution and monitor the credit ratings of these counterparties. We generally do not give or receive collateral on an interest rate swap agreement 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 position.

### Concentrations of Credit Risk

Financial instruments that subject us to concentrations of credit risk consist primarily of short-term investments, trade receivables and interest rate swap agreements. Concentrations of credit risk with respect to trade receivables, other than those from AT&T, are limited due to the large number of customers. We generated revenues from services provided to AT&T (primarily network access and billing and collection) of \$205 million in 2005 and \$226 million in 2004.

### Fair Values of Financial Instruments

The table below provides additional information about our material financial instruments at December 31:

| Financial Instrument  | Valuation Method                              |            |                 |            |
|---|---|------------|-----------------|------------|
| Note payable to affiliate (VNFC) and short-term investments | Carrying amounts                              |            |                 |            |
| Debt and interest rate swaps (excluding capital leases)     | Future cash flows discounted at current rates |            |                 |            |
|   | (dollars in millions)                         |            |                 |            |
|   | 2005  |            | 2004            |            |
|   | Carrying Amount                               | Fair Value | Carrying Amount | Fair Value |
| Debt, interest rate swaps and notes payable to affiliates   | \$ 3,144                                      | \$ 3,194   | \$ 3,088        | \$ 3,262   |

## 6. EMPLOYEE BENEFITS



We participate in Verizon's benefit plans. Verizon maintains noncontributory defined benefit pension plans for many of our management and associate 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 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 December 2005, Verizon announced that Verizon management employees will no longer earn pension benefits or earn service towards the company retiree medical subsidy after June 30, 2006. 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 will receive an increased company match on their savings plan contributions.

The structure of Verizon's benefit plans does not provide for the separate determination of certain disclosures for our company. The required information is provided on a consolidated basis in Verizon's Annual Report on Form 10-K for the year ended December 31, 2005.

### Pension and Other Postretirement Benefits

Pension and other postretirement benefits for the majority of our employees are subject to collective bargaining agreements. Approximately 86% of our employees (associates) are covered by collective bargaining agreements. Modifications in benefits have been bargained from time to time, and Verizon may also periodically amend the benefits in the management plans.

### Benefit Cost

| Years ended December 31,           | (dollars in millions) |        |                      |        |
|------------------------------------|-----------------------|--------|----------------------|--------|
|                                    | Pension               |        | Health Care and Life |        |
|                                    | 2005                  | 2004   | 2005                 | 2004   |
| Net periodic benefit (income) cost | \$ 1                  | \$ (2) | \$ 283               | \$ 233 |
| Settlement loss (gain)             | ---                   | 35     | ---                  | ---    |
| Curtailment loss (gain)            | 36                    | ---    | (23)                 | ---    |
| Subtotal                           | 36                    | 35     | (23)                 | ---    |
| Total (income) cost                | \$ 37                 | \$ 33  | \$ 260               | \$ 233 |

In 2005 as a result of our announcement regarding management retiree benefits, we recorded expense of \$36 million for pension curtailments and income of \$23 million for retiree medical curtailments. We recorded pension settlement losses of \$35 million in 2004 as lump-sum payments exceeded the threshold of service and interest costs. The settlement and curtailment of pension and retiree medical obligations are recorded in accordance with SFAS No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Pension Plans and for Termination Benefits" and SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other than Pensions."

Amounts recognized in the balance sheets at December 31 consist of:

|                                      | (dollars in millions) |       |                      |        |
|--------------------------------------|-----------------------|-------|----------------------|--------|
|                                      | Pension               |       | Health Care and Life |        |
|                                      | 2005                  | 2004  | 2005                 | 2004   |
| Prepaid pension asset                | \$102                 | \$101 | \$ ---               | \$ --- |
| Employee benefit obligations         | 641                   | 784   | 1,201                | 1,108  |
| Other assets                         | 140                   | 139   | ---                  | ---    |
| Accumulated other comprehensive loss | 295                   | 362   | ---                  | ---    |

The changes in the employee benefit asset and obligations from year to year were caused by a number of factors, including changes in actuarial assumptions (see Assumptions), curtailments and settlements.

We evaluate each pension plan to determine whether any additional minimum liability is required. As a result of changes in interest rates and investment returns, an adjustment to the additional minimum pension liability was required for the

## Verizon New England Inc.

North Associate Plan. The adjustment in the liability is recorded as a charge or (credit) to Accumulated Other Comprehensive Loss, net of tax, in shareowners' investment in the consolidated balance sheets.

(dollars in millions)

| Years ended December 31,   | Pension |        |
|--|---------|--------|
|  | 2005    | 2004   |
| Increase (decrease) in minimum liability included in other comprehensive income (loss), before tax | \$ (67) | \$ 123 |

### Assumptions

The actuarial assumptions used are based on market interest rates, past experience, and management's best estimate of future economic conditions. Changes in these assumptions may impact future benefit costs and obligations.

The weighted-average assumptions used in determining benefit obligations at December 31,

|  | Pension |       | Health Care and Life |       |
|--|---------|-------|----------------------|-------|
|  | 2005    | 2004  | 2005                 | 2004  |
| Discount rate                            | 5.75%   | 5.75% | 5.75%                | 5.75% |
| Rate of future increases in compensation | 4.00    | 5.00  | 4.00                 | 4.00  |

The weighted-average assumptions used in determining net periodic cost for years ended December 31,

|                                | Pension |       | Health Care and Life |       |
|--------------------------------|---------|-------|----------------------|-------|
|                                | 2005    | 2004  | 2005                 | 2004  |
| Discount rate                  | 5.75%   | 6.25% | 5.75%                | 6.25% |
| Expected return on plan assets | 8.50    | 8.50  | 7.75                 | 8.50  |
| Rate of compensation increase  | 5.00    | 5.00  | 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 at December 31,

|  | Health Care and Life |        |
|--|----------------------|--------|
|  | 2005                 | 2004   |
| Health care cost trend rate assumed for next year              | 10.00%               | 10.00% |
| Rate to which cost trend rate gradually declines               | 5.00%                | 5.00%  |
| Year the rate reaches level it is assumed to remain thereafter | 2010                 | 2009   |

### Savings Plans and Employee Stock Ownership Plans

Substantially all of our employees are eligible to participate in savings plans maintained by Verizon. Verizon maintains four leveraged employee stock ownership plans (ESOPs) for its management employees. The final debt service payments and related share allocations for two of our leveraged ESOPs were made in 2004. Under these plans, a certain percentage of eligible employee contributions are matched with shares of Verizon's common stock. We recognize savings plan cost based on our matching obligation attributed to our participating employees. In addition to the ESOPs, Verizon also maintains a savings plan for associate employees. We recorded total savings plan costs of \$34 million in 2005 and \$34 million in 2004.

### Severance Benefits

We maintain ongoing severance plans for both management and associate employees, which provide benefits to employees that are terminated. The costs for these plans are accounted for under SFAS No. 112, "Employers' Accounting for Postemployment Benefits—an amendment of FASB Statements No. 5 and 43." We accrue for severance benefits based on

## Verizon New England Inc.

the terms of our severance plan over the estimated service periods of the employees. The accruals are also based on the historical run-rate of actual severances and expectations for future severances.

The following table provides an analysis of our severance liability:

| (dollars in millions) |                   |                        |             |            |             |
|-----------------------|-------------------|------------------------|-------------|------------|-------------|
| Year                  | Beginning of Year | Charged to Expense (a) | Payments    | Other (b)  | End of Year |
| 2004                  | \$ 154            | \$ (3)                 | \$ (85)     | \$ ---     | \$ 66       |
| <b>2005</b>           | <b>66</b>         | <b>5</b>               | <b>(33)</b> | <b>---</b> | <b>38</b>   |

(a) Includes accruals for ongoing employee severance costs and special charges of \$3 million in 2005.

(b) Includes amounts reallocated to other Verizon affiliates. From time to time, Verizon must redistribute across its subsidiaries the amount of severance liability based on actual experience at the companies.

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

## 7. INCOME TAXES

The components of income tax expense (benefit) are presented in the following table:

| Years ended December 31,           |  | (dollars in millions) |         |
|------------------------------------|--|-----------------------|---------|
|                                    |  | 2005                  | 2004    |
| Current:                           |  |                       |         |
| Federal                            |  | <b>\$ 96</b>          | \$ (98) |
| State and local                    |  | <b>18</b>             | 4       |
|                                    |  | <b>114</b>            | (94)    |
| Deferred:                          |  |                       |         |
| Federal                            |  | <b>(64)</b>           | 130     |
| State and local                    |  | <b>(9)</b>            | 16      |
|                                    |  | <b>(73)</b>           | 146     |
| Investment tax credits             |  | <b>(1)</b>            | (2)     |
| Total income tax expense (benefit) |  | <b>\$ 40</b>          | \$ 50   |

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

| Years ended December 31,                        | 2005         | 2004   |
|---|--------------|--------|
| Statutory federal income tax rate               | <b>35.0%</b> | 35.0%  |
| State income taxes, net of federal tax benefits | <b>3.6</b>   | 6.5    |
| Investment tax credits                          | <b>(.6)</b>  | (.5)   |
| Equity investments                              | <b>(5.2)</b> | (10.6) |
| Other, net                                      | <b>(7.0)</b> | (4.6)  |
| Effective income tax rate                       | <b>25.8%</b> | 25.8%  |

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

| At December 31,                      |  | (dollars in millions) |          |
|--------------------------------------|--|-----------------------|----------|
|                                      |  | 2005                  | 2004     |
| Depreciation                         |  | <b>\$ 1,197</b>       | \$ 1,277 |
| Employee benefits                    |  | <b>(621)</b>          | (675)    |
| Allowance for uncollectible accounts |  | <b>(42)</b>           | (60)     |
| Investment tax credits               |  | <b>(7)</b>            | (8)      |
| Other, net                           |  | <b>(5)</b>            | 34       |

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|                            |        |        |
|----------------------------|--------|--------|
| Net deferred tax liability | \$ 522 | \$ 568 |
|----------------------------|--------|--------|

Employee benefits include \$488 million deferred tax asset at December 31, 2005 and \$466 million at December 31, 2004, related to postretirement benefit costs recognized under SFAS No. 106. This deferred tax asset will gradually be realized over the estimated lives of current retirees and employees.

### 8. TRANSACTIONS WITH AFFILIATES

Our financial statements include transactions with the following affiliates:

| Years Ended December 31,                          | 2005          | (dollars in millions)<br>2004 |
|---|---------------|-------------------------------|
| Operating revenues:                               |               |                               |
| Verizon Internet Services Inc.                    | \$ 244        | \$ 151                        |
| Verizon Wireless Inc.                             | 43            | 36                            |
| Verizon Long Distance                             | 50            | 48                            |
| Verizon Global Networks Inc.                      | 54            | 52                            |
| Verizon Services                                  | 26            | 20                            |
| Verizon Operating Telephone Companies             | 2             | 2                             |
| Other   | 7             | 6                             |
|   | <u>\$ 426</u> | <u>\$ 315</u>                 |
| Operating expenses:                               |               |                               |
| Verizon Services                                  | \$ 814        | \$ 821                        |
| Verizon Data Services Inc.                        | 52            | 58                            |
| Verizon Advanced Data Inc.                        | ---           | 12                            |
| Verizon Wireless Inc.                             | 2             | 3                             |
| Verizon Operating Telephone Companies             | 3             | 2                             |
| Other   | 2             | 3                             |
|   | <u>\$ 873</u> | <u>\$ 899</u>                 |
| Other income and (expense), net:                  |               |                               |
| Equity income (loss) from investees               | \$ 23         | \$ 59                         |
| Interest income from Verizon Services             | 2             | ---                           |
|   | <u>\$ 25</u>  | <u>\$ 59</u>                  |
| Interest expense:                                 |               |                               |
| Interest expense to Verizon Network Funding Corp. | \$ 9          | \$ 3                          |
| Interest expense to Verizon NSI Holdings Inc.     | 8             | 4                             |
|   | <u>\$ 17</u>  | <u>\$ 7</u>                   |
| Capital contribution from NYNEX                   | \$ 111        | \$ ---                        |
| Return of capital to NYNEX                        | 162           | 301                           |
| Dividends paid to NYNEX                           | 60            | 137                           |
| Dividends received from affiliates                | 31            | 37                            |

Outstanding balances with affiliates are reported on the balance sheets at December 31, 2005 and 2004 as Accounts Receivable - Affiliates, Note Payable to Affiliate, Accounts Payable and Accrued Liabilities – Affiliates and Long – term Debt – Note Payable to Affiliate.

### Verizon Services

Our operating revenues include transactions with Verizon Services (including Verizon Services Corp., Verizon Services Group and Verizon Corporate Services Group Inc.) for the provision of local telephone service and for the rental of facilities and equipment.

We have contractual arrangements with Verizon Services for the provision of various centralized services. These services are divided into two broad categories. The first category is comprised of network related services which generally benefit

## **Verizon New England Inc.**

only Verizon's operating telephone subsidiaries. These services include marketing, sales, legal, accounting, finance, data processing, materials management, procurement, labor relations, and staff support for various network operations. The second category is comprised of overhead and support services which generally benefit all subsidiaries of Verizon. Such services include corporate governance, corporate finance, external affairs, legal, media relations, employee communications, corporate advertising, human resources, and treasury. Costs may be either directly assigned to one subsidiary or allocated to more than one subsidiary based on functional reviews of the work performed.

### **Verizon Internet Services Inc.**

Our operating revenues include transactions with Verizon Internet Services Inc. (Verizon Internet Services) associated with the provision of network access and billing and collection services. These revenues are earned from Verizon Internet Services who utilizes our facilities to provide Internet access services to their customers.

### **Verizon Wireless Inc.**

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

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

### **Verizon Long Distance**

Our operating revenues include transactions with Verizon Long Distance who utilizes our facilities to provide long distance services to their customers. We record revenue in connection with the provision of billing and collection services, including programming charges associated with billing system changes.

### **Verizon Global Networks Inc.**

Our operating revenues include transactions with Verizon Global Networks Inc. (Global Networks) associated with the provision of network access services. These revenues are earned from Global Networks who utilizes our facilities to provide access and data transport services to their customers.

### **Verizon Operating Telephone Companies**

Our operating revenues and expenses include transactions with other Verizon Operating Telephone Companies. Revenues associated with transactions with these affiliates are primarily earned from the rental of our facilities and equipment. We also earn revenue from fees associated with the termination of their customer's calls on our network. In addition, we also recognize expenses associated with transactions with these affiliates. These costs are primarily associated with the rental of their facilities and equipment.

### **Verizon Advanced Data Inc.**

In 2004, we had a contractual arrangement with Verizon Advanced Data Inc. for the provision of various centralized services associated with advanced data services. These services were divided into two broad categories. The first category comprised of network related services which included provisioning, maintenance, engineering, and data processing for various network operations. The second category was comprised of overhead and support services which included finance, human resources, treasury, procurement, marketing, sales, and support staffs. The costs were allocated based on advanced data services revenues.

### Verizon Data Services Inc.

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

### Verizon Network Funding Corp. and Verizon NSI Holdings Inc.

We recognize interest expense/income in connection with a contractual agreement with an affiliated company, Verizon Network Funding Corp. (VNFC), for the provision of short-term financing and cash management services. VNFC issues commercial paper and obtains bank loans to fund the working capital requirements of Verizon's network services subsidiaries, including us, and invests funds in temporary investments on their behalf. We also recognized interest expense related to a promissory note held by Verizon NSI Holdings Inc.

### Other Affiliates

Other operating revenues and expenses include miscellaneous items of income and expense resulting from transactions with other affiliates. These transactions include the provision of local and network access services, billing and collection services, rental of facilities and equipment, electronic repair services, and sales and purchases of material and supplies. We also earn fees from an affiliate for usage of our directory listings.

## 9. ADDITIONAL FINANCIAL INFORMATION

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

|   | (dollars in millions) |          |
|---|-----------------------|----------|
| Years ended December 31,                  | 2005                  | 2004     |
| <b>Statements of Cash Flows:</b>          |                       |          |
| Cash paid (refunded) during the year for: |                       |          |
| Income taxes, net of amounts refunded     | \$ 175                | \$ (236) |
| Interest, net of amounts capitalized      | 156                   | 155      |
| <b>Statements of Income:</b>              |                       |          |
| Interest expense incurred                 | 184                   | 171      |
| Capitalized interest                      | (12)                  | (6)      |
| Advertising expense                       | 19                    | 22       |
| Depreciation expense                      | 982                   | 1,035    |

Advertising expense includes \$19 million in 2005 and \$22 million in 2004 allocated to us by Verizon Services.

## 10. STRATEGIC ACTIONS

During the third quarter of 2005, we redeemed the entire outstanding principal amount of our \$250 million 6 7/8% debentures due on October 1, 2023. We recorded a pretax loss of \$10 million to other income and (expense), net due to this redemption.

In the second quarter of 2004, we recorded a pretax expense credit of \$30.0 million resulting from the favorable resolution of pre-bankruptcy amounts due from MCI, Inc. Previously reached settlement agreements became fully effective when MCI emerged from bankruptcy proceedings in the second quarter of 2004.

## **11. COMMITMENTS AND CONTINGENCIES**

Various legal actions and regulatory proceedings are pending to which we are a party and claims which, if asserted, may lead to other legal actions. We have established reserves for specific liabilities in connection with regulatory and legal matters that we currently deem to be probable and estimable. We do not expect that the ultimate resolution of pending regulatory and legal matters in future periods will have a material effect on our financial condition, but it could have a material effect on our results of operations.

From time to time, state regulatory decisions require us to assure customers that we will provide a level of service performance that falls within prescribed parameters. There are penalties associated with failing to meet those service parameters and we, from time to time, pay such penalties. We do not expect these penalties to have a material effect on our financial condition, but they could have a material effect on our results of operations.

## **12. SUBSEQUENT EVENTS**

On February 1, 2006, we returned capital in the amount of \$17 million to our parent, NYNEX.