

Telephone and Data Systems, Inc.
Consolidated Statement of Operations

<u>Year Ended December 31,</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
	<u>(Dollars and shares in thousands, except per share amounts)</u>		
Operating revenues	\$5,020,674	\$5,092,019	\$4,828,984
Operating expenses			
Cost of services and products (excluding Depreciation, amortization and accretion expense reported below)	1,864,426	1,853,686	1,693,531
Selling, general and administrative expense	1,966,707	1,921,430	1,800,480
Depreciation, amortization and accretion expense	749,970	750,077	748,136
Loss on impairment of intangible assets	14,000	414,376	24,923
Loss on asset disposals, net	17,765	24,296	34,016
Total operating expenses	<u>4,612,868</u>	<u>4,963,865</u>	<u>4,301,086</u>
Operating income	407,806	128,154	527,898
Investment and other income (expense)			
Equity in earnings of unconsolidated entities	90,732	89,812	91,831
Interest and dividend income	11,121	39,131	199,435
Interest expense	(124,557)	(137,899)	(208,736)
Gain on investments and financial instruments	—	31,595	81,423
Other, net	2,000	2,213	(6,401)
Total investment and other income (expense)	<u>(20,704)</u>	<u>24,852</u>	<u>157,552</u>
Income before income taxes and extraordinary item	387,102	153,006	685,450
Income tax expense	133,376	30,093	269,054
Income before extraordinary item	253,726	122,913	416,396
Extraordinary item, net of tax (Note 5)	—	—	42,827
Net income	253,726	122,913	459,223
Less: Net income attributable to noncontrolling interests, net of tax	(59,824)	(29,372)	(73,111)
Net income attributable to TDS shareholders	193,902	93,541	386,112
Preferred dividend requirement	(51)	(52)	(52)
Net income available to common	<u>\$ 193,851</u>	<u>\$ 93,489</u>	<u>\$ 386,060</u>
Basic weighted average shares outstanding	109,339	115,817	117,624
Basic earnings per share attributable to TDS shareholders (Note 7)			
Net Income before extraordinary item attributable to TDS Shareholders	\$ 1.77	\$ 0.81	\$ 2.92
Extraordinary item	—	—	0.36
Net Income available to common	<u>\$ 1.77</u>	<u>\$ 0.81</u>	<u>\$ 3.28</u>
Diluted weighted average shares outstanding	109,577	116,255	119,126
Diluted earnings per share attributable to TDS shareholders (Note 7)			
Net Income before extraordinary item attributable to TDS Shareholders	\$ 1.77	\$ 0.80	\$ 2.86
Extraordinary item	—	—	0.36
Net Income available to common	<u>\$ 1.77</u>	<u>\$ 0.80</u>	<u>\$ 3.22</u>
Dividends per share	<u>\$ 0.43</u>	<u>\$ 0.41</u>	<u>\$ 0.39</u>

The accompanying notes are an integral part of these consolidated financial statements.

Telephone and Data Systems, Inc.
Consolidated Statement of Cash Flows

<u>Year Ended December 31,</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
	<u>(Dollars in thousands)</u>		
Cash flows from operating activities			
Net income	\$ 253,726	\$ 122,913	\$ 459,223
Add (deduct) adjustments to reconcile net income to net cash flows from operating activities			
Depreciation, amortization and accretion	749,970	750,077	748,136
Bad debts expense	115,989	83,004	74,988
Stock-based compensation expense	32,486	22,693	31,891
Deferred income taxes, net	31,053	(437,919)	(283,047)
Gain on investments and financial instruments, net	—	(31,595)	(81,423)
Equity in earnings of unconsolidated entities	(90,732)	(89,812)	(91,831)
Distributions from unconsolidated entities	91,587	92,335	87,404
Loss on impairment of intangible assets	14,000	414,376	24,923
Loss on asset disposals, net	17,765	24,296	34,016
Extraordinary item, net of tax	—	—	(42,827)
Noncash interest expense	4,412	10,125	21,124
Excess tax benefit from stock awards	(25)	(1,966)	(28,981)
Other operating activities	(46)	(1,831)	(3,683)
Changes in assets and liabilities			
Accounts receivable	(110,258)	(79,427)	(88,889)
Inventory	(34,566)	(17,123)	16,848
Accounts payable	29,646	6,804	13,905
Customer deposits and deferred revenues	(6,165)	7,692	24,725
Accrued taxes	56,068	(11,725)	56,225
Accrued interest	(2,009)	(4,221)	(8,273)
Other assets and liabilities	(50,307)	(9,804)	(23,422)
	<u>1,102,594</u>	<u>848,892</u>	<u>941,032</u>
Cash flows from investing activities			
Additions to property, plant and equipment	(671,165)	(734,923)	(699,566)
Cash paid for acquisitions and licenses	(29,276)	(389,189)	(23,764)
Cash received from divestitures	50	6,838	4,277
Proceeds from disposition of investments	—	259,017	92,002
Cash paid to settle derivative liabilities	—	(17,404)	—
Cash paid for short-term investments	(109,230)	(27,446)	—
Cash received from short-term investments	23,660	—	—
Other investing activities	4,515	355	(804)
	<u>(781,446)</u>	<u>(902,752)</u>	<u>(627,855)</u>
Cash flows from financing activities			
Borrowings from revolving credit facilities	—	100,000	25,000
Repayment of revolving credit facilities	—	(100,000)	(60,000)
Issuance of long-term debt	—	—	2,857
Repayment of long-term debt	(143,078)	(9,448)	(3,552)
Settlement of variable prepaid forward contracts	—	(47,357)	—
TDS Common Shares and Special Common Shares reissued for benefit plans, net of tax payments	819	1,409	113,605
U.S. Cellular Common Shares reissued for benefit plans, net of tax payments	(82)	(2,288)	10,073
Excess tax benefit from stock awards	25	1,966	28,981
Repurchase of TDS Common and Special Common Shares	(178,536)	(197,672)	(126,668)
Repurchase of U.S. Cellular Common Shares	(33,585)	(28,366)	(87,902)
Dividends paid	(46,798)	(47,320)	(45,830)
Payment of debt issuance costs	(10,079)	—	—
Distributions to noncontrolling interests	(17,533)	(16,769)	(8,559)
Other financing activities	1,382	2,568	(61)
	<u>(427,465)</u>	<u>(343,277)</u>	<u>(152,056)</u>
Net increase (decrease) in cash and cash equivalents	<u>(106,317)</u>	<u>(397,137)</u>	<u>161,121</u>
Cash and cash equivalents			
Beginning of period	<u>777,309</u>	<u>1,174,446</u>	<u>1,013,325</u>
End of period	<u>\$ 670,992</u>	<u>\$ 777,309</u>	<u>\$1,174,446</u>

The accompanying notes are an integral part of these consolidated financial statements.

Telephone and Data Systems, Inc.
Consolidated Balance Sheet—Assets

<u>December 31,</u>	<u>2009</u>	<u>2008</u>
	(Dollars in thousands)	
Current assets		
Cash and cash equivalents	\$ 670,992	\$ 777,309
Short-term investments	113,275	27,705
Accounts receivable		
Due from customers, less allowances of \$30,422 and \$12,822, respectively	380,941	377,054
Other, principally connecting companies, less allowances of \$7,201 and \$6,380, respectively	130,973	139,795
Inventory	156,987	122,377
Net deferred income tax asset	29,874	27,758
Prepaid expenses	94,336	93,382
Other current assets	66,764	63,556
	<u>1,644,142</u>	<u>1,628,936</u>
Investments		
Licenses	1,443,025	1,441,440
Goodwill	707,840	707,079
Customer lists, net of accumulated amortization of \$108,944 and \$97,891, respectively	26,589	34,032
Investments in unconsolidated entities	203,799	205,768
Notes receivable, less valuation allowance of \$55,144 and \$55,144, respectively	7,605	7,898
Other investments	2,180	2,725
	<u>2,391,038</u>	<u>2,398,942</u>
Property, plant and equipment		
In service and under construction	8,760,327	8,680,388
Less: Accumulated depreciation	5,252,482	5,111,464
	<u>3,507,845</u>	<u>3,568,924</u>
Other assets and deferred charges	<u>65,759</u>	<u>55,614</u>
Total assets	<u>\$7,608,784</u>	<u>\$7,652,416</u>

The accompanying notes are an integral part of these consolidated financial statements.

Telephone and Data Systems, Inc.
Consolidated Balance Sheet—Liabilities and Equity

<u>December 31,</u>	<u>2009</u>	<u>2008</u>
	<u>(Dollars in thousands)</u>	
Current liabilities		
Current portion of long-term debt	\$ 2,509	\$ 15,337
Accounts payable	347,348	319,575
Customer deposits and deferred revenues	167,963	174,101
Accrued interest	12,227	14,236
Accrued taxes	39,644	25,192
Accrued compensation	93,524	90,512
Other current liabilities	117,081	134,334
	<u>780,296</u>	<u>773,287</u>
Deferred liabilities and credits		
Net deferred income tax liability	517,762	471,623
Other deferred liabilities and credits	373,862	368,045
	<u>891,624</u>	<u>839,668</u>
Long-term debt	1,492,908	1,621,422
Commitments and contingencies		
Noncontrolling interests with redemption features	727	589
Equity		
TDS stockholders' equity		
Common Shares, par value \$.01 per share; authorized 100,000,000 shares; issued 57,082,000 shares	571	571
Special Common Shares, par value \$.01 per share; authorized 165,000,000 shares; issued 63,442,000 shares	634	634
Series A Common Shares, par value \$.01 per share; authorized 25,000,000 shares; issued and outstanding 6,492,000 and 6,461,000 shares, respectively	65	65
Capital in excess of par value	2,088,807	2,066,597
Treasury Shares at cost:		
Common Shares, 7,277,000 and 5,435,000 shares, respectively	(217,381)	(163,017)
Special Common Shares, 13,717,000 and 9,352,000 shares, respectively	(464,268)	(350,091)
Accumulated other comprehensive income	(2,710)	(16,812)
Retained earnings	2,371,587	2,229,540
Total TDS stockholders' equity	<u>3,777,305</u>	<u>3,767,487</u>
Preferred shares	832	852
Noncontrolling interests	665,092	649,111
Total equity	<u>4,443,229</u>	<u>4,417,450</u>
Total liabilities and equity	<u>\$7,608,784</u>	<u>\$7,652,416</u>

The accompanying notes are an integral part of these consolidated financial statements.

Telephone and Data Systems, Inc.
Consolidated Statement of Changes in Equity

	TDS Stockholders											
	Common Shares	Special Common Shares	Series A Common Shares	Capital in Excess of Par Value	Treasury Common Shares	Treasury Special Common Shares	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total TDS Stockholders' Equity	Preferred Shares	Non controlling Interests	Total Equity
	(Dollars in thousands)											
December 31, 2006	\$571	\$633	\$64	\$1,992,597	\$(187,108)	\$(187,020)	\$ 522,113	\$1,428,570	\$3,570,420	\$863	\$611,794	\$4,183,077
Net income attributable to TDS shareholders . . .	—	—	—	—	—	—	—	386,112	386,112	—	—	386,112
Net income attributable to noncontrolling interests classified as equity	—	—	—	—	—	—	—	—	—	—	76,867	76,867
Net change in marketable equity securities and equity method investments	—	—	—	—	—	—	(114,907)	—	(114,907)	—	(13,037)	(127,944)
Net change in derivative instruments	—	—	—	—	—	—	80,122	—	80,122	—	(549)	79,573
Changes in plan assets and projected benefit obligation related to retirement plan	—	—	—	—	—	—	3,403	—	3,403	—	—	3,403
Termination of defined benefit pension plan(1) . .	—	—	—	—	—	—	322	—	322	—	—	322
Cumulative-effect adjustment related to accounting for unrecognized tax benefits	—	—	—	—	—	—	20,723	(16,323)	4,400	—	—	4,400
Dividends:												
Common, Special Common and Series A Common Shares	—	—	—	—	—	—	—	(45,778)	(45,778)	—	—	(45,778)
Preferred shares	—	—	—	—	—	—	—	(52)	(52)	—	—	(52)
Repurchase of shares	—	—	—	—	—	(126,668)	—	—	(126,668)	(3)	—	(126,671)
Dividend reinvestment plan	—	—	—	1,483	—	—	—	—	1,483	—	—	1,483
Incentive and compensation plans	—	—	—	368	66,559	108,770	—	(61,878)	113,819	—	—	113,819
Adjust investment in subsidiaries for repurchases, issuances and other compensation plans	—	—	—	8,431	—	—	—	—	8,431	—	(11,544)	(3,113)
Stock-based compensation awards(2)	—	—	—	17,219	—	—	—	—	17,219	—	—	17,219
Tax windfall (shortfall) from stock awards(3)	—	—	—	28,376	—	—	—	—	28,376	—	—	28,376
Distributions to noncontrolling interests	—	—	—	—	—	—	—	—	—	—	(8,559)	(8,559)
Other	—	—	—	(364)	—	—	—	—	(364)	—	—	(364)
December 31, 2007	\$571	\$633	\$64	\$2,048,110	\$(120,549)	\$(204,918)	\$ 511,776	\$1,690,651	\$3,926,338	\$860	\$654,972	\$4,582,170

Telephone and Data Systems, Inc.
Consolidated Statement of Changes in Equity

	TDS Stockholders											
	Common Shares	Special Common Shares	Series A Common Shares	Capital in Excess of Par Value	Treasury Common Shares	Treasury Special Common Shares	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total TDS Stockholders' Equity	Preferred Shares	Non controlling Interests	Total Equity
	(Dollars in thousands)											
December 31, 2007	\$571	\$633	\$64	\$2,048,110	\$(120,549)	\$(204,918)	\$ 511,776	\$1,690,651	\$3,926,338	\$860	\$654,972	\$4,582,170
Net income attributable to TDS shareholders . . .	—	—	—	—	—	—	—	93,541	93,541	—	—	93,541
Net income attributable to noncontrolling interests classified as equity	—	—	—	—	—	—	—	—	—	—	25,518	25,518
Net change in marketable equity securities and equity method investments	—	—	—	—	—	—	(17,509)	—	(17,509)	—	(1,945)	(19,454)
Cumulative-effect adjustment related to fair value accounting (Note 3)	—	—	—	—	—	—	(502,677)	502,677	—	—	—	—
Changes in plan assets and projected benefit obligation related to retirement plan	—	—	—	—	—	—	(8,402)	—	(8,402)	—	—	(8,402)
Dividends:												
Common, Special Common and Series A Common Shares	—	—	—	—	—	—	—	(47,256)	(47,256)	—	—	(47,256)
Preferred shares	—	—	—	—	—	—	—	(52)	(52)	—	—	(52)
Repurchase of shares	—	—	—	—	(44,624)	(154,983)	—	—	(199,607)	(8)	—	(199,615)
Dividend reinvestment plan	—	1	1	1,755	—	—	—	—	1,757	—	—	1,757
Incentive and compensation plans	—	—	—	51	2,156	9,810	—	(10,021)	1,996	—	—	1,996
Adjust investment in subsidiaries for repurchases, issuances and other compensation plans	—	—	—	8,690	—	—	—	—	8,690	—	(12,848)	(4,158)
Stock-based compensation awards(2)	—	—	—	7,571	—	—	—	—	7,571	—	—	7,571
Tax windfall (shortfall) from stock awards(3)	—	—	—	420	—	—	—	—	420	—	—	420
Distributions to noncontrolling interests	—	—	—	—	—	—	—	—	—	—	(16,769)	(16,769)
Other	—	—	—	—	—	—	—	—	—	—	183	183
December 31, 2008	\$571	\$634	\$65	\$2,066,597	\$(163,017)	\$(350,091)	\$ (16,812)	\$2,229,540	\$3,767,487	\$852	\$649,111	\$4,417,450

Telephone and Data Systems, Inc.
Consolidated Statement of Changes in Equity

	TDS Stockholders											
	Common Shares	Special Common Shares	Series A Common Shares	Capital in Excess of Par Value	Treasury Common Shares	Treasury Special Common Shares	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total TDS Stockholders' Equity	Preferred Shares	Non controlling Interests	Total Equity
	(Dollars in thousands)											
December 31, 2008	\$571	\$634	\$65	\$2,066,597	\$(163,017)	\$(350,091)	\$ (16,812)	\$2,229,540	\$3,767,487	\$852	\$649,111	\$4,417,450
Net income attributable to TDS shareholders . . .	—	—	—	—	—	—	—	193,902	193,902	—	—	193,902
Net income attributable to noncontrolling interests classified as equity	—	—	—	—	—	—	—	—	—	—	59,686	59,686
Net unrealized losses on equity investments . . .	—	—	—	—	—	—	(302)	—	(302)	—	—	(302)
Changes in plan assets and projected benefit obligation related to retirement plan	—	—	—	—	—	—	14,404	—	14,404	—	—	14,404
Dividends:												
Common, Special Common and Series A Common Shares	—	—	—	—	—	—	—	(46,747)	(46,747)	—	—	(46,747)
Preferred shares	—	—	—	—	—	—	—	(51)	(51)	—	—	(51)
Repurchase of shares	—	—	—	—	(55,103)	(121,498)	—	(4)	(176,605)	(20)	—	(176,625)
Dividend reinvestment plan	—	—	—	1	410	833	—	286	1,530	—	—	1,530
Incentive and compensation plans	—	—	—	(44)	329	6,488	—	(5,339)	1,434	—	—	1,434
Adjust investment in subsidiaries for repurchases, issuances, other compensation plans and noncontrolling interest purchase	—	—	—	7,705	—	—	—	—	7,705	—	(26,172)	(18,467)
Stock-based compensation awards(2)	—	—	—	16,124	—	—	—	—	16,124	—	—	16,124
Tax windfall (shortfall) from stock awards(3)	—	—	—	(1,576)	—	—	—	—	(1,576)	—	—	(1,576)
Distributions to noncontrolling interests	—	—	—	—	—	—	—	—	—	—	(17,533)	(17,533)
December 31, 2009	<u>\$571</u>	<u>\$634</u>	<u>\$65</u>	<u>\$2,088,807</u>	<u>\$(217,381)</u>	<u>\$(464,268)</u>	<u>\$ (2,710)</u>	<u>\$2,371,587</u>	<u>\$3,777,305</u>	<u>\$832</u>	<u>\$665,092</u>	<u>\$4,443,229</u>

- (1) Represents additional liability of an individual telephone company's defined benefit pension plan which was terminated on November 13, 2007.
- (2) Reflects TDS Corporate and TDS Telecom's current year stock-based compensation awards impact on Capital in Excess of Par Value. U.S. Cellular's amounts are included in "Adjust investment in subsidiaries for repurchases, issuances and other compensation plans."
- (3) Reflects tax windfalls/(shortfalls) associated with the exercise of options and the vesting of restricted stock awards of TDS Common Shares and TDS Special Common Shares. U.S. Cellular's tax windfalls/(shortfalls) associated with the exercise of options and the vesting of restricted stock awards of U.S. Cellular are included in "Adjust investment in subsidiaries for repurchases, issuances and other compensation plans."

The accompanying notes are an integral part of these consolidated financial statements.

Telephone and Data Systems, Inc.
Consolidated Statement of Comprehensive Income

<u>Year Ended December 31,</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
	(Dollars in thousands)		
Net income	\$253,726	\$122,913	\$ 459,223
Net change in accumulated other comprehensive income			
Net change in marketable equity securities and equity method investments	(302)	(19,454)	(127,944)
Changes in plan assets and projected benefit obligation related to retirement plan	14,404	(8,402)	3,403
Net change in derivative instruments	—	—	79,573
Termination of defined benefit plan(1)	—	—	322
Comprehensive income	<u>267,828</u>	<u>95,057</u>	<u>414,577</u>
Less: Comprehensive income attributable to noncontrolling interests	<u>(59,824)</u>	<u>(27,427)</u>	<u>(59,525)</u>
Comprehensive income attributable to TDS shareholders	<u>\$208,004</u>	<u>\$ 67,630</u>	<u>\$ 355,052</u>

(1) Represents additional liability of an individual telephone company's defined benefit pension plan which was terminated on November 13, 2007.

The accompanying notes are an integral part of these consolidated financial statements.

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND RECENT ACCOUNTING PRONOUNCEMENTS

Nature of Operations

Telephone and Data Systems, Inc. (“TDS”) is a diversified telecommunications company providing high-quality telecommunications services in 36 states to approximately 6.1 million wireless customers and 1.1 million wireline equivalent access lines at December 31, 2009. TDS conducts substantially all of its wireless operations through its 82% owned subsidiary, United States Cellular Corporation (“U.S. Cellular”), and provides wireline services through its incumbent local exchange carrier (“ILEC”) and competitive local exchange carrier (“CLEC”) operations under its wholly owned subsidiary, TDS Telecommunications Corporation (“TDS Telecom”). TDS conducts printing and distribution services through its 80%-owned subsidiary, Suttle-Straus, Inc. (“Suttle-Straus”), which represents a small portion of TDS’ operations.

TDS has three reportable segments: (i) U.S. Cellular’s wireless operations; (ii) TDS Telecom’s ILEC wireline operations and (iii) TDS Telecom’s CLEC wireline operations. TDS does not have any foreign operations. See Note 19—Business Segment Information, for summary financial information on each business segment.

Principles of Consolidation

The accounting policies of TDS conform to accounting principles generally accepted in the United States of America (“GAAP”) as set forth in the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”). Unless otherwise specified, references to accounting provisions and GAAP in these notes refer to the requirements of the FASB ASC. The consolidated financial statements include the accounts of TDS, its majority-owned subsidiaries, general partnerships in which it has a majority partnership interest and any entity in which TDS has a variable interest that requires TDS to recognize a majority of the entity’s expected gains or losses. All material intercompany accounts and transactions have been eliminated.

Reclassifications

Certain prior year amounts have been reclassified to conform to the 2009 financial statement presentation. These reclassifications did not affect consolidated net income attributable to TDS shareholders, cash flows, assets, liabilities or equity for the years presented.

Business Combinations Accounting

Effective January 1, 2009, TDS adopted new required provisions under GAAP related to accounting for business combinations. Although the revised provisions still require that all business combinations are to be accounted for at fair value in accordance with the acquisition method, they require TDS to revise its application of the acquisition method in a number of significant aspects. Specifically, the new provisions require that transaction costs are to be expensed and that the acquirer must recognize 100% of the acquiree’s assets and liabilities rather than a proportional share, for acquisitions of less than 100% of a business. In addition, the revised provisions eliminate the step acquisition model and provide that all business combinations, whether full, partial or step acquisitions, will result in all assets and liabilities of an acquired business being recorded at their fair values at the acquisition date.

During 2008 and 2007, TDS applied the provisions of GAAP related to business combinations in effect during those periods. Similar to the revised provisions, the previous provisions required the application of the acquisition method whereby business combinations were to be accounted for at fair value. However the previous provisions were different in a number of respects, including (but not limited to) the requirement that all direct and incremental costs relating to an acquisition be included in the acquisition

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND RECENT ACCOUNTING PRONOUNCEMENTS (Continued)

costs, and the requirement that the acquirer only recognize its proportional share of the fair value of assets and liabilities acquired in a partial business acquisition.

Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect (a) the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and (b) the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates. Significant estimates are involved in accounting for goodwill and indefinite-lived intangible assets, depreciation, amortization and accretion, allowance for doubtful accounts, and income taxes.

Cash and Cash Equivalents

Cash and cash equivalents include cash and short-term, highly liquid investments with original maturities of three months or less.

Outstanding checks totaled \$26.1 million and \$28.5 million at December 31, 2009 and 2008, respectively, and are classified as Accounts payable in the Consolidated Balance Sheet.

Short-Term Investments

As of December 31, 2009 and 2008, TDS held certificates of deposit totaling \$113.3 million and \$27.7 million, respectively, which were included in Short-term investments in the Consolidated Balance Sheet. At December 31, 2009, these certificates of deposit had original maturities of between 120 days and one year on the dates TDS acquired these certificates of deposit and earn interest at annual rates between 0.50% and 1.75%.

Accounts Receivable and Allowance for Doubtful Accounts

U.S. Cellular's accounts receivable primarily consist of amounts owed by customers pursuant to service contracts and for equipment sales, by agents for sales of equipment to them and by other wireless carriers whose customers have used U.S. Cellular's wireless systems.

TDS Telecom's accounts receivable primarily consist of amounts owed by customers for services provided, by connecting companies for carrying interstate and intrastate long-distance traffic on its network, and by interstate and intrastate revenue pools that distribute access charges.

The allowance for doubtful accounts is the best estimate of the amount of probable credit losses related to existing accounts receivable. The allowance is estimated based on historical experience and other factors that could affect collectability. Accounts receivable balances are reviewed on either an aggregate or individual basis for collectability depending on the type of receivable. When it is probable that an account balance will not be collected, the account balance is charged against the allowance for doubtful accounts. TDS does not have any off-balance sheet credit exposure related to its customers.

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND RECENT ACCOUNTING PRONOUNCEMENTS (Continued)

The changes in the allowance for doubtful accounts during the years ended December 31, 2009, 2008 and 2007 were as follows:

<u>Year Ended December 31,</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
	(Dollars in thousands)		
Beginning Balance	\$ 19,202	\$ 21,623	\$ 25,383
Additions, net of recoveries	115,989	83,004	74,988
Deductions	(97,568)	(85,425)	(78,748)
Ending Balance	<u>\$ 37,623</u>	<u>\$ 19,202</u>	<u>\$ 21,623</u>

Inventory

Inventory primarily consists of handsets stated at the lower of cost or market, with cost determined using the first-in, first-out method and market determined by replacement costs. TDS Telecom’s materials and supplies are stated at average cost.

Fair Value Measurements

Effective January 1, 2008, for financial assets and liabilities measured in the Consolidated Balance Sheet at fair value on a recurring basis, TDS adopted the required provisions under GAAP that define “fair value”, establish a framework for measuring fair value in the application of GAAP, and expand disclosure about fair value measurements. Effective January 1, 2009, TDS adopted these same provisions for nonfinancial assets and liabilities measured in the Consolidated Balance Sheet at fair value on a nonrecurring basis, and for amounts that are presented only in disclosures. The provisions do not expand the use of fair value measurements in financial statements, but standardize their definition and application in GAAP. The provisions provide that fair value is a market-based measurement and not an entity-specific measurement, based on an exchange transaction in which the entity sells an asset or transfers a liability (exit price). The provisions establish a fair value hierarchy that contains three levels for inputs used in fair value measurements. Level 1 inputs include quoted market prices for identical assets or liabilities in active markets. Level 2 inputs include quoted market prices for similar assets and liabilities in active markets or quoted market prices for identical assets and liabilities in inactive markets. Level 3 inputs are unobservable.

In addition, on January 1, 2008, TDS elected provisions under GAAP that permit companies to choose to measure various financial instruments and certain other items at fair value. At the date the option is elected, entities are required to record a cumulative-effect adjustment to beginning retained earnings. In subsequent periods, for those instruments in which the fair value option is elected, unrealized gains and losses are recorded in the Consolidated Statement of Operations. On January 1, 2008, TDS elected these provisions for its investment in Deutsche Telekom Ordinary Shares, and also for the “collar” portions of the variable prepaid forward contracts (“forward contracts”) related to such Deutsche Telekom Ordinary Shares. TDS elected to do this for these items in order to better align the financial statement presentation of the unrealized gains and losses attributable to these items with their underlying economics. The forward contracts were settled and the Deutsche Telekom Ordinary Shares were disposed of in 2008.

Derivative Financial Instruments

TDS has in the past used derivative financial instruments in the form of forward contracts to reduce risks related to fluctuations in market prices of marketable equity securities. TDS did not hold or issue derivative financial instruments for trading purposes. During 2008 and 2007, TDS had forward contracts in place with respect to substantially all TDS’ marketable equity security portfolio, hedging the market

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND RECENT ACCOUNTING PRONOUNCEMENTS (Continued)

price risk with respect to the contracted securities. Some of these forward contracts settled in 2007 and the remaining contracts settled in 2008. The downside market risk was hedged at or above the accounting cost basis of the securities.

TDS recognized all of the forward contracts as either assets or liabilities in the Consolidated Balance Sheet and measured those instruments at their fair value. Changes in fair value of those instruments are reported in the Consolidated Statement of Operations or classified as Accumulated other comprehensive income, net of tax, in the Consolidated Balance Sheet, depending on the use of the derivative and whether it qualified for hedge accounting. Qualification for hedge accounting is dependent on whether the hedge is anticipated to be highly effective in achieving offsetting changes in the fair value of the hedged item or cash flows of the asset hedged.

TDS originally designated the embedded collars within the forward contracts related to Deutsche Telekom Ordinary Shares and Vodafone American Depositary Receipts (“ADRs”) as cash flow hedges. Accordingly, all changes in the fair value of the embedded collars were recorded in Accumulated other comprehensive income, net of income taxes. Subsequently, upon contractual modifications to the terms of the collars of the contracts related to Deutsche Telekom Ordinary Shares in June 2003 and Vodafone ADRs in September 2002, the embedded collars no longer qualified for hedge accounting treatment and all changes in fair value of the collars from the time of the contractual modification to the termination or settlement of the terms of the collars have been included in the Consolidated Statement of Operations.

The VeriSign forward contract was designated as a fair value hedge. Changes in the fair value of the embedded collar were recognized in the Consolidated Statement of Operations.

See Note 3—Fair Value Measurements for more information.

Licenses

Licenses consist of costs incurred in acquiring Federal Communications Commission (“FCC”) licenses to provide wireless service. These costs include amounts paid to license applicants and owners of interests in entities awarded licenses and all direct and incremental costs related to acquiring the licenses. Prior to a change in required GAAP in 2009, TDS had also allocated amounts to Licenses in conjunction with step acquisitions related to U.S. Cellular’s repurchase of U.S. Cellular Common Shares.

TDS has determined that wireless licenses are indefinite-lived intangible assets and, therefore, not subject to amortization, based on the following factors:

- Radio spectrum is not a depleting asset.
- The ability to use radio spectrum is not limited to any one technology.
- U.S. Cellular and its consolidated subsidiaries are licensed to use radio spectrum through the FCC licensing process, which enables licensees to utilize specified portions of the spectrum for the provision of wireless service.
- U.S. Cellular and its consolidated subsidiaries are required to renew their FCC licenses every ten years or, in some cases, every fifteen years. From the inception of U.S. Cellular to date, all of U.S. Cellular’s license renewal applications have been granted by the FCC. Generally, license renewal applications filed by licensees otherwise in compliance with FCC regulations are routinely granted. If, however, a license renewal application is challenged either by a competing applicant for the license or by a petition to deny the renewal application, the license will be renewed if the licensee can demonstrate its entitlement to a “renewal expectancy.” Licensees are entitled to such an expectancy if they can demonstrate to the FCC that they have provided “substantial service” during their license term and

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND RECENT ACCOUNTING PRONOUNCEMENTS (Continued)

have “substantially complied” with FCC rules and policies. U.S. Cellular believes that it is probable that its future license renewal applications will be granted.

Goodwill

TDS has goodwill as a result of its acquisitions of wireless markets, the acquisition of operating telephone companies and, prior to 2009, step acquisitions related to U.S. Cellular’s repurchase of its common shares. Such goodwill represents the excess of the total purchase price over the fair value of net assets acquired in these transactions.

Goodwill and Licenses Impairment Assessment

Goodwill and licenses must be assessed for impairment annually or more frequently if events or changes in circumstances indicate that such assets might be impaired.

The impairment test for goodwill is a two-step process. The first step compares the fair value of the reporting unit to its carrying value. If the carrying amount exceeds the fair value, the second step of the test is performed to measure the amount of impairment loss, if any. The second step compares the implied fair value of reporting unit goodwill with the carrying amount of that goodwill. To calculate the implied fair value of goodwill in this second step, an enterprise allocates the fair value of the reporting unit to all of the assets and liabilities of that reporting unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value was the price paid to acquire the reporting unit. The excess of the fair value of the reporting unit over the amount assigned to the assets and liabilities of the reporting unit is the implied fair value of goodwill. If the carrying amount of goodwill exceeds the implied fair value of goodwill, an impairment loss is recognized for that difference.

The impairment test for an intangible asset other than goodwill consists of comparing the fair value of the intangible asset to its carrying amount. If the carrying amount exceeds the fair value, an impairment loss is recognized for the difference.

Quoted market prices in active markets are the best evidence of fair value of an intangible asset or reporting unit and are used when available. If quoted market prices are not available, the estimate of fair value is based on the best information available, including prices for similar assets and the use of other valuation techniques. Other valuation techniques include present value analysis, multiples of earnings or revenues, or similar performance measures. The use of these techniques involve assumptions by management about factors that are uncertain including future cash flows, the appropriate discount rate, and other inputs. Different assumptions for these inputs could create materially different results.

Historically, U.S. Cellular completed the required annual impairment assessment of its licenses and goodwill as of April 1 of each year. As a result of the deterioration in the credit and financial markets and the decline of the overall economy in the fourth quarter of 2008, U.S. Cellular performed an interim impairment assessment of licenses and goodwill as of December 31, 2008. Effective April 1, 2009, U.S. Cellular adopted a new accounting policy whereby its annual impairment review of goodwill and indefinite-lived intangible assets will be performed as of November 1 instead of the second quarter of each year. The change in the annual goodwill and indefinite-lived intangible asset impairment testing date was made to better align the annual impairment test with the timing of U.S. Cellular’s annual strategic planning process, which allows for a better estimate of the future cash flows used in discounted cash flow models to test for impairment. This change in accounting policy does not delay, accelerate or avoid an impairment charge. Accordingly, U.S. Cellular management believes that this accounting change is preferable under the circumstances.

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND RECENT ACCOUNTING PRONOUNCEMENTS (Continued)

U.S. Cellular tests goodwill for impairment at the level of reporting referred to as a reporting unit. For purposes of impairment testing of goodwill in 2009, U.S. Cellular identified five reporting units. The five reporting units represent five geographic groupings of FCC licenses, representing five geographic service areas. U.S. Cellular tests licenses for impairment at the level of reporting referred to as a unit of accounting. For purposes of its annual impairment testing of licenses as of November 1, 2009, U.S. Cellular combined its FCC licenses into eighteen units of accounting. Of these, thirteen of such eighteen units of accounting represented geographic groupings of licenses which, because they were not being utilized and, therefore, were not expected to generate cash flows from operating activities in the foreseeable future, were considered separate units of accounting for purposes of impairment testing. The five units of accounting for which licenses are being utilized are referred to as “built licenses” and the thirteen units of accounting for which licenses are not being utilized are referred to as “unbuilt licenses.”

For purposes of impairment testing of goodwill, U.S. Cellular prepares valuations of each of the five reporting units. A discounted cash flow approach was used to value each reporting unit, using value drivers and risks specific to the current industry and economic markets. The cash flow estimates incorporated assumptions that market participants would use in their estimates of fair value. Key assumptions made in this process were the discount rate, estimated future cash flows, projected capital expenditures and the terminal growth rate.

In 2009, U.S. Cellular changed its method of estimating the fair value of built licenses for purposes of impairment testing from the multiple period excess cash flow method (“MPECF method”) to the build-out method. U.S. Cellular elected to make this change as the build-out method is a more widely used and accepted valuation method in estimating the fair value of licenses for purposes of impairment testing in the wireless industry. U.S. Cellular does not believe the build-out method yields a significantly different estimate of the fair value of licenses than the MPECF method.

The MPECF method estimated the fair value of the units of accounting by measuring the future cash flows of the license groups, reduced by charges for contributory assets such as working capital, trademarks, existing subscribers, fixed assets and assembled workforce to arrive at the economic margin. A contributory asset charge for goodwill was subtracted from the economic margin to arrive at the after-tax excess cash flows applicable to the licenses.

The build-out method estimates the value of licenses by calculating future cash flows from a hypothetical start-up wireless company and assumes that the only assets available upon formation are the underlying licenses. To apply this method, a hypothetical build-out of the company’s wireless network, infrastructure, workforce and related costs are projected based on market participant information. Calculated cash flows, along with a terminal value, are discounted to the present and summed to determine the estimated fair value.

For units of accounting which consist of unbuilt licenses, U.S. Cellular prepares estimates of fair value by reference to prices paid in recent auctions and market transactions where available. If such information is not available, the fair value of the unbuilt licenses is assumed to change by the same percentage, and in the same direction, that the fair value of built licenses measured using the build-out method changed during the period.

As a result of updated guidance promulgated by the FASB effective January 1, 2009, TDS did not record any amounts to licenses and goodwill as a result of U.S. Cellular’s purchases of U.S. Cellular Common Shares as step acquisitions using purchase accounting during 2009. Prior to January 1, 2009, TDS had recorded amounts as licenses and goodwill as a result of accounting for U.S. Cellular’s purchases of U.S. Cellular Common Shares as step acquisitions using purchase accounting. TDS’ ownership percentage of U.S. Cellular increases upon these U.S. Cellular share repurchases. The purchase price in

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND RECENT ACCOUNTING PRONOUNCEMENTS (Continued)

excess of the fair value of the net assets acquired is allocated principally to licenses and goodwill. For impairment testing purposes, the additional TDS licenses and goodwill amounts are allocated to the same reporting units and units of accounting used by U.S. Cellular. Consequently, U.S. Cellular's license and goodwill balances reported on a stand-alone basis do not match the TDS consolidated licenses and goodwill balances for U.S. Cellular, and impairment losses recognized by TDS related to U.S. Cellular licenses and goodwill may exceed those recognized by U.S. Cellular.

TDS Telecom has recorded goodwill primarily as a result of the acquisition of operating telephone companies and has assigned this goodwill to its ILEC reporting unit. For the purposes of impairment testing, the publicly-traded guideline company method and the recent transaction method were utilized. The publicly-traded guideline company method develops an indication of value by calculating market pricing multiples for selected publicly-traded companies. The recent transaction method calculates market pricing multiples based upon recent actual acquisitions of similar businesses. In both methods, the developed multiples are applied to the appropriate financial measure of TDS Telecom's ILEC reporting unit to determine the reporting unit's fair value.

Investments in Unconsolidated Entities

Investments in unconsolidated entities consist of investments in which TDS holds a non-controlling ownership interest of 50% or less. TDS follows the equity method of accounting for such investments in which its ownership interest equals or exceeds 20% for corporations and equals or exceeds 3% for partnerships and limited liability companies. The cost method of accounting is followed for such investments in which TDS' ownership interest is less than 20% for corporations and is less than 3% for partnerships and limited liability companies, and for investments for which TDS does not have the ability to exercise significant influence.

For its equity method investments for which financial information is readily available, TDS records its equity in the earnings of the entity in the current period. For its equity method investments for which financial information is not readily available, TDS records its equity in the earnings of the entity on a one quarter lag basis.

Property, Plant and Equipment

Property, plant and equipment is stated at the original cost of construction or purchase including capitalized costs of certain taxes, payroll-related expenses, interest and estimated costs to remove the assets.

Expenditures that enhance the productive capacity of assets in service or extend their useful lives are capitalized and depreciated. Expenditures for maintenance and repairs of assets in service are charged to Cost of services and products or Selling, general and administrative expense, as applicable.

For U.S. Cellular and TDS Telecom's CLEC operations, retirements and disposals of assets are recorded by removing the original cost of the asset (along with the related accumulated depreciation) from plant in service and charging it, together with removal cost less any salvage realized, to Loss on asset disposals, net. TDS Telecom's ILEC operations primarily use a group composite depreciation method. Under this method, when property, plant and equipment is retired, the original cost, net of salvage value, is charged against accumulated depreciation. A loss is recognized to the extent the cost to remove the plant exceeds the amounts established under the asset retirement obligation.

Costs of developing new information systems are capitalized and amortized over their expected economic useful lives.

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND RECENT ACCOUNTING PRONOUNCEMENTS (Continued)

Depreciation

TDS provides for depreciation using the straight-line method over the estimated useful life of the assets. However, prior to the third quarter of 2007 when TDS Telecom discontinued the use of accounting provisions now included in FASB ASC 980, *Regulated Operations* ("FASB ASC 980"), TDS Telecom's ILEC operations provided for depreciation according to depreciable rates approved by state public utility commissions. This change did not have a significant impact on TDS Telecom's depreciation expense.

TDS depreciates leasehold improvement assets associated with leased properties over periods ranging from one to thirty years; such periods approximate the shorter of the assets' economic lives or the specific lease terms.

Useful lives of specific assets are reviewed throughout the year to determine if changes in technology or other business changes would warrant accelerating the depreciation of those specific assets.

U.S. Cellular and TDS Telecom did not materially change the useful lives of their property, plant and equipment in 2009, 2008 or 2007.

Impairment of Long-lived Assets

TDS reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the assets might be impaired. The impairment test for tangible long-lived assets is a two-step process. The first step compares the carrying value of the asset (or asset group) with the estimated undiscounted cash flows over the remaining asset (or asset group) life. If the carrying value of the asset (or asset group) is greater than the undiscounted cash flows, the second step of the test is performed to measure the amount of impairment loss. The second step compares the carrying value of the asset to its estimated fair value. If the carrying value exceeds the estimated fair value (less cost to sell), an impairment loss is recognized for the difference.

Quoted market prices in active markets are the best evidence of fair value of a tangible long-lived asset and are used when available. If quoted market prices are not available, the estimate of fair value is based on the best information available, including prices for similar assets and the use of other valuation techniques. A present value analysis of cash flow scenarios is often the best available valuation technique. The use of this technique involves assumptions by management about factors that are uncertain including future cash flows, the appropriate discount rate, and other inputs. Different assumptions for these inputs could create materially different results.

Other Assets and Deferred Charges

Other assets and deferred charges primarily represent legal and other charges related to various borrowing instruments, and are amortized over the respective term of each instrument. The amounts for deferred charges included in the Consolidated Balance Sheet at December 31, 2009 and 2008 are shown net of accumulated amortization of \$23.0 million and \$22.0 million, respectively.

Asset Retirement Obligations

TDS accounts for asset retirement obligations in accordance with GAAP, which requires entities to record the fair value of a liability for legal obligations associated with an asset retirement in the period in which the obligations are incurred. At the time the liability is incurred, TDS records a liability equal to the net present value of the estimated cost of the asset retirement obligation and increases the carrying amount of the related long-lived asset by an equal amount. Over time, the liability is accreted to its present value, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND RECENT ACCOUNTING PRONOUNCEMENTS (Continued)

obligation, any difference between the cost to retire the asset and the recorded liability (including accretion of discount) is recognized in the Consolidated Statement of Operations.

Treasury Shares

Common Shares and Special Common Shares repurchased by TDS are recorded at cost as treasury shares and result in a reduction of equity. Treasury shares are reissued as part of TDS' stock-based compensation programs. When treasury shares are reissued, TDS determines the cost using the first-in, first-out cost method. The difference between the cost of the treasury shares and reissuance price is included in Capital in excess of par value or Retained earnings.

Revenue Recognition

U.S. Cellular

Revenues from wireless operations consist primarily of:

- Charges for access, airtime, roaming, long distance, data and other value added services provided to U.S. Cellular's retail customers and to end users through third-party resellers;
- Charges to carriers whose customers use U.S. Cellular's systems when roaming;
- Sales of equipment and accessories; and
- Amounts received from the Universal Service Fund ("USF") in states where U.S. Cellular has been designated an Eligible Telecommunications Carrier ("ETC").

Revenues related to wireless services are recognized as services are rendered. Revenues billed in advance or in arrears of the services being provided are estimated and deferred or accrued, as appropriate. Revenues from sales of equipment and accessories are recognized when title passes to the agent or end-user customer.

In order to provide better control over handset quality, U.S. Cellular sells handsets to agents. U.S. Cellular provides rebates to agents at the time an agent activates a new customer for U.S. Cellular or retains an existing customer in a transaction involving a handset. U.S. Cellular accounts for anticipated rebates on sales of handsets to agents by reducing revenues at the time of the sale to the agent rather than at the time the agent enrolls a new customer or retains a current customer. Similarly, U.S. Cellular offers certain rebates to retail customers who purchase new handsets. The revenue from a handset sale which includes such a rebate is recorded net of the rebate.

Activation fees charged with the sale of service only, where U.S. Cellular does not also sell a handset to the end user, are deferred and recognized over the average customer life. U.S. Cellular defers recognition of a portion of commission expenses related to activations in the amount of deferred activation fee revenues. This method of accounting provides for matching of revenues from activations to direct incremental costs associated with such activations within each reporting period. The activation fee charged with the sale of equipment and service is allocated to the equipment and service based upon the relative fair values of each item. This generally results in the recognition of the activation fee as additional handset revenue at the time of sale.

ETC revenues recognized in the reporting period represent the amounts which U.S. Cellular is entitled to receive for such period, as determined and approved in connection with U.S. Cellular's designation as an ETC in various states.

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND RECENT ACCOUNTING PRONOUNCEMENTS (Continued)

TDS Telecom

Revenue from wireline operations consist primarily of charges for:

- The provision of local telephone exchange service;
- Compensation for carrying interstate and intrastate long-distance voice and data traffic on TDS Telecom's local telephone networks, including compensation from Universal Service Funds;
- Leasing, selling, installing and maintaining customer premise equipment;
- Providing billing and collection services;
- Providing broadband services;
- Reselling long-distance services; and
- Selling digital broadcast satellite service.

Revenues are recognized as services are rendered. Activation fees charged are deferred and recognized over the average customer's service period.

TDS Telecom offers some products and services that are provided by third-party vendors, primarily satellite television service. TDS records satellite television service revenue on a net basis.

TDS Telecom offers discounts and incentives to customers who receive certain groupings of products and services (bundled arrangements). These discounts are recognized concurrently with the associated revenue and are allocated to the various products and services in the bundled offering based on their relative fair value. A bundled service offering TDS Telecom currently offers is telephone service, digital subscriber line ("DSL") service and satellite television service.

Discounts and incentives offered by TDS Telecom that are given directly to customers are recorded in the financial statements as a reduction of Operating revenues.

TDS' ILECs participate in revenue pools with other telephone companies for interstate revenue and for certain intrastate revenue. Such pools are funded by toll revenue and/or access charges within state jurisdictions and by access charges in the interstate market. Revenues earned through the various pooling processes are recorded based on estimates following the National Exchange Carrier Association's rules as approved by the FCC.

Amounts Collected from Customers and Remitted to Governmental Authorities

TDS records amounts collected from customers and remitted to governmental authorities net within a tax liability account if the tax is assessed upon the customer and TDS merely acts as an agent in collecting the tax on behalf of the imposing governmental authority. If the tax is assessed upon TDS, then amounts collected from customers as recovery of the tax are recorded in Operating revenues and amounts remitted to governmental authorities are recorded in Selling, general and administrative expenses in the Consolidated Statement of Operations. The amounts recorded gross in revenues that are billed to customers and remitted to governmental authorities totaled \$131.1 million, \$161.9 million and \$147.8 million for 2009, 2008 and 2007, respectively.

Advertising Costs

TDS expenses advertising costs as incurred. Advertising costs totaled \$266.5 million, \$284.9 million and \$240.3 million in 2009, 2008 and 2007, respectively.

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND RECENT ACCOUNTING PRONOUNCEMENTS (Continued)

Income Taxes

TDS files a consolidated federal income tax return. Deferred taxes are computed using the liability method, whereby deferred tax assets are recognized for future deductible temporary differences and operating loss carryforwards, and deferred tax liabilities are recognized for future taxable temporary differences. Both deferred tax assets and liabilities are measured using the tax rates anticipated to be in effect when the temporary differences reverse. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. Deferred tax assets are reduced by a valuation allowance when it is more likely than not that some portion or all of the deferred tax assets will not be realized. TDS evaluates income tax uncertainties, assesses the probability of the ultimate settlement with the applicable taxing authority and records an amount based on that assessment.

Stock-Based Compensation

TDS has established long-term incentive plans, employee stock purchase plans, dividend reinvestment plans, and a non-employee director compensation plan which are described more fully in Note 18—Stock-Based Compensation. These plans are considered compensatory plans; therefore, recognition of compensation costs for grants made under these plans is required. The dividend reinvestment plan of TDS is not considered a compensatory plan, therefore recognition of compensation costs for grants made under this plan is not required.

TDS values its share-based payment transactions using a Black-Scholes valuation model. Stock-based compensation cost recognized during the period is based on the portion of the share-based payment awards that are ultimately expected to vest. Accordingly, stock-based compensation cost recognized has been reduced for estimated forfeitures. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Pre-vesting forfeitures and expected life are estimated based on historical experience related to similar awards, giving consideration to the contractual terms of the stock-based awards, vesting schedules and expectations of future employee behavior. TDS believes that its historical experience provides the best estimates of future pre-vesting forfeitures and future expected life. The expected volatility assumption is based on the historical volatility of TDS' common stock over a period commensurate with the expected life. The dividend yield assumption is equal to the dividends declared in the most recent year as a percentage of the share price on the date of grant. The risk-free interest rate assumption is determined using the implied yield for zero-coupon U.S. government issues with a remaining term that approximates the expected life of the stock options.

Compensation cost for stock option awards is recognized over the respective requisite service period of the awards, which is generally the vesting period, on a straight-line basis for each separate vesting portion of the awards as if the awards were, in-substance, multiple awards (graded vesting attribution method).

Operating Leases

TDS is a party to various lease agreements for office space, retail sites, cell sites and equipment that are accounted for as operating leases. Certain leases have renewal options and/or fixed rental increases. Renewal options that are reasonably assured of exercise are included in determining the lease term. TDS accounts for certain operating leases that contain rent abatements, lease incentives and/or fixed rental increases by recognizing lease revenue and expense on a straight-line basis over the lease term.

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND RECENT ACCOUNTING PRONOUNCEMENTS (Continued)

Recent Accounting Pronouncements

In June 2009, the FASB issued an update to accounting standards now reflected in FASB ASC 810, *Consolidation*. Subsequently, in December 2009, the FASB issued Accounting Standards Update No. 2009-17, *Consolidations (Topic 810)—Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities* (“ASU 2009-17”) to formally codify such update. The revised guidance changes how TDS determines when an entity that is insufficiently capitalized or is not controlled through voting or similar rights should be consolidated. TDS has interests in several entities within the scope of these requirements (see Note 6—Variable Interest Entities). TDS adopted this accounting standards update effective January 1, 2010. TDS anticipates that the adoption of this pronouncement will not have a significant impact on its financial position or results of operations.

In October 2009, the FASB issued Accounting Standards Update No. 2009-13, *Multiple Deliverable Revenue Arrangements—a consensus of FASB Emerging Issues Task Force* (“ASU 2009-13”). ASU 2009-13 addresses how arrangement consideration should be allocated to products and services included in revenue arrangements. It replaces “fair value” with “selling price” in revenue allocation guidance and establishes a selling price hierarchy for determining the selling price of each product or service. ASU 2009-13 will be effective for TDS on January 1, 2011. TDS does not anticipate that this pronouncement will have a significant impact on its financial position or results of operations.

In October 2009, the FASB issued Accounting Standards Update No. 2009-14, *Certain Revenue Arrangements that include Software Elements* (“ASU 2009-14”). ASU 2009-14 amends accounting and reporting guidance for revenue arrangements involving both tangible products and software that is “more than incidental to the tangible product as a whole”. ASU 2009-14 will be effective for TDS on January 1, 2011. TDS does not anticipate that this pronouncement will have a significant impact on its financial position or results of operations.

In January 2010, the FASB issued Accounting Standards Update No. 2010-06, *Improving Disclosures about Fair Value Measurements* (“ASU 2010-06”). ASU 2010-06 requires new disclosures regarding transfers in and out of Levels 1 and 2 and activity in Level 3 fair value measurements. It also clarifies existing disclosure requirements regarding the level of disaggregation in certain disclosures and inputs and valuation techniques used in FASB ASC 820, *Fair Value Measurements and Disclosures*. TDS adopted this accounting standards update effective January 1, 2010 for all the disclosure requirements in ASU 2010-06 except the new requirement regarding activity in Level 3 fair value measurements which becomes effective for TDS on January 1, 2011. TDS does not anticipate that this pronouncement will have a significant impact on its financial position or results of operations.

NOTE 2 NONCONTROLLING INTERESTS

Noncontrolling Interests Accounting

Effective January 1, 2009, TDS adopted new required provisions under GAAP related to the accounting and reporting for noncontrolling interests.

Pursuant to this adoption, the following provisions were applied retrospectively to all periods presented in these financial statements:

- TDS reclassified noncontrolling interests, formerly known as “minority interests,” from a separate caption between liabilities and equity (“mezzanine section”) to a component of equity, with the exception of noncontrolling interests with redemption features, which continue to require mezzanine section presentation. Previously, minority interests generally were reported in the balance sheet in the mezzanine section.

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 2 NONCONTROLLING INTERESTS (Continued)

- Consolidated net income and comprehensive income include amounts attributable to both TDS and the noncontrolling interests. Previously, net income attributable to the noncontrolling interests was reported as a deduction in arriving at consolidated net income. This presentation change does not impact the calculation of basic or diluted earnings per share, which continue to be calculated based on Net income attributable to TDS shareholders.
- Shares of TDS held by its subsidiary are reflected as treasury shares in the consolidated financial statements. Previously, these shares were not reflected as issued shares and treasury shares in the consolidated financial statements. As a result, 484,012 Common Shares and 484,012 Special Common Shares were added to both Common and Special Common Shares issued and Treasury Shares in the Consolidated Balance Sheet as of December 31, 2009 and December 31, 2008.

Pursuant to this adoption, the following provisions were applied prospectively effective January 1, 2009:

- All earnings and losses of a subsidiary are attributed to the parent and the noncontrolling interest, even if the losses attributable to the noncontrolling interest result in a deficit noncontrolling interest balance. Previously, any losses exceeding the noncontrolling interest's investment in the subsidiary were attributed to the parent. This change did not have a significant impact on TDS' financial statements in 2009.
- Once control of a subsidiary is obtained, changes in ownership interests in that subsidiary that do not result in a loss of control are accounted for as equity transactions. Previously, decreases in ownership interest in a subsidiary were accounted for as equity transactions, while increases in ownership interests in a subsidiary were accounted for as step acquisitions. Therefore, U.S. Cellular's repurchases of U.S. Cellular Common Shares in 2009 were accounted for as equity transactions in TDS' financial statements, whereby the difference between the fair value of the consideration paid and the related carrying value of the noncontrolling interests was recorded as Capital in excess of par value in TDS' Consolidated Balance Sheet. Previously, these transactions had been recorded as step acquisitions in TDS' financial statements.

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 2 NONCONTROLLING INTERESTS (Continued)

The following schedule discloses the effects of net income attributable to TDS shareholders and changes in TDS' ownership interest in U.S. Cellular on TDS' equity for 2009, 2008 and 2007:

<u>Year Ended December 31,</u>	<u>2009</u>	<u>2008(1)</u>	<u>2007(1)</u>
	<u>(Dollars in thousands)</u>		
Net income attributable to TDS shareholders	\$193,902	\$ 93,541	\$386,112
Transfer (to) from the noncontrolling interests			
Change in TDS' Capital in excess of par value from U.S. Cellular's issuance of U.S. Cellular shares	(4,709)	(11,179)	(16,959)
Change in TDS' Capital in excess of par value from U.S. Cellular's repurchase of U.S. Cellular shares	182	—	—
Purchase of ownership in subsidiary from noncontrolling interest	(105)	—	—
Net transfers (to) from noncontrolling interests	<u>(4,632)</u>	<u>(11,179)</u>	<u>(16,959)</u>
Change from net income attributable to TDS shareholders and transfers (to) from noncontrolling interests	<u>\$189,270</u>	<u>\$ 82,362</u>	<u>\$369,153</u>

(1) During 2008 and 2007, U.S. Cellular repurchased U.S. Cellular Common Shares and/or purchased noncontrolling interests in consolidated subsidiaries. TDS accounted for these transactions as step acquisitions, pursuant to GAAP in effect at that time. The amounts recorded in these transactions are reflected in the changes in the balances of Licenses, Goodwill and Customer lists.

Mandatorily Redeemable Noncontrolling Interests in Finite-Lived Subsidiaries

Under GAAP, certain noncontrolling interests in consolidated entities with finite lives may meet the definition of mandatorily redeemable financial instruments. TDS' consolidated financial statements include certain noncontrolling interests that meet this definition of mandatorily redeemable financial instruments. These mandatorily redeemable noncontrolling interests represent interests held by third parties in consolidated partnerships and limited liability companies ("LLCs"), where the terms of the underlying partnership or LLC agreement provide for a defined termination date at which time the assets of the subsidiary are to be sold, the liabilities are to be extinguished and the remaining net proceeds are to be distributed to the noncontrolling interest holders and TDS in accordance with the respective partnership and LLC agreements. The termination dates of these mandatorily redeemable noncontrolling interests range from 2085 to 2094.

The settlement value of TDS' mandatorily redeemable noncontrolling interests in finite-lived subsidiaries is estimated to be \$121.6 million at December 31, 2009. This amount represents the estimate of cash that would be due and payable to settle these noncontrolling interests assuming an orderly liquidation of the finite-lived consolidated partnerships and LLCs on December 31, 2009, net of estimated liquidation costs and it excludes redemption amounts recorded in Noncontrolling interests with redemption features in the Consolidated Balance Sheet. TDS currently has no plans or intentions relating to the liquidation of any of the related partnerships or LLCs prior to their scheduled termination dates. The corresponding carrying value of the mandatorily redeemable noncontrolling interests in finite-lived consolidated partnerships and LLCs at December 31, 2009 is \$42.3 million, and is included in Noncontrolling interests in the Consolidated Balance Sheet. The excess of the aggregate settlement value over the aggregate

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 2 NONCONTROLLING INTERESTS (Continued)

carrying value of these mandatorily redeemable noncontrolling interests is due primarily to the unrecognized appreciation of the noncontrolling interest holders' share of the underlying net assets in the consolidated partnerships and LLCs. Neither the noncontrolling interest holders' share, nor TDS' share, of the appreciation of the underlying net assets of these subsidiaries is reflected in the consolidated financial statements. The estimate of settlement value was based on certain factors and assumptions which are subjective in nature. Changes in those factors and assumptions could result in a materially larger or smaller settlement amount.

NOTE 3 FAIR VALUE MEASUREMENTS

As of December 31, 2009 and 2008, TDS did not have any financial assets or liabilities that were required, under GAAP, to be recorded at fair value on a recurring basis in its Consolidated Balance Sheet. However, TDS has applied the provisions of fair value accounting for purposes of computing the fair value of financial instruments for disclosure purposes. The fair value of financial instruments was as follows:

	December 31, 2009		December 31, 2008	
	Book Value	Fair Value	Book Value	Fair Value
	(Dollars in thousands)			
Cash and cash equivalents	\$ 670,992	\$ 670,992	\$ 777,309	\$ 777,309
Short-term investments	113,275	113,275	27,705	27,705
Current portion of long-term debt(1)	2,173	1,782	14,618	14,715
Long-term debt(1)	1,488,196	1,461,976	1,617,534	1,035,554

(1) Excludes capital lease obligations.

The fair value of cash equivalents included in Cash and cash equivalents and Short-term investments approximates their book value due to the short-term nature of these financial instruments. The fair value of Current portion of long-term debt, excluding capital lease obligations, was estimated using a discounted cash flow analysis. The fair value of Long-term debt, excluding capital lease obligations, was estimated using market prices for TDS' 7.6% Series A notes and 6.625% senior notes, U.S. Cellular's 7.5% and 8.75% senior notes, and discounted cash flow analysis for remaining debt. U.S. Cellular's 8.75% senior notes were redeemed in December 2009.

As of December 31, 2009 and 2008, TDS had certain Licenses recorded at fair value in its Consolidated Balance Sheet as a result of impairment losses recognized at or proximate to these respective dates. For

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 3 FAIR VALUE MEASUREMENTS (Continued)

Licenses recