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 domestic wireline telecommunications business provides local telephone services, including broadband, in 28 states and Washington, D.C. and nationwide long-distance and other communications products and services. 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 wireless networks. Information Services operates directory publishing businesses and provides electronic commerce services. Verizon's International segment includes wireline and wireless communications operations and investments in the Americas and Europe. In connection with the closing of the merger with MCI, Inc. (MCI), which occurred on January 6, 2006, Verizon now owns and operates one of the most expansive end-to-end global Internet Protocol (IP) networks which includes over 270,000 domestic and 360,000 international route miles of fiber optic cable and provides access to over 140 countries worldwide. Operating as Verizon Business, we are now better able to provide next-generation IP network services to medium and large businesses and government customers. Stressing diversity and commitment to the communities in which we operate, Verizon has a highly diverse workforce of 250,000 employees, including Verizon Business.

The sections that follow provide information about the important aspects of our operations and investments, both at the consolidated and segment levels, and include discussions of our results of operations, financial position and sources and uses of cash. In addition, we have highlighted key trends and uncertainties to the extent practicable. The content and organization of the financial and non-financial data presented in these sections are consistent with information used by our chief operating decision makers for, among other purposes, evaluating performance and allocating resources. We also monitor several key economic indicators as well as the state of the economy in general, primarily in the United States where the majority of our operations are located, in evaluating our operating results and analyzing and understanding business trends. While most key economic indicators, including gross domestic product, impact our operations to some degree, we have noted higher correlations to housing starts, non-farm employment, personal consumption expenditures and capital spending, as well as more general economic indicators such as inflation and unemployment rates.

Our results of operations, financial position and sources and uses of cash in the current and future periods reflect Verizon management's focus on the following four key areas:

- Revenue Growth – Our emphasis is on revenue transformation, devoting more resources to higher growth markets such as wireless, wireline broadband connections, including digital subscriber lines (DSL) and fiber optics to the home (Verizon's FiOS data product), long distance and other data services as well as expanded services to business markets, rather than to traditional wireline voice services, where we have been experiencing access line losses. In 2005, revenues from these growth areas increased by 15% compared to 2004 and represent 58% of our total revenues, up from 53% of total revenues in 2004 and 47% in 2003. Verizon reported consolidated revenue growth of 5.4% in 2005 compared to 2004, led by 16.8% higher revenue at Domestic Wireless and 10.5% total data revenue growth at Domestic Telecom. Verizon added 7,521,000 wireless customers, 1,659,000 broadband connections and 992,000 long distance lines. Excluding the revenues of Verizon's Hawaii wireline and directory operations, which were sold in 2005, consolidated revenue growth would have been 6.0% in 2005 compared to 2004.
- Operational Efficiency – While focusing resources on growth markets, we are continually challenging our management team to lower expenses, particularly through technology-assisted productivity improvements including self-service initiatives. The effect of these and other efforts, such as the 2003 labor agreements and voluntary separation plans, real estate consolidations and call center routing improvements, has been to significantly change the company's cost structure and maintain stable operating income margins. Real estate consolidations include our decision to establish Verizon Center for the leadership team. In 2005, Verizon restructured its management retirement benefit plans such that management employees will no longer earn pension benefits or earn service towards the company retiree medical subsidy after June 30, 2006, after receiving an 18-month enhancement of the value of their pension and retiree medical benefits, but will receive higher savings plan matching contributions. The net effect of these management benefit plan changes is expected to be a reduction in pretax benefit expenses of approximately $3 billion over 10 years. In addition, Domestic Telecom's salary and benefits expenses have declined in 2005 and 2004 as a result of the 2003 voluntary separation plan. Workforce levels in 2005 and 2004 increased to 217,000 and 209,000, respectively, from 200,000 as of December 31, 2003 driven by wireless and wireline broadband growth markets.
- Capital Allocation – Verizon's capital expenditures continue 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 home, as well as expanded services to business markets are examples of areas of capital expenditures in support of these growth markets. In 2005, Verizon achieved targeted increased capital expenditures of $15,324 million compared to 2004 capital expenditures of $13,259 million in support of growth initiatives. Approximately 69% of 2005 capital expenditures related to growth initiatives. In 2006, Verizon management expects capital expenditures to be in the range of $15.4 billion to $15.7 billion, excluding capital expenditures associated with MCI. Including MCI, capital expenditures are expected to be $17.0 billion to $17.4 billion in 2006. In addition to capital expenditures, Domestic Wireless continues to acquire wireless spectrum in support of expanding data applications and customer base. In 2005, this included participation in the Federal Communications Commission (FCC) Auction 58 and the NextWave Telecom Inc. (NextWave) and Qwest Wireless, LLC acquisitions.
- Cash Flow Generation – The financial statements reflect the emphasis of management on not only directing resources to growth markets, but also using cash provided by our operating and investing activities for the repayment of debt in addition to providing a competitive dividend to our shareowners. In 2005, Verizon increased its dividend by 5.2% to $1.62 per share from $1.54 per share in 2004. At December 31, 2005, Verizon's total debt was $39,010 million, a decrease of $257 million from $39,267 million at December 31, 2004. However, Verizon's balance of cash and cash equivalents at December 31, 2005 of $776 million declined by $1,514 million from $2,290 million at December 31, 2004.

Supporting these key focus areas are continuing initiatives to package more effectively and add more value to our products and services. In 2004, Verizon announced a deployment expansion of FiOS in several states in our service territory. As of the end of 2005, we have met our goal of passing three million premises by the end of 2005. We have achieved a penetration rate of 9% in markets where Verizon has been actively marketing for more than six months and 14% in markets where we have been marketing for nine months, and continue to progress toward our goal of reaching 30% penetration in five years. In 2005, Verizon began offering video on the FiOS network in three markets and expects to begin offering video services in markets in New York, Massachusetts and California in the first quarter of 2006. In Keller, Texas, the first market that FiOS TV has been offered, we have achieved a 21% penetration rate in four months. FiOS TV includes a collection of all-digital programming with more than 375 channels, 47 music channels and 20 high-definition television channels. Innovative product bundles 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 that have contributed to declining Domestic Telecom revenues over the past several years.

Verizon Business will serve medium and large businesses and government customers from related business operations within Domestic Telecom that market communications and information technology and services to large businesses and governments and MCI's global, corporate and government customers group. Beginning in 2006, Verizon will be positioned as a global communications solutions provider. In connection with this merger, Verizon expects to achieve merger synergies with a net present value of approximately $8 billion; annual synergies over the next three years are estimated to be $550 million in 2006, $825 million in 2007 and $1,100 million in 2008. Integration costs over that same three year period are estimated to be $400 million in 2006, $325 million in 2007 and $275 million in 2008 and integration capital expenditures are estimated to be between $1.6 billion and $1.9 billion, of which $550 million is expected to be spent in 2006. Examples of these synergies include moving more voice and data traffic, such as long-haul long distance traffic, onto Verizon's networks rather than paying third party access providers and duplicate work force reductions.

At Domestic Wireless, we will continue to execute on the fundamentals of our network superiority and value proposition to deliver growth for the business while at the same time provide new and innovative products and services for our customers. We are continuing to expand the areas where we are offering BroadbandAccess, our EV-DO service. During 2005, Domestic Wireless expanded its broadband network to 180 major metropolitan areas, covering over 150 million people across the United States. We have achieved our goal of reaching approximately one-half of the U.S. population by the end of 2005. During 2005, we launched V CAST, our consumer broadband wireless service offering, which provides customers with unlimited access to a variety of video and gaming content on EV-DO handsets. In the first year of V CAST service, customers received 11.8 million downloads. Beginning in 2006, Domestic Wireless launched V CAST Music, a comprehensive mobile music service in which customers can download music over the air directly to their wireless phones and to their personal computers.

In December 2005, Verizon announced that it is exploring divesting Information Services through a spin-off, sale or other strategic transaction. However, since this process is still ongoing, Information Services' results of operations, financial position and cash flows remain in Verizon's continuing operations.

CONSOLIDATED RESULTS OF OPERATIONS

In this section, we discuss our overall results of operations and highlight special and non-recurring items. In the following section, we review the performance of our four reportable segments. We exclude the effects of the special and non-recurring items from the segments' results of operations since management does not consider them in assessing segment performance, due primarily to their non-recurring and/or non-operational nature. We believe that this presentation will assist readers in better understanding our results of operations and trends from period to period. This section on consolidated results of operations carries forward the segment results, which exclude the special and non-recurring items, and highlights and describes those items separately to ensure consistency of presentation in this section and the "Segment Results of Operations" section.

The special and non-recurring items include operating results through the sale date of our wireline and directory businesses in Hawaii which operated approximately 700,000 switched access lines and were sold in the second quarter of 2005. These operating results are not in segment results of operations to enhance comparability. Segment results also do not include discontinued operations in segment income. See "Other Consolidated Results – Discontinued Operations" for a discussion of these results of operations. In addition, consolidated operating results include several other events and transactions that are highlighted because of their non-recurring and/or non-operational nature. See "Special Items" for additional discussion of these items.

Consolidated Revenues

(dollars in millions)

Years Ended December 31,	**2005**	2004	% Change	2004	2003	% Change
Domestic Telecom	**$ 37,616**	$ 38,021	(1.1)%	$ 38,021	$ 39,055	(2.6)%
Domestic Wireless	**32,301**	27,662	16.8	27,662	22,489	23.0
Information Services	**3,452**	3,549	(2.7)	3,549	3,763	(5.7)
International	**2,193**	2,014	8.9	2,014	1,949	3.3
Corporate & Other	**(652)**	(558)	16.8	(558)	(402)	38.8
Revenues of Hawaii operations sold	**202**	595	(66.1)	595	614	(3.1)
Consolidated Revenues	**$ 75,112**	$ 71,283	5.4	$ 71,283	$ 67,468	5.7

2005 Compared to 2004

Consolidated revenues in 2005 were higher by $3,829 million, or 5.4% compared to 2004 revenues. This increase was primarily the result of significantly higher revenues at Domestic Wireless and higher International revenues, partially offset by lower revenues at Domestic Telecom and the sale of Hawaii operations in the second quarter of 2005.

Domestic Wireless's revenues increased by $4,639 million, or 16.8% in 2005 compared to 2004 due to a 7.5 million, or 17.2% increase in customers to 51.3 million as of December 31, 2005 and higher equipment and other revenue, partially offset by a decrease in average revenue per customer per month. Increased equipment and other revenues was principally the result of an increase in wireless devices sold together with an increase in revenue per unit sold. Average revenue per customer per month 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. Data revenues were $2,243 million in 2005 compared to $1,116 million in 2004. Average minutes of use (MOUs) per customer increased to 665, or 16.1% in 2005 compared to 2004.

Domestic Telecom'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. The decline in local service revenues of $669 million, or 3.7% in 2005 was mainly due to lower demand and usage of our basic local exchange and accompanying services, as reflected by declines in switched access lines in service of 6.7% in 2005, driven by the effects of competition and technology substitution. Our network access revenues increased by $159 million, or 1.3% in 2005 principally due to increased DSL and carrier special access revenues, partially offset by the impact of decreasing switched MOUs and access lines and mandatory price reductions associated with federal and state price cap filings and other regulatory decisions. 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. Switched MOUs declined by 7.1% in 2005 compared to 2004 reflecting the impact of access line loss and technology substitution. Network access revenues also increased in 2005 as a result of a favorable adjustment associated with a recent regulatory decision. Long distance service revenues increased $206 million, or 5.0% in 2005 principally as a result of customer growth from our interLATA long distance services. In 2005, we added 1.0 million long distance lines, for a total of 18.4 million long distance lines nationwide, representing a 5.7% increase from December 31, 2004. The introduction of our Freedom service plans continues to stimulate growth in long distance services. As of December 31, 2005, approximately 53% of our local wireline customers have chosen Verizon as their long distance carrier.

Lower revenue of Hawaii operations sold of $393 million, or 66.1% 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.

2004 Compared to 2003

Consolidated revenues in 2004 were higher by $3,815 million, or 5.7% compared to 2003 revenues. This increase was primarily the result of significantly higher revenues at Domestic Wireless, partially offset by lower revenues at Domestic Telecom.

Domestic Wireless's revenues increased by $5,173 million, or 23.0% in 2004 compared to 2003 as a result of 6.3 million net customer additions and higher revenue per customer per month, including higher data revenue per customer. Average revenue per customer per month was $50.22, or 2.8% higher in 2004 compared to 2003, primarily due to a larger number of customers on higher access price plan offerings as well as an increase in data revenues per subscriber. Data revenues were $1,116 million in 2004 compared to $449 million in 2003. These increases were partially offset by decreased roaming revenue due to bundled pricing.

Domestic Telecom's revenues in 2004 were lower than 2003 by $1,034 million, or 2.6% primarily due to lower local and network access services, partially offset by higher long distance revenues. The decline in local service revenues of $916 million, or 4.8% in 2004 was mainly due to lower demand and usage of our basic local exchange and accompanying services, as reflected by a decline in switched access lines in service of 4.6% in 2004. These revenue declines were mainly driven by the effects of competition, regulatory pricing rules for unbundled network elements (UNEs) and technology substitution. Network access revenues declined by $486 million, or 3.9% in 2004 compared to 2003 principally due to decreasing MOUs and access lines, as well as mandatory price reductions associated with federal and state price cap filings and other regulatory decisions. Switched MOUs declined in 2004 by 5.7% compared to 2003, reflecting the impact of access line loss and wireless substitution. Domestic Telecom's long distance service revenues increased $390 million, or 10.4% in 2004 compared to 2003, principally as a result of customer growth from our interLATA long distance services. In 2004, we added 2.3 million long distance lines, for a total of 17.7 million long distance lines nationwide, representing a 15.5% increase from December 31, 2003.

Consolidated Operating Expenses

(dollars in millions)

Years Ended December 31,	2005	2004	% Change	2004	2003	% Change
Cost of services and sales	**$ 25,469**	$ 23,168	9.9%	$ 23,168	$ 21,701	6.8%
Selling, general and administrative expense	**21,312**	21,088	1.1	21,088	24,894	(15.3)
Depreciation and amortization expense	**14,047**	13,910	1.0	13,910	13,607	2.2
Sales of businesses, net	**(530)**	–	nm	–	(141)	(100.0)
Consolidated Operating Expenses	**$ 60,298**	$ 58,166	3.7	$ 58,166	$ 60,061	(3.2)

nm – Not meaningful

2005 Compared to 2004

Cost of Services and Sales

Cost of services and sales increased by $2,301 million, or 9.9% 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 $399 million in 2005 (primarily in cost of services and sales) compared to 2004. Higher direct wireless network charges resulted from increased MOUs 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 Domestic Telecom 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 was $224 million, or 1.1% higher 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. In addition, 2004 included the favorable resolution of a 2003 Telecomunicaciones de Puerto Rico, Inc. (TELPRI) charge. Special and non-recurring items in selling, general and administrative expenses in 2005 were $315 million compared to special and non-recurring items in 2004 of $995 million.

Special and non-recurring items in 2005 included a pretax impairment charge of $125 million pertaining to our leasing operations for airplanes 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 $815 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 $137 million, or 1.0% 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.

2004 Compared to 2003

Cost of Services and Sales

Cost of services and sales increased by $1,467 million, or 6.8% in 2004 compared to 2003. This increase was principally due to increased pension and other postretirement benefit costs, primarily at Domestic Telecom, higher direct wireless network charges and customer handset costs at Domestic Wireless as a result of customer base growth and higher costs at Domestic Telecom associated with growth businesses, partially offset by lower workforce levels and other cost reductions at Domestic Telecom.

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 $1,166 million in 2004 (primarily in cost of services and sales) compared to 2003. Costs increased in 2004 at Domestic Wireless primarily due to higher direct wireless network charges resulting from increased MOUs in 2004 compared to 2003 and higher cost of equipment sales due to an increase in handsets sold, driven by growth in customer additions and an increase in equipment upgrades in 2004 compared to 2003. Higher customer premises equipment and other costs associated with our growth businesses at Domestic Telecom such as long distance and DSL also contributed to the increase in cost of services and sales. These expense increases were partially offset by the effect of workforce reductions. In 2004, Domestic Telecom benefited from an average of approximately 15,000 fewer employees compared to 2003 levels. This reduction in employees was principally due to a voluntary separation plan, which was completed in November 2003. Costs in 2004 were also impacted by lower interconnection expense charged by CLECs and settlements with carriers, including the MCI settlement recorded in the second quarter of 2004.

Selling, General and Administrative Expense

Selling, general and administrative expense was $3,806 million, or 15.3% lower in 2004 compared to 2003. This decrease was driven by lower special charges in 2004 by $5,390 million and lower costs

at Domestic Telecom associated with workforce reductions and by lower bad debt expense, partially offset by cost increases at Domestic Wireless and Domestic Telecom. Special charges related to severance, pension and benefits were $4,607 million lower in 2004 compared to 2003, driven primarily by fourth quarter 2003 charges incurred in connection with the voluntary separation of approximately 21,000 employees. Lease impairment and other special charges in 2003 were $496 million, compared to other special credits, net of $91 million in 2004.

Domestic Wireless's salary and benefits expense increased by $821 million, including a $447 million increase in costs incurred in 2004 related to that segment's long-term incentive program, and by an increase in the employee base, primarily in the customer care and sales channels. Also contributing to the increase at Domestic Wireless were higher sales commissions in our direct and indirect channels primarily related to an increase in customer additions and renewals during the year. Cost increases in 2004 at Domestic Telecom included higher net pension and benefit costs, as described in costs of services and sales above, additional other employee benefit costs and higher professional and general costs.

Depreciation and Amortization Expense
Depreciation and amortization expense increased by $303 million, or 2.2% in 2004 compared to 2003. This increase was primarily due to increased depreciation expense related to the increase in depreciable assets, partially offset by lower rates of depreciation on telephone plant.

Sales of Businesses, Net
In 2003, Information Services recorded a pretax gain of $141 million primarily related to the sale of its European directory publication operations in Austria, the Czech Republic, Gibraltar, Hungary, Poland and Slovakia.

Pension and Other Postretirement Benefits
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 expected rate of return on pension plan assets remained 8.50% while the expected rate of return on postretirement benefit plan assets was lowered to 7.75% from 8.50% in 2004. The medical cost trend rate was 10% for 2005. For 2004 pension and other postretirement benefit costs, the discount rate assumption was lowered to 6.25% from 6.75% in 2003, consistent with interest rate levels at the end of 2003. The expected rate of return on pension and postretirement benefit plan assets was maintained at 8.50%. The medical cost trend rate assumption was 10% in 2004.

For 2006 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 maintained at 5.75%, consistent with interest rate levels at the end of 2005. The expected rate of return on pension plan assets will remain 8.50% while the expected rate of return on postretirement benefit plan assets will increase to 8.25% from 7.75% in 2005. The medical cost trend rate will be 10% for 2006.

Verizon's union contracts contain health care cost provisions that limit company payments toward health care costs to specific dollar amounts (known as caps). These caps pertain to both current and future retirees, and have a significant impact on the actuarial valuation of postretirement benefits. These caps have been included in union contracts for several years, but have exceeded the annual health care cost every year until 2003. During the negotiation of new collective bargaining agreements for union contracts covering 79,000 unionized employees in the second half of 2003, the date health care caps would become effective was extended and the dollar amounts of the caps were increased. In the fourth quarter of 2003, we began recording retiree health care costs as if there were no caps, in connection with the ratification of the union contracts. Since the caps are an assumption included in the actuarial determination of Verizon's postretirement obligation, the effect of extending and increasing the caps increased the accumulated postretirement obligation in the fourth quarter of 2003 by $5,158 million, which increased the annual postretirement benefit expense by $667 million in 2004.

During 2005, we recorded net pension and postretirement benefit expense of $1,376 million ($839 million after-tax, or $.30 per diluted share), compared to net pension and postretirement benefit expense of $977 million ($596 million after-tax, or $.21 per diluted share) in 2004 and net pension and postretirement benefit income of $(189) million ($115 million after-tax, or $.04 per diluted share) in 2003.

Other Consolidated Results

Equity in Earnings of Unconsolidated Businesses
Equity in earnings of unconsolidated businesses decreased by $1,002 million 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 Compañía Anónima Nacional Teléfonos de Venezuela (CANTV), partially offset by higher tax benefits and operational results at our Italian investment Vodafone Omnitel N.V. (Vodafone Omnitel).

Equity in earnings of unconsolidated businesses increased by $413 million in 2004 compared to 2003. The increase was primarily due to a pretax gain of $787 million recorded on the sale of our 20.5% interest in TELUS in 2004. This increase was partially offset by tax benefits in 2003 from a reorganization at Vodafone Omnitel and a contribution tax reversal benefiting Vodafone Omnitel. In early 2003, Vodafone Group Plc (Vodafone) completed the reorganization of several of its investments in Vodafone Omnitel that resulted in the consolidation of several holding companies. As a result, the intangible assets held by these holding companies were transferred to Vodafone Omnitel and became tax-deductible for Italian tax purposes. It was determined that this intangible asset was deductible over a three-year period as a customer database. At the time that the reorganization was effective, Vodafone Omnitel began recording the tax benefit associated with the newly created intangible asset in its reported income and Verizon recorded its share of that tax benefit. Separately, in September 2003, the European Court of Justice ruled that an Italian contribution tax on the use of wireless frequencies, established by Italy in 1998, was contrary to European Union law and that the Italian government must refund amounts previously paid by Italian wireless carriers. During the fourth quarter of 2003, Verizon recorded its share of the earnings impact of this favorable ruling. In 2003, we also recorded a pretax gain of $348 million in connection with the sale of our interest in Eurotel Praha, spol. s r.o. (Eurotel Praha), a wireless joint venture in the Czech Republic.

Income From Other Unconsolidated Businesses

Income from other unconsolidated businesses increased by $17 million in 2005 compared to 2004 and decreased by $256 million in 2004 compared to 2003. The decrease in 2004 was primarily driven by a $176 million net gain recorded in 2003 as a result of a payment received in connection with the liquidation of Genuity Inc. (Genuity) and the sales of shares of investments, including Taiwan Cellular Corporation (TCC) and TelecomAsia Corporation Public Company Limited (TelecomAsia) in 2003. This decrease was partially offset by a pretax gain of $43 million recorded in connection with the sale of our investment in Iowa Telecom preferred stock and TCC share sales in 2004.

Other Income and (Expense), Net (dollars in millions)

Years Ended December 31,	**2005**	2004	2003
Interest income	**$ 120**	$ 116	$ 95
Foreign exchange gains (losses), net	**10**	(13)	(11)
Other, net	**107**	(81)	(47)
Total	**$ 237**	$ 22	$ 37

In 2005, the changes in Other Income and (Expense), Net were primarily due to other, net income in the current year compared to other, net expenses in the prior year. Other, net in 2005 includes a pretax gain on the sale of a small international business, leased asset gains and investment gains. Other, net in 2005 and 2004 include expenses of $14 million and $55 million, respectively, related to the early retirement of debt. The changes in Other Income and (Expense), Net in 2004 were primarily due to higher other, net expenses, partially offset by higher interest income. Other, net in 2004 and 2003 includes expenses of $55 million and $61 million, respectively, related to the early retirement of debt.

Interest Expense (dollars in millions)

Years Ended December 31,	**2005**	2004	2003
Total interest expense	**$ 2,180**	$ 2,384	$ 2,797
Capitalized interest costs	**352**	177	144
Total interest costs on debt balances	**$ 2,532**	$ 2,561	$ 2,941
Average debt outstanding	**$ 39,939**	$ 42,555	$ 49,181
Effective interest rate	**6.3%**	6.0%	6.0%

In 2005, the decrease in interest costs was primarily due to a reduction in average debt level of $2,616 million compared to 2004, partially offset by higher average interest rates. Higher capital expenditures contributed to higher capitalized interest costs. In 2004, the decrease in interest costs was primarily due to a reduction in average debt level of $6,626 million compared to 2003. Higher capital expenditures contributed to higher capitalized interest costs.

Minority Interest (dollars in millions)

Years Ended December 31,	**2005**	2004	2003
Minority interest	**$ 3,045**	$ 2,409	$ 1,583

The increase in minority interest expense in 2005 was primarily due to higher earnings at Domestic Wireless, which has a significant minority interest attributable to Vodafone. The increase in minority interest expense in 2004 was primarily due to higher earnings at Domestic Wireless and higher earnings at TELPRI.

Provision for Income Taxes (dollars in millions)

Years Ended December 31,	**2005**	2004	2003
Provision for income taxes	**$ 3,210**	$ 2,851	$ 1,213
Effective income tax rate	**30.3%**	28.2%	26.0%

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 2005 was higher than 2004 due to a higher state income tax rate, lower foreign-related tax benefits and lower favorable deferred tax reconciliation adjustments. As a result of the capital gain realized in the second quarter of 2005 in connection with the sale of our Hawaii businesses, we recorded tax benefits of $336 million primarily related to prior year investment losses, which were largely offset by 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. The effective income tax rate in 2004 was favorably impacted from the reversal of a valuation allowance relating to investments, and tax benefits related to deferred tax balance adjustments and expense credits that are not taxable.

Our effective income tax rate in 2004 was higher than 2003 due to lower foreign-related tax benefits, particularly associated with lower equity income from our investment in Vodafone Omnitel and higher state taxes. Vodafone Omnitel income is not taxable until received in the form of dividends. The effective income tax rate in 2004 was favorably impacted by the reversal of a valuation allowance relating to investments, and tax benefits related to deferred tax balance adjustments and expense credits that are not taxable. The effective income tax rate in 2003 was favorably impacted by higher equity income from Vodafone Omnitel, a decrease in state taxes and a benefit related to a deferred tax balance adjustment.

A reconciliation of the statutory federal income tax rate to the effective rate for each period is included in Note 16 to the consolidated financial statements.

Discontinued Operations

Discontinued operations represent the results of operations of Verizon Information Services Canada Inc. for all years presented in the consolidated statements of income and Grupo Iusacell, S.A. de C.V. (Iusacell) prior to the sale of Iusacell in July 2003. During 2004, we announced our decision to sell Verizon Information Services Canada Inc. and, in accordance with Statement of Financial Accounting Standards (SFAS) No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," we have classified the results of operations of Verizon Information Services Canada as discontinued operations. The sale closed in the fourth quarter of 2004 and resulted in a pretax gain of $1,017 million ($516 million after-tax, or $.18 per diluted share). In connection with the decision to sell our interest in Iusacell and a comparison of expected net sale proceeds to the net book value of our investment in Iusacell (including the foreign currency translation balance), we recorded a pretax loss of $957 million ($931 million after-tax, or $.33 per diluted share) in the second quarter of 2003.

Cumulative Effect of Accounting Change

Directory Accounting Change

During 2003, we changed our method for recognizing revenues and expenses in our directory business from the publication-date method to the amortization method. The publication-date method recognizes revenues and direct expenses when directories are published. Under the amortization method, revenues and direct

expenses, primarily printing and distribution costs, are recognized over the life of the directory, which is usually 12 months. This accounting change affected the timing of the recognition of revenues and expenses. As required by generally accepted accounting principles, the directory accounting change was recorded effective January 1, 2003. The cumulative effect of the accounting change was a one-time charge of $2,697 million ($1,647 million after-tax, or $.58 per diluted share).

Impact of SFAS No. 143

We adopted the provisions of SFAS No. 143, "Accounting for Asset Retirement Obligations," on January 1, 2003. SFAS No. 143 requires that companies recognize the fair value of a liability for asset retirement obligations in the period in which the obligations are incurred and capitalize that amount as part of the book value of the long-lived asset. We determined that Verizon does not have a material legal obligation to remove long-lived assets as described by this statement. However, prior to the adoption of SFAS No. 143, we included estimated removal costs in our group depreciation models. Consequently, in connection with the initial adoption of SFAS No. 143 we reversed accrued costs of removal in excess of salvage from our accumulated depreciation accounts for these assets. The adjustment was recorded as a cumulative effect of an accounting change, resulting in the recognition of a gain of $3,499 million ($2,150 million after-tax, or $.76 per diluted share).

SEGMENT RESULTS OF OPERATIONS

We have four reportable segments, which we operate and manage as strategic business units and organize by products and services. Our segments are Domestic Telecom, Domestic Wireless, Information Services and International. You can find additional information about our segments in Note 17 to the consolidated financial statements.

We measure and evaluate our reportable segments based on segment income. This segment income excludes unallocated corporate expenses and other adjustments arising during each period. The other adjustments include transactions that the chief operating decision makers exclude in assessing business unit performance due primarily to their non-recurring and/or non-operational nature. Although such transactions are excluded from business segment results, they are included in reported consolidated earnings. We previously highlighted the more significant of these transactions in the "Consolidated Results of Operations" section. Gains and losses that are not individually significant are included in all segment results, since these items are included in the chief operating decision makers' assessment of unit performance. These gains and losses are primarily contained in Information Services and International since they actively manage investment portfolios.

Domestic Telecom

Domestic Telecom provides local telephone services, including voice, DSL, data transport, enhanced and custom calling features, network access, directory assistance, private lines and public telephones in 28 states and Washington, D.C. 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 Domestic 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. This segment also provides long distance services, customer premises equipment distribution, video services, data solutions and systems integration, billing and collections and inventory management services.

Operating Revenues (dollars in millions)

Years Ended December 31,	**2005**	2004	2003
Local services	**$ 17,600**	$ 18,269	$ 19,185
Network access services	**12,217**	12,058	12,544
Long distance services	**4,347**	4,141	3,751
Other services	**3,452**	3,553	3,575
	$ 37,616	$ 38,021	$ 39,055

Local Services

Local service revenues are earned by our telephone operations from the provision of local exchange, local private line, wire maintenance, voice messaging and value-added services. Value-added services are a family of services that expand the utilization of the network, including products such as Caller ID, Call Waiting and Return Call. The provision of local exchange services not only includes retail revenues but also includes local wholesale revenues from UNEs, interconnection revenues from CLECs and wireless carriers, and some data transport revenues.

The decline in local service revenues of $669 million, or 3.7% in 2005 and $916 million, or 4.8% in 2004 was mainly due to lower demand and usage of our basic local exchange and accompanying services, as reflected by declines in switched access lines in service of 6.7% in 2005 and 4.6% in 2004. These revenue declines were mainly driven by the effects of competition and technology substitution. Technology substitution affected local service revenue growth in both years, as declining demand for residential access lines resulted in 8.4% fewer lines at December 31, 2005 compared to December 31, 2004 and a reduction in lines of 5.4% during 2004, as more customers substituted wireless, broadband and cable services for traditional landline services. At the same time, basic business access lines declined by 3.5% in 2005 and 3.1% in 2004, primarily reflecting competition and a shift to high-speed, high-volume special access lines.

In the first quarter of 2005, the FCC adopted significant new unbundling rules which eliminated the requirement to unbundle mass market local switching for new orders on a nationwide basis, and provided for a one year transition period for existing UNE switching arrangements. See "Other Factors That May Affect Future Results – Regulatory and Competitive Trends – FCC Regulation" for additional information on FCC rulemakings concerning UNEs. Due to a decision by two major competitors to deemphasize their local market initiatives, wholesale voice connections (commercial local wholesale arrangements, UNE platform and resale lines) declined 1.1 million in 2005, to 5.5 million as of December 31, 2005, which reflected a 16.1% decrease compared to December 31, 2004. In 2004, prior to the adoption of these new rules, wholesale voice connections increased 0.8 million to 6.6 million as of December 31, 2004.

We continue to seek opportunities to retain and win-back customers. Our Freedom service plans offer local services with various combinations of long distance, wireless and Internet access services in a discounted bundle available on one customer bill. Since 2003, we have introduced our Freedom service plans in nearly all of our key markets. As of December 31, 2005, approximately 65% of

Verizon's residential customers have purchased local services in combination with either Verizon long distance or Verizon DSL, or both. For small businesses, we have also introduced Verizon Freedom for Business in eleven key markets, covering approximately 86% of business access lines.

Network Access Services

Network access services revenues are earned from end-user customers and long distance and other competing carriers who use our local exchange facilities to provide usage services to their customers. Switched access revenues are derived from fixed and usage-based charges paid by carriers for access to our local network. Special access revenues originate from carriers and end-users that buy dedicated local exchange capacity to support their private networks. End-user access revenues are earned from our customers and from resellers who purchase dial-tone services. Further, network access revenues include our DSL services.

Our network access revenues increased by $159 million, or 1.3% in 2005, and decreased $486 million, or 3.9% in 2004. These changes were principally due to increased DSL and carrier special access revenues, partially offset in 2005, and more than offset in 2004, by the impact of decreasing switched MOUs and access lines and mandatory price reductions associated with federal and state price cap filings and other regulatory decisions. 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. Total revenues for high-capacity and data services were $8,489 million in 2005, an increase of 10.5% compared to 2004 revenues of $7,679 million, which increased 7.1% compared to 2003. 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 and ongoing price reductions. Switched access revenues decreased due to declines in switched MOUs of 7.1% in 2005 compared to 2004 and 5.7% in 2004 compared to 2003, reflecting the impact of access line loss and technology substitution, partially offset in 2005 by a favorable adjustment associated with a recent regulatory decision.

The FCC regulates the rates that we charge long distance carriers and end-user customers for interstate access services. See "Other Factors That May Affect Future Results – Regulatory and Competitive Trends – FCC Regulation" for additional information on FCC rulemakings concerning federal access rates, universal service and unbundling of network elements and broadband services.

Long Distance Services

Long distance service revenues include both intraLATA toll services and interLATA long distance voice and data services.

Long distance service revenues increased $206 million, or 5.0% in 2005 and $390 million, or 10.4% in 2004, principally as a result of customer growth from our interLATA long distance services. In 2005, we added 1.0 million long distance lines, for a total of 18.4 million long distance lines nationwide, representing a 5.7% increase from December 31, 2004. In 2004, we added 2.3 million long distance lines, representing an increase of 15.5% from December 31, 2003. The introduction of our Freedom service plans continues to stimulate growth in long distance services. As of December 31, 2005, approximately 53% of our local wireline customers have chosen Verizon as their long distance carrier.

Other Services

Our other services include such services as billing and collections for long distance carriers, public (coin) telephone and customer premises equipment and supply sales. Other services revenues also include services provided by our non-regulated subsidiaries such as data solutions and systems integration businesses, and other services.

Revenues from other services declined by $101 million, or 2.8% in 2005, and by $22 million, or 0.6% in 2004. Revenues decreased due to the dissolution of non-strategic businesses, including the termination of a large commercial inventory management contract in 2005, and reduced business volumes related to billing and collection services and public telephone services, partially offset by increases resulting from higher sales of voice and data customer premises equipment and other services.

Operating Expenses (dollars in millions)

Years Ended December 31,	**2005**	2004	2003
Cost of services and sales	**$ 15,604**	$ 14,830	$ 14,512
Selling, general and administrative expense	**8,419**	8,621	8,363
Depreciation and amortization expense	**8,801**	8,910	9,107
	$ 32,824	$ 32,361	$ 31,982

Cost of Services and Sales

Cost of services and sales includes the following costs directly attributable to a service or product: salaries and wages, benefits, materials and supplies, contracted services, network access and transport costs, customer provisioning costs, computer systems support and cost of products sold. Aggregate customer care costs, which include billing and service provisioning, are allocated between cost of services and sales and selling, general and administrative expense.

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. As of December 31, 2004, Verizon evaluated key employee benefit plan assumptions in response to conditions in the securities markets. The expected rate of return on pension plan assets has been maintained at 8.50%. However, the discount rate assumption has been lowered from 6.25% 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, including a 2,400, or 1.7% increase in the number of employees as of December 31, 2005 compared to December 31, 2004. 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, including the MCI settlement recorded in 2004.

In 2004, our cost of services and sales increased by $318 million, or 2.2% compared to 2003. Costs in 2004 were also impacted by increased pension and other postretirement benefit costs. As of December 31, 2003, Verizon evaluated key employee benefit plan assumptions in response to conditions in the securities markets

and the result of extending and increasing limits (caps) on company payments toward retiree health care costs in connection with the union contracts ratified in 2003. 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 $803 million in 2004, as compared to pension income, net of other postretirement benefit expense of $312 million in 2003. Higher customer premises equipment and other costs associated with our growth businesses and annual wage increases also contributed to the increase in cost of services and sales. Further, the comparison of 2004 to 2003 cost of services and sales was affected by the 2003 reduction in operating expenses (primarily cost of services and sales) of approximately $130 million in 2003 for insurance recoveries related to the terrorist attacks on September 11, 2001.

These 2004 expense increases were partially offset by the effect of workforce reductions of an average of approximately 15,000 employees, principally due to a voluntary separation plan in November 2003. Costs in 2004 were also impacted by lower interconnection expense as a result of our ongoing reviews of local interconnection expense charged by CLECs and settlements with carriers, including the MCI settlement. Expense comparisons were also impacted by 2003 contingency costs incurred in connection with labor negotiations and other costs recorded in 2003.

See "Other Factors That May Affect Future Results – Regulatory and Competitive Trends – Interstate Access Charges and Intercarrier Compensation" for additional information on FCC rulemakings and other court decisions addressing intercarrier compensation for dial-up connections for Internet-bound traffic.

Selling, General and Administrative Expense

Selling, general and administrative expense includes salaries and wages and benefits not directly attributable to a service or product, bad debt charges, taxes other than income, advertising and sales commission costs, customer billing, call center and information technology costs, professional service fees and rent for administrative space.

Selling, general and administrative expense in 2005 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.

In 2004, our selling, general and administrative expense increased by $258 million, or 3.1% compared to 2003. This increase includes higher net pension and benefit costs and higher professional and general costs, partially offset by the effect of workforce reductions and by lower bad debt expense, reduced property and gross receipts taxes, and a gain on the sale of two small business units.

Depreciation and Amortization Expense

The decreases in depreciation and amortization expense in 2005 of $109 million, or 1.2%, and $197 million, or 2.2% in 2004, were 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,	**2005**	2004	2003
(dollars in millions)			
Segment Income	**$ 1,906**	$ 2,652	$ 3,299

Segment income decreased by $746 million, or 28.1% in 2005 and $647 million, or 19.6% in 2004 primarily as a result of the after-tax impact of operating revenues and operating expenses described above. Special and non-recurring items of ($168) million, $346 million and $1,063 million, after-tax, affected the Domestic Telecom segment but were excluded from segment income in 2005, 2004 and 2003, respectively. Special and non-recurring items in 2005 primarily included a gain on the sale of the Hawaii wireline operations, Hawaii results of operations, and a net gain on the sale of a New York City office building, partially offset by net expenses associated with 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. Special and non-recurring items in 2003 primarily include the costs associated with severance activity, including retirement enhancement costs, and pension settlements, partially offset by the favorable impact of adopting SFAS No. 143.

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,	**2005**	2004	2003
(dollars in millions)			
Wireless sales and services	**$ 32,301**	$ 27,662	$ 22,489

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. The service revenue growth was primarily due to increased customers, partially offset by a decrease in average revenue per customer per month. Equipment and other revenue increased by $908 million, or 27.8%, principally as a result of an increase in wireless devices sold together with an increase in revenue per unit sold.

Our Domestic Wireless segment ended 2005 with 51.3 million customers, an increase of 7.5 million net new customers, or 17.2% compared to December 31, 2004. Retail net additions accounted for 7.2 million, or 95.8% of the total net additions. The overall composition of our Domestic Wireless customer base as of December 31, 2005 was 92.4% retail postpaid, 3.1% retail prepaid and 4.5% resellers. The average monthly churn rate, the rate at which customers disconnect service, 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. Average MOUs per customer increased to 665, or 16.1% in 2005 compared to 2004.

Domestic Wireless's total revenues of $27,662 million were $5,173 million, or 23.0% higher in 2004 compared to 2003. Service revenues of $24,400 million were $4,064 million, or 20.0% higher than 2003. This revenue growth was largely attributable to customer additions and higher revenue per customer per month, including higher data revenue per customer. At December 31, 2004, customers totaled 43.8 million, an increase of 16.8% compared to December 31, 2003. Retail net additions accounted for 5.8 million, or 92.5% of the total net additions. Total churn decreased to 1.5% in 2004 compared to 1.8% in 2003. Average revenue per customer per month increased by 2.8% to $50.22 in 2004 compared to 2003, primarily due to a larger number of customers on higher access price plan offerings as well as an increase in data revenues per subscriber. Data revenues were $1,116 million in 2004 compared to $449 million in 2003. These increases were partially offset by decreased roaming revenue due to bundled pricing. Average MOUs per customer increased to 573, or 16.5% in 2004 compared to 2003.

Operating Expenses (dollars in millions)

Years Ended December 31,	**2005**	2004	2003
Cost of services and sales	**$ 9,393**	$ 7,747	$ 6,460
Selling, general and administrative expense	**10,768**	9,591	8,057
Depreciation and amortization expense	**4,760**	4,486	3,888
	$ 24,921	$ 21,824	$ 18,405

Cost of Services and Sales

Cost of services and sales, which are costs to operate the wireless network as well as the cost of roaming, long distance and equipment sales, increased by $1,646 million, or 21.2% in 2005 compared to 2004. Cost of services increased primarily due to higher direct wireless network charges resulting from increased MOUs in 2005 compared to 2004, partially offset by lower roaming, local interconnection and long distance rates. Cost of equipment sales was higher by 23.0% 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 compared to 2004.

Cost of services and sales increased by $1,287 million, or 19.9% in 2004 compared to 2003. This increase was due primarily to increased network costs resulting from increased MOUs and an increase in cost of equipment sales driven by growth in new customer additions and increased equipment upgrades. These cost increases were partially offset by lower roaming, local interconnection and long distance rates.

Selling, General and Administrative Expense

Selling, general and administrative expense increased by $1,177 million, or 12.3% in 2005 compared to 2004. This increase was primarily due to an increase in salary and benefits expense of $382 million, which included a $70 million increase in costs incurred in 2005 related to our long-term incentive program, and by an increase in the employee base, primarily in the customer care and sales channels. Also contributing to the increase were higher sales commissions in our direct and indirect channels of $215 million, primarily related to an increase in customer additions and renewals during the year. Costs associated with regulatory fees, primarily the universal service fund, increased by $179 million in 2005 compared to 2004.

Selling, general and administrative expense increased by $1,534 million, or 19.0% in 2004 compared to 2003. This increase was due primarily to higher salary and benefits expense and increased sales commissions related to the growth in customer additions and higher costs associated with our long-term incentive program.

Depreciation and Amortization Expense

Depreciation and amortization expense increased by $274 million, or 6.1% in 2005 compared to 2004 and increased by $598 million, or 15.4% in 2004 compared to 2003. These increases were primarily due to increased depreciation expense related to the increases in depreciable assets.

Segment Income (dollars in millions)

Years Ended December 31,	**2005**	2004	2003
Segment Income	**$ 2,219**	$ 1,645	$ 1,083

Segment income increased by $574 million, or 34.9% in 2005 compared to 2004 and increased by $562 million, or 51.9% in 2004 compared to 2003, primarily as a result of the after-tax impact of operating revenues and operating expenses described above, partially offset by higher minority interest. There were no special items affecting this segment in 2005, 2004 or 2003.

Increases in minority interest in 2005 and 2004 were principally due to the increased income of the wireless joint venture and the significant minority interest attributable to Vodafone.

Information Services

Information Services' multi-platform business comprises yellow pages directories, SuperPages.com, our online directory and search services, and SuperPages On the Go, our directory and information services on wireless telephones. This segment's operations are principally in the United States.

We sold our directory operations in Hawaii in connection with the sale of Verizon's wireline properties in Hawaii discussed earlier under "Consolidated Results of Operations." For comparability purposes, the results of operations shown in the tables below exclude the Hawaii operations that have been sold. In 2004, Verizon sold Verizon Information Services Canada, our directory operations in Canada, to an affiliate of Bain Capital, a private investment firm, for $1.6 billion. The sale resulted in an after-tax gain of $516 million. This gain and current and prior years' results of operations for this business unit are classified as discontinued operations in accordance with SFAS No. 144, and are excluded from Information Services segment results.

Operating Revenues (dollars in millions)

Years Ended December 31,	**2005**	2004	2003
Operating Revenues	**$ 3,452**	$ 3,549	$ 3,763

Operating revenues in 2005 decreased $97 million, or 2.7% compared to 2004, primarily due to reduced domestic print advertising revenue, partially offset by SuperPages.com revenue growth. Verizon's domestic Internet directory service, SuperPages.com, achieved growth of 18% in gross revenues compared with 2004.

Operating revenues in 2004 decreased $214 million, or 5.7% compared to 2003, primarily due to reduced domestic print advertising revenue and elimination of revenue from the 2003 sale of European operations. SuperPages.com reported a 22% increase in revenue over 2003.

Operating Expenses (dollars in millions)

Years Ended December 31,	2005	2004	2003
Cost of services and sales	**$ 593**	$ 542	$ 554
Selling, general and administrative expense	**1,107**	1,319	1,387
Depreciation and amortization expense	**92**	87	79
Sales of businesses, net	**–**	–	(141)
	$ 1,792	$ 1,948	$ 1,879

Cost of Services and Sales
Cost of services and sales in 2005 increased $51 million, or 9.4% compared to 2004 and decreased by $12 million, or 2.2% in 2004 compared to 2003. The 2005 increase was primarily due to increased printing and distribution costs and higher costs associated with SuperPages.com. The decrease in 2004 was primarily due to reduced expenses related to the July 2003 sale of European operations.

Selling, General and Administrative Expense
Selling, general and administrative expenses decreased $212 million, or 16.1% in 2005 compared to 2004. This decrease was due primarily to cost reductions, as well as reduced bad debt and legal expenses. Selling, general and administrative expenses decreased $68 million, or 4.9% in 2004 compared to 2003. Lower bad debt expenses and reduced expenses related to the July 2003 sale of European operations were partially offset by higher domestic pension and benefit costs.

Depreciation and Amortization Expense
Depreciation and amortization expense in 2005 increased by $5 million, or 5.7% compared to 2004 and by $8 million, or 10.1% in 2004 compared to 2003, primarily due to increased software amortization expense.

Sales of Businesses, Net
In 2003, we recorded a net pretax gain of $141 million primarily related to the sale of our European directory publication operations in Austria, the Czech Republic, Gibraltar, Hungary, Poland and Slovakia.

Segment Income (dollars in millions)

Years Ended December 31,	2005	2004	2003
Segment Income	**$ 1,044**	$ 968	$ 1,128

Segment income in 2005 increased by $76 million, or 7.9% compared to 2004 and decreased by $160 million, or 14.2% in 2004 compared to 2003. The increase in 2005 and decrease in 2004 were primarily the result of the after-tax impact of the operating revenues and expenses described above and lower interest expense in 2005 compared to 2004.

Special and non-recurring items of $(10) million, $(596) million, $1,660 million, after-tax, affected the Information Services segment but were excluded from segment income in 2005, 2004 and 2003, respectively. The special and non-recurring items in all years include the results of operations of the Hawaii directory operations. The special and non-recurring items in 2004 and 2003 include the results of operations of Verizon Information Services Canada. The special and non-recurring items in 2004 also included the gain on the sale of Verizon Information Services Canada, partially offset by pension settlement losses for employees who received lump-sum distributions under a prior year voluntary separation plan. Special and non-recurring items in 2003 also included a loss recorded in connection with the cumulative effect of the directory accounting change from the publication-date method of recognizing revenue and expenses to the amortization method, effective January 1, 2003, and severance charges related to a voluntary separation plan.

International

Our International segment includes international wireline and wireless telecommunication operations in the Americas and Europe. Our consolidated international investments as of December 31, 2005 included Verizon Dominicana, C. por A. (Verizon Dominicana) in the Dominican Republic and TELPRI in Puerto Rico. Either the cost or the equity method is applied to those investments in which we have less than a controlling interest.

On June 13, 2003, we announced our decision to sell our 39.4% consolidated interest in Iusacell and reclassified our investment and the results of operations of Iusacell as discontinued operations. We sold our shares in Iusacell on July 29, 2003. The results of operations for this business unit in 2003 are classified as discontinued operations in accordance with SFAS No. 144, and are excluded from International segment results.

Operating Revenues (dollars in millions)

Years Ended December 31,	2005	2004	2003
Operating Revenues	**$ 2,193**	$ 2,014	$ 1,949

Revenues generated by our international businesses increased by $179 million, or 8.9% in 2005 compared to 2004 and increased by $65 million, or 3.3% in 2004 compared to 2003. The increase in 2005 was primarily due to favorable foreign exchange rates in the Dominican Republic as well as favorable wireless growth at both TELPRI and Verizon Dominicana, partially offset by a favorable adjustment to carrier access revenues at TELPRI in 2004. The increase in 2004 was primarily due to operational growth at Verizon Dominicana and a 2003 adjustment to carrier access revenues at TELPRI, partially offset by declining foreign exchange rates in the Dominican Republic.

Operating Expenses (dollars in millions)

Years Ended December 31,	2005	2004	2003
Cost of services and sales	**$ 707**	$ 626	$ 574
Selling, general and administrative expense	**675**	471	691
Depreciation and amortization expense	**340**	324	346
	$ 1,722	$ 1,421	$ 1,611

Cost of Services and Sales
Cost of services and sales increased in 2005 by $81 million, or 12.9% compared to 2004 and by $52 million, or 9.1% in 2004 compared to 2003. The increase in 2005 was due primarily to higher variable costs at Verizon Dominicana and at TELPRI as well as the appreciation of the Dominican Republic peso. The increase in 2004 reflected higher variable costs at Verizon Dominicana, partially offset by the decline of the Dominican Republic's foreign exchange rates.

Selling, General and Administrative Expense
Selling, general and administrative expenses increased in 2005 by $204 million, or 43.3% compared to 2004 and decreased by $220 million, or 31.8% in 2004 compared to 2003. The increase in 2005 reflects the favorable resolution in 2004 of a 2003 TELPRI charge recorded as a result of an adverse Puerto Rico Circuit Court of Appeals ruling on intra-island long distance access rates, the

appreciation of the Dominican Republic peso and higher employee-related costs and commission expenses. The decrease in 2004 was primarily due to a TELPRI charge recorded in 2003 as a result of the Puerto Rico Circuit Court of Appeals ruling as well as the favorable resolution to the charge in 2004, an asset write-off in 2003, and declining foreign exchange rates in the Dominican Republic.

Depreciation and Amortization Expense
Depreciation and amortization expense increased in 2005 by $16 million, or 4.9% compared to 2004 and decreased $22 million, or 6.4% in 2004 compared to 2003. The increase in 2005 primarily reflects the appreciation of the Dominican Republic peso. The decrease in 2004 was due primarily to declining foreign exchange rates in the Dominican Republic and the adoption of SFAS No. 143 in 2003, offset in part by increased depreciation related to ongoing network capital expenditures in 2004.

Segment Income (dollars in millions)

Years Ended December 31,	**2005**	2004	2003
Segment Income	**$ 1,251**	$ 1,225	$ 1,392

Segment income increased in 2005 by $26 million, or 2.1% compared to 2004 and decreased by $167 million, or 12.0% in 2004 compared to 2003. The increase in 2005 reflects an increase in interest income, foreign exchange gains and lower income taxes, largely offset by lower equity in earnings of unconsolidated businesses and Verizon's share (after minority interest) of the after-tax impact of the operating revenues and operating expenses previously described. The decrease in 2004 was primarily the result of the decrease in equity in earnings of unconsolidated businesses and income from other unconsolidated businesses, partially offset by Verizon's share (after minority interest) of the after-tax impact of the operating revenues and operating expenses previously described.

Equity in earnings of unconsolidated businesses decreased in 2005 by $224 million, or 21.7% compared to 2004 and decreased by $60 million, or 5.5% in 2004 compared to 2003. The decrease in 2005 primarily resulted from lower equity income due to the sale of our TELUS interest in 2004, estimated additional pension liabilities at CANTV and the gain on the sale of an equity investment in 2004, partially offset by higher tax benefits and operational results at Vodafone Omnitel. The decrease in 2004 was driven primarily from Italian tax benefits in 2003 arising from a reorganization and the 2003 contribution tax reversal that resulted from a favorable European Court of Justice ruling at Vodafone Omnitel, partially offset by favorable foreign currency impacts from the euro on that investment and continued operational growth, as well as a gain on the sale of an equity investment in 2004. Income from other unconsolidated businesses decreased by $138 million, or 81.7% in 2004 compared to 2003. This decrease reflects lower gains realized from the sale of investments compared to 2003.

Special and non-recurring items of $(112) million, $(797) million and $791 million, after-tax, affected the International segment but were excluded from segment income in 2005, 2004 and 2003, respectively. The special and non-recurring items in 2005 primarily related to tax benefits realized in connection with prior years' investment losses, partially offset by a net tax provision from the repatriation of foreign earnings. The special and non-recurring items in 2004 were related to the gain on sale of our investment in TELUS and tax benefits realized in connection with prior years' sales of investments, partially offset by pension settlement losses for employees that received lump-sum distributions under a voluntary separation plan. The special and non-recurring items in 2003 include the impairment of our investment in Iusacell, partially offset by a gain on the sale of Eurotel Praha.

SPECIAL ITEMS

Discontinued Operations

During 2004, we announced our decision to sell Verizon Information Services Canada 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, or $.18 per diluted share). In accordance with SFAS No. 144, we have classified the results of operations of Verizon Information Services Canada as discontinued operations in the consolidated statements of income in all years.

During 2003, we announced our decision to sell our 39.4% consolidated interest in Iusacell into a tender offer launched by Movil Access, a Mexican company. Verizon tendered its shares shortly after the tender offer commenced, and the tender offer closed on July 29, 2003. In accordance with SFAS No. 144, we have classified the results of operations of Iusacell as discontinued operations in the consolidated statements of income in all years until the sale. In connection with a comparison of expected net sale proceeds to net book value of our investment in Iusacell (including the foreign currency translation balance), we recorded a pretax loss of $957 million ($931 million after-tax, or $.33 per diluted share).

Sales of Businesses and Investments, Net

Sales of Businesses, Net
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).

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.

During 2003, we recorded a pretax gain of $348 million on the sale of our interest in Eurotel Praha. Also during 2003, we recorded a net pretax gain of $176 million as a result of a payment received in connection with the liquidation of Genuity. In connection with these sales transactions, Verizon recorded contributions of $150 million for each of the transactions to Verizon Foundation to fund its

charitable activities and increase its self-sufficiency. Consequently, we recorded a net gain of $44 million after taxes, or $.02 per diluted share related to these transactions and the accrual of the Verizon Foundation contributions.

Tax Matters

During 2005, we recorded a tax benefit of $336 million ($.12 per diluted share) 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 $242 million ($.09 per diluted share) related to prior year investment losses. The investment losses pertain to Iusacell, CTI Holdings, S.A. (CTI) and TelecomAsia.

Also during 2005, we recorded a net tax provision of $206 million ($.07 per diluted share) 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 Verizon's foreign investments repatriated earnings resulting in income taxes of $332 million, partially offset by a tax benefit of $126 million.

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 $234 million ($.08 per diluted share) 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.

Facility and Employee-Related Items

During 2005, we recorded a net pretax gain of $18 million ($8 million after-tax, or less than $.01 per diluted share) in connection with our planned relocation of several functions to Verizon Center, including a pretax gain of $120 million ($72 million after-tax, or $.03 per diluted share) related to the sale of a New York City office building, partially offset by a pretax charge of $102 million ($64 million after-tax, or $.02 per diluted share) primarily associated with relocation-related employee severance costs and related activities. Additional relocation costs are anticipated in 2006.

During 2005, we recorded a net pretax charge of $98 million ($59 million after-tax, or $.02 per diluted share) related to the restructuring of the Verizon management retirement benefit plans. This pretax charge was recorded in accordance with SFAS No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits" and SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" and includes the unamortized cost of prior pension enhancements of $441 million offset partially by a pretax curtailment gain of $343 million related to retiree medical benefits. In connection with this restructuring, management employees will no longer earn pension benefits or earn service towards the company retiree medical subsidy after June 30, 2006, after receiving an 18-month enhancement of the value of their pension and retiree medical subsidy, but will receive a higher savings plan matching contribution.

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 2004, we recorded pretax pension settlement losses of $815 million ($499 million after-tax, or $.18 per diluted share) 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, which requires that settlement losses be recorded once prescribed payment thresholds have been reached.

Total pension, benefit and other costs related to severance activities were $5,524 million ($3,399 million after-tax, or $1.20 per diluted share) in 2003, primarily in connection with the voluntary separation of more than 25,000 employees, as follows:

- In connection with the voluntary separation of more than 21,000 employees during the fourth quarter of 2003, we recorded a pretax charge of $4,695 million ($2,882 million after-tax, or $1.02 per diluted share). This pretax charge included $2,716 million recorded in accordance with SFAS No. 88 and SFAS No. 106, for pension and postretirement benefit enhancements and a net curtailment gain for a significant reduction of the expected years of future service resulting from early retirements. In addition, we recorded a pretax charge of $76 million for pension settlement losses related to lump-sum settlements of some existing pension obligations. The fourth quarter pretax charge also included severance costs of $1,720 million and costs related to other severance-related activities of $183 million.
- We also recorded a special charge in 2003 of $235 million ($150 million after-tax, or $.05 per diluted share) primarily associated with employee severance costs and severance-related activities in connection with the voluntary separation of approximately 4,000 employees. In addition, we recorded pretax pension settlement losses of $131 million ($81 million after-tax, or $.03 per diluted share) in 2003 related to employees that received lump-sum distributions during the year in connection with previously announced employee separations.
- Further, in 2003 we recorded a special charge of $463 million ($286 million after-tax, or $.10 per diluted share) in connection with enhanced pension benefits granted to employees retiring in the first half of 2003, estimated costs associated with the July 10, 2003 Verizon New York arbitration ruling and pension settlement losses related to lump-sum pay-outs in 2003. On July 10, 2003, an arbitrator ruled that Verizon New York's termination of 2,300 employees in 2002 was not permitted under a union contract; similar cases were pending impacting an additional 1,100 employees. Verizon offered to reinstate all 3,400 impacted employees, and accordingly, recorded a charge in the second quarter of 2003 representing estimated payments to employees and other related company-paid costs.

Other Special Items

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 our leasing operations for aircraft leases involved in recent airline 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 retirement of debt.

In 2004, we recorded an expense credit of $204 million ($123 million after-tax, or $.04 per diluted share) resulting from the favorable resolution of pre-bankruptcy amounts due from MCI. Previously reached

settlement agreements became fully effective when MCI emerged from bankruptcy proceedings in the second quarter of 2004.

Also during 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 retirement of debt.

During 2003, we recorded other special pretax charges of $557 million ($419 million after-tax, or $.15 per diluted share). These charges included $240 million ($156 million after-tax, or $.06 per diluted share) primarily in connection with environmental remediation efforts relating to several discontinued businesses, including a former facility that processed nuclear fuel rods in Hicksville, New York (see "Other Factors That May Affect Future Results – Recent Developments – Environmental Matters") and a pretax impairment charge of $184 million ($184 million after-tax, or $.06 per diluted share) pertaining to our leasing operations for airplanes leased to airlines experiencing financial difficulties and for power generating facilities. These 2003 charges also include pretax charges of $61 million ($38 million after-tax, or $.01 per diluted share) related to the early retirement of debt and other pretax charges of $72 million ($41 million after-tax, or $.01 per diluted share).

CONSOLIDATED FINANCIAL CONDITION

(dollars in millions)

Years Ended December 31,	2005	2004	2003
Cash Flows Provided By (Used In)			
Operating activities	**$ 22,012**	$ 21,820	$ 22,467
Investing activities	**(18,492)**	(10,343)	(12,236)
Financing activities	**(5,034)**	(9,856)	(10,959)
Increase (Decrease) In Cash and Cash Equivalents	**$ (1,514)**	$ 1,621	$ (728)

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 2005, the increase in cash from operations compared to 2004 was primarily driven by the repatriation of $2.2 billion of foreign earnings from unconsolidated businesses and lower severance payments in 2005, largely offset by 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.

In 2004, the decrease in cash from operations compared to 2003 was primarily driven by an increase in working capital requirements. The increase in working capital requirements was driven by higher severance payments in 2004 compared to higher severance accruals in 2003, primarily related to the fourth quarter 2003 voluntary separation plan. In addition, a higher tax refund was recorded in the 2003 period.

Cash Flows Used In Investing Activities

Capital expenditures continue to be our primary use of capital resources and facilitate the introduction of new products and services, enhance responsiveness to competitive challenges and increase the operating efficiency and productivity of our networks. Including capitalized software, we invested $8,267 million in our Domestic Telecom business in 2005, compared to $7,118 million and $6,820 million in 2004 and 2003, respectively. We also invested $6,484 million in our Domestic Wireless business in 2005, compared to $5,633 million and $4,590 million in 2004 and 2003, respectively. The increase in capital spending of both Domestic Telecom and Domestic Wireless represents our continuing effort to invest in high growth areas including wireless, long distance, broadband and other wireline data initiatives.

In 2006, capital expenditures including capitalized software are expected to be in the range of $15.4 billion to $15.7 billion, excluding capital expenditures associated with MCI. Including MCI, capital expenditures are expected to be $17.0 billion to $17.4 billion in 2006.

We invested $4,684 million in acquisitions and investments in businesses during 2005, 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 the NextWave licenses covering the New York metropolitan area, and $144 million related to Verizon's limited partnership investments in entities that invest in affordable housing projects. In 2003, we invested $1,162 million in acquisitions and investments in businesses, including $762 million to acquire 50 wireless licenses and related network assets from Northcoast Communications LLC, $242 million related to Verizon's limited partnership investments in entities that invest in affordable housing projects and $157 million for other wireless properties.

In 2005, we received cash proceeds of $1,326 million in connection with the sale of Verizon's wireline and directory operations in Hawaii. In 2004, we received cash proceeds of $1,720 million, including $1,603 million from the sale of Verizon Information Services Canada and $117 million from the sale of a small business unit. In 2003, we received cash proceeds of $229 million, from the sale of our European directory publication operations in Austria, the Czech Republic, Gibraltar, Hungary, Poland and Slovakia.

Our short-term investments include principally cash equivalents held in trust accounts for payment of employee benefits. In 2005, 2004 and 2003, we invested $1,978 million, $1,827 million and $1,887 million, respectively, in short-term investments, primarily to pre-fund active employees' health and welfare benefits. Proceeds from the sales of all short-term investments, principally for the payment of these benefits, were $1,634 million, $1,727 million and $1,767 million in the years 2005, 2004 and 2003, respectively.

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 Helu, 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 include 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. Other, net investing activities for 2003 include net cash proceeds of $415 million in connection with sales of our interests in various investments, primarily TCC and Crown Castle International Corp. and $195 million in connection with the sale of our interest in Eurotel Praha, representing a portion of the total proceeds of $525 million.

Under the terms of an investment agreement, Vodafone may require Verizon Wireless to purchase up to an aggregate of $20 billion worth of Vodafone's interest in Verizon Wireless at designated times at its then fair market value. In the event Vodafone exercises its put rights, we have the right, exercisable at our sole discretion, to purchase up to $12.5 billion of Vodafone's interest instead of Verizon Wireless for cash or Verizon stock at our option. Vodafone had the right to require the purchase of up to $10 billion during the 61-day period opening on June 10 and closing on August 9 in 2005, and did not exercise that right. As a result, Vodafone still has the right to require the purchase of up to $20 billion worth of its interest, not to exceed $10 billion in any one year, during a 61-day period opening on June 10 and closing on August 9 in 2006 and 2007. Vodafone also may require that Verizon Wireless pay for up to $7.5 billion of the required repurchase through the assumption or incurrence of debt.

Cash Flows Used In Financing Activities

Cash of $303 million was used to reduce our total debt during 2005. We repaid $1,533 million of Domestic Wireless, $1,183 million of Domestic Telecom, $996 million of Verizon Global Funding Corp., $113 million of other corporate and $93 million of International long-term debt. The Domestic Telecom debt repayment includes 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 Global Funding 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 $2,129 million.

Cash of $5,467 million was used to reduce our total debt during 2004. We repaid $2,315 million and $2,769 million of Domestic Telecom and corporate long-term debt, respectively. The Domestic Telecom debt repayment includes the early retirement of $1,275 million of long-term debt 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 Global Funding and $723 million of other corporate long-term debt at maturity. Also, during 2004, we decreased our short-term borrowings by $783 million and Verizon Global Funding issued $500 million of long-term debt.

Cash of $7,436 million was used to reduce our total debt during 2003. We repaid $5,646 million of Verizon Global Funding, $2,190 million of Domestic Telecom, $1,582 million of Domestic Wireless and $1,239 million of other corporate long-term debt, and reduced our short-term borrowings by $1,330 million with cash from operations and the issuance of Verizon Global Funding, Domestic Telecom and Domestic Wireless long-term debt. Verizon Global Funding, Domestic Telecom and Domestic Wireless issued long-term debt with principal amounts of $1,500 million, $1,653 million and $1,525 million, respectively, resulting in total cash proceeds of $4,591 million, net of discounts, costs and a payment related to a hedge on the interest rate for an anticipated financing.

Our ratio of debt to debt combined with shareowners' equity was 49.6% at December 31, 2005 compared to 51.1% at December 31, 2004.

As of December 31, 2005, we had $11 million in bank borrowings outstanding. We also had approximately $6.7 billion of unused bank lines of credit (including a $6.0 billion three-year committed facility which expires in June 2008, a $400 million one-year committed facility for TELPRI which expires in February 2006 and various other facilities totaling approximately $400 million). In addition, our financing subsidiary had shelf registrations for the issuance of up to $8.5 billion of unsecured debt securities. The debt securities of our telephone and financing subsidiaries continue to be accorded high ratings by primary rating agencies. In February 2005, both Standard & Poor's and Moody's Investors Service (Moody's) indicated that the proposed acquisition of MCI (see "Other Factors That May Affect Future Results – Recent Developments – MCI Merger") may result in downgrades in Verizon's debt ratings. At that time, Moody's placed the short-term and long-term debt of Verizon and its telephone subsidiaries on review for possible downgrade, while simultaneously changing the outlook on the A3-rated Verizon Wireless debt to stable from positive. Standard & Poor's placed the A+ long-term debt rating of Verizon and affiliates (including Verizon Wireless) on credit watch with negative implications. Fitch Ratings also placed the A+ rating of Verizon, along with the ratings of its affiliates, on ratings watch negative as a result of the proposed acquisition of MCI. In December 2005, Moody's downgraded the long-term debt rating of Verizon to A3 from A2. At the same time, the short-term debt ratings of Verizon Global Funding and Verizon Network Funding were changed to Prime-2 from Prime-1. Both outlooks were changed to stable. Moody's also placed the A3-rated long-term debt of Verizon Wireless on review for possible upgrade. These actions resolved the reviews initiated in February 2005. In January 2006, Fitch Ratings affirmed the A+ long-term debt ratings of Verizon and affiliates (including Verizon Wireless), removed them from rating watch negative, and assigned stable rating outlooks. The F1 short-term debt ratings of Verizon Global Funding and Verizon Network Funding were also affirmed. These short-term ratings had not been on rating watch negative. Also in January 2006, Standard & Poor's lowered the long-term ratings of Verizon and subsidiaries (including Verizon Wireless) to A from A+, removed them from credit watch, and assigned a negative outlook. Short-term ratings assigned by Standard & Poor's to Verizon remain at A-1.

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 2005, Verizon increased its quar-

terly dividend by $.02 per share, or 5.2% to $.405 per share. In 2004 and 2003, we declared quarterly cash dividends of $.385 per share.

Common stock has generally been issued to satisfy some of the funding requirements of employee benefit plans. On January 19, 2006, the Board of Directors authorized the repurchase of up to 100 million common shares terminating no later than the close of business on February 28, 2008. The Board of Directors also determined that no additional common shares may be purchased under the previous program.

Increase (Decrease) In Cash and Cash Equivalents

Our cash and cash equivalents at December 31, 2005 totaled $776 million, a $1,514 million decrease compared to cash and cash equivalents at December 31, 2004 of $2,290 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. Our cash and cash equivalents at December 31, 2004 was $1,621 million higher compared to December 31, 2003. The increase was driven by higher proceeds from disposition of businesses and investments and lower debt repayment activity, partially offset by higher capital expenditures.

Additional Minimum Pension Liability and Employee Benefit Plan Contributions

We evaluate each pension plan to determine whether an additional minimum pension liability is required or whether any adjustment is necessary as determined by the provisions of SFAS No. 87, "Employers' Accounting for Pensions." In 2005, we recorded a net benefit of $59 million, primarily in Employee Benefit Obligations and Other Assets. In 2004, we recorded an additional minimum pension liability of $587 million, primarily in Employee Benefit Obligations in the consolidated balance sheets, as a result of a lower discount rate at December 31, 2004. The changes in the assets and liabilities are recorded in Accumulated Other Comprehensive Loss, net of a tax benefit, in shareowners' investment in the consolidated balance sheets.

We operate numerous qualified and nonqualified pension plans and other postretirement benefit plans. These plans primarily relate to our domestic business units and TELPRI. The majority of Verizon's pension plans are adequately funded. We contributed $744 million, $325 million and $123 million in 2005, 2004 and 2003, respectively, to our qualified pension trusts. We also contributed $108 million, $118 million and $159 million to our nonqualified pension plans in 2005, 2004 and 2003, respectively.

Federal legislation was enacted on April 10, 2004 that provides temporary pension funding relief for the 2004 and 2005 plan years. The legislation replaced the 30-year treasury rate with a higher corporate bond rate for determining the current liability. Based on the funded status of the plans at December 31, 2005, we anticipate qualified pension trust contributions of $100 million in 2006, primarily for the TELPRI plans. Our estimate of the amount and timing of required qualified pension trust contributions for 2007 is based on current regulations including continued pension funding relief and is approximately $1,200 million, including TELPRI plans. Nonqualified pension contributions are estimated to be approximately $145 million and $180 million for 2006 and 2007, 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 similar funding requirements as the pension plans. Consequently, we contributed $1,085 million, $1,143 million and $1,014 million to our other postretirement benefit plans in 2005, 2004 and 2003, respectively. Contributions to our other postretirement benefit plans are estimated to be approximately $1,180 million in 2006 and $1,370 million in 2007, 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 property, telecommunications and other equipment are leased for remaining terms of less than 1 year to 50 years as of December 31, 2005. 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 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, 2005. Additional detail about these items is included in the notes to the consolidated financial statements.

(dollars in millions)

	Payments Due By Period				
Contractual Obligations	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-term debt (see Note 11)	$ 36,683	$ 4,909	$ 7,078	$ 4,439	$ 20,257
Capital lease obligations (see Note 10)	112	17	36	18	41
Total long-term debt	36,795	4,926	7,114	4,457	20,298
Interest on long-term debt (see Note 11)	24,973	2,219	3,587	3,116	16,051
Operating leases (see Note 10)	4,497	1,184	1,443	820	1,050
Purchase obligations (see Note 22)	669	486	151	22	10
Other long-term liabilities (see Note 15)	3,850	1,280	2,570	–	–
Total contractual obligations	$ 70,784	$ 10,095	$ 14,865	$ 8,415	$ 37,409

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.

Subsequent to the sale of Verizon Information Services Canada (see "Special Items – Discontinued Operations"), our Information Services segment continues 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. 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, 2005, letters of credit totaling $140 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, 2005 and 2004. The table also provides a sensitivity analysis of the estimated fair values of these financial instruments assuming 100-basis-point upward and downward parallel shifts in the yield curve. Our sensitivity analysis did not include the fair values of our commercial paper and bank loans because they are not significantly affected by changes in market interest rates.

(dollars in millions)

At December 31, 2005	Fair Value	Fair Value assuming +100 basis point shift	Fair Value assuming –100 basis point shift
Long-term debt and interest rate derivatives	**$ 38,052**	**$ 36,123**	**$ 40,202**
At December 31, 2004			
Long-term debt and interest rate derivatives	$ 42,072	$ 39,952	$ 44,378

Foreign Currency Translation

The functional currency for our foreign operations is the local currency. At December 31, 2005, our primary translation exposure was to the Venezuelan bolivar, Dominican Republic peso and the euro. 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. We also periodically hold cash balances in foreign currencies. The translation of foreign currency cash balances is recorded in the consolidated statements of income in Other Income and (Expense), Net. During 2005, the translation of these cash balances were not material. 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.

During 2004, we entered into foreign currency forward contracts to hedge our net investment in our Canadian operations and investments. 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 in the operations being hedged. During 2004, we sold our Canadian operations and investments. Accordingly, the unrealized losses on these net investment hedge contracts were realized 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.

Our earnings were affected by foreign currency gains or losses associated with the U.S. dollar denominated assets and liabilities at Verizon Dominicana.

Through June 30, 2003, our earnings were affected by foreign currency gains or losses associated with the unhedged portion of U. S. dollar denominated debt at Iusacell (see "Consolidated Results of Operations – Other Consolidated Results – Discontinued Operations").

SIGNIFICANT ACCOUNTING POLICIES 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. Several of these special and non-recurring items include impairment losses. These impairment losses were determined in accordance with our policy of comparing the fair value of the asset with its carrying value. The fair value is determined by quoted market prices or by estimates of future cash flows. There is inherent subjectivity involved in estimating future cash flows, which can have a significant impact on the amount of any impairment.
- Verizon's plant, property and equipment balance represents a significant component of our consolidated assets. Depreciation expense on Verizon's 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 heath 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, 2005 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.

Pension Plans (dollars in millions)

	Percentage point change	Benefit obligation increase (decrease) at December 31, 2005	Pension expense increase (decrease) for the year ended December 31, 2005
Discount rate	+ 1.00	$ (4,093)	$ (216)
	- 1.00	5,165	173
Long-term rate of return on plan assets	+ 1.00	–	(393)
	- 1.00	–	393

Postretirement Plans (dollars in millions)

	Percentage point change	Benefit obligation increase (decrease) at December 31, 2005	Postretirement benefit expense increase (decrease) for the year ended December, 31, 2005
Discount rate	+ 1.00	$ (3,315)	$ (186)
	- 1.00	3,774	221
Long-term rate of return on plan assets	+ 1.00	–	(45)
	- 1.00	–	45
Health care trend rates	+ 1.00	3,378	474
	- 1.00	(2,745)	(352)

- Our accounting policy concerning the method of accounting applied to investments (consolidation, equity or cost) involves an evaluation of all significant terms of the investments that explicitly grant or suggest evidence of control or influence over the operations of the entity in which we have invested. Where control is determined, we consolidate the investment. If we determine that we have significant influence over the operating and financial policies of an entity in which we have invested, we apply the equity method. We apply the cost method in situations where we determine that we do not have significant influence.
- Our current and deferred income taxes, and associated valuation allowances, are impacted by events and transactions arising in the normal course of business as well as in connection with special and non-recurring items. Assessment of the appropriate amount and classification of income taxes is dependent on several factors, including estimates of the timing and realization of deferred income tax assets and the timing of income tax payments. Actual collections and payments may materially differ from these estimates as a result of changes in tax laws as well as unanticipated future transactions impacting related income tax balances.
- Intangible assets are a significant component of our consolidated assets. Wireless licenses of $47,804 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.

Recent Accounting Pronouncements

Stock-Based Compensation

In December 2004, the 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. We plan to adopt SFAS No. 123(R) effective January 1, 2006, using the modified prospective method and expect that any impact will not be material to our financial position or ongoing results of operations.

OTHER FACTORS THAT MAY AFFECT FUTURE RESULTS

Recent Developments

MCI Merger

On February 14, 2005, Verizon announced that it had agreed to acquire MCI for a combination of Verizon common shares and cash (including MCI dividends). On May 2, 2005, Verizon announced that it agreed with MCI to further amend its agreement to acquire MCI for cash and stock of at least $26.00 per share, consisting of cash of $5.60, which was paid as a special dividend by MCI on October 27, 2005, after the October 6, 2005 approval of the transaction by MCI shareholders, plus the greater of .5743 Verizon shares for each MCI common share or a sufficient number of Verizon shares to deliver to shareholders $20.40 of value. Under this price protection feature, Verizon had the option of paying additional cash instead of issuing additional shares over the .5743 exchange ratio. This consideration was subject to adjustment at closing and may have been decreased based on MCI's bankruptcy claims-related experience and international tax liabilities. The merger received the required state, federal and international regulatory approvals by year-end 2005, and on January 6, 2006, Verizon and MCI closed the merger.

Under terms of the merger agreement, MCI shareholders received .5743 shares of Verizon and cash for each of their MCI shares. Verizon elected to make a supplemental cash payment of $2.738 per MCI share, $779 million in the aggregate, rather than issue additional shares of Verizon common stock, so that the merger consideration was equal to at least $20.40 per MCI share. Verizon and MCI management mutually agreed that there was no purchase price adjustment related to the amount of MCI's bankruptcy claims-related experience and international tax liabilities.

Separately, on April 9, 2005, Verizon entered into a stock purchase agreement with eight entities affiliated with Carlos Slim Helu 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 and the additional cash payment was made through May 13, 2005. The total cash payment was $1,121 million. Under the stock purchase agreement, Verizon will pay the Slim entities an adjustment at the end of one year in an amount per MCI share calculated by multiplying (i) .7241 by (ii) the amount, if any, by which the price of Verizon's common stock exceeds $35.52 per share (measured over a 20-day period), subject to a maximum excess amount per Verizon share of $26.98. After the closing of the stock purchase agreement, Verizon transferred the shares of MCI common stock it had purchased to a trust established pursuant to an agreement between Verizon and the Department of Justice. 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.

Redemption of MCI Debt

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 is 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 is 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.

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 February 15, 2005, the FCC's auction of broadband personal communications services licenses ended and Verizon Wireless and Vista PCS, LLC were the highest bidders for 63 licenses totaling approximately $697 million. On May 13, 2005, the licenses won by Verizon Wireless were granted by the FCC. The licenses won by Vista PCS remain subject to FCC approval.

Sales of Businesses and Investments

Information Services

In December 2005, we announced that we are exploring divesting Information Services through a spin-off, sale or other strategic transaction. However, since this process is still ongoing, Information Services' results of operations, financial position and cash flows remain in Verizon's continuing operations.

Telephone Access Lines

We continually consider plans for a reduction in the size of our access line business, including through a spin-off mechanism or otherwise, so that we may pursue our strategy of placing greater focus on the higher growth businesses of broadband and wireless.

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. As a result, an additional environmental remediation expense of $240 million was recorded in 2003, for remedial activities likely to take place over the next several years. 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 this reserve 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 2" losses, and on March 29, 2005 we amended our application seeking an additional $3 million. Category 2 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 original $266 million of costs in our Category One applications. On December 8, 2005, we provided a detailed rebuttal to the preliminary audit findings and are currently awaiting the final audit report. Our applications are pending.

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 voice over the Internet, or 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.

Broadband

The FCC has adopted a series of orders that recognize the competitive nature of the broadband market, and impose lesser regulatory requirements to 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. The FCC's order addressing the appropriate regulatory treatment of broadband Internet access services is the subject of a pending appeal.

Video

The FCC has a body of rules that apply to cable operators under Title VI of the Communications Act of 1934, 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. The FCC currently is conducting a rulemaking proceeding to determine whether the local franchising process is serving as a barrier to entry for new providers of video services, like Verizon. In this proceeding, the FCC is evaluating the scope of its authority over the local franchise process and is considering adopting rules under Section 621 of the Communications Act of 1934 to ensure that the local franchising process does not undermine competitive entry.

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 notice seeks comments about intercarrier compensation in general, and requests input on seven 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 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 is the subject of an appeal by several parties. Disputes also remain pending in a number of forums relating to the appropriate compensation for Internet-bound traffic during previous periods under the terms of our interconnection agreements with other carriers.

The FCC also is 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. Any 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. Verizon and other parties have challenged various aspects of the new FCC rules 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 is the subject of an ongoing appeal.

CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS

In this Management's Discussion and Analysis of Results of Operations and Financial Condition, and elsewhere in this Annual Report, we have made forward-looking statements. These statements are based on our estimates and assumptions and are subject to risks and uncertainties. Forward-looking statements include the information concerning our possible or assumed future results of operations. Forward-looking statements also include those preceded or followed by the words "anticipates," "believes," "estimates," "hopes" or similar expressions. For those statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

The following important factors, along with those discussed elsewhere in this Annual Report, could affect future results and could cause those results to differ materially from those expressed in the forward-looking statements:

- materially adverse changes in economic and industry conditions and labor matters, including workforce levels and labor negotiations, and any resulting financial and/or operational impact, in the markets served by us or by companies in which we have substantial investments;
- material changes in available technology;
- technology substitution;
- an adverse change in the ratings afforded our debt securities by nationally accredited ratings organizations;
- the final results of federal and state regulatory proceedings concerning our provision of retail and wholesale services and judicial review of those results;
- the effects of competition in our markets;
- 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; and
- the extent and timing of our ability to obtain revenue enhancements and cost savings following our business combination with MCI.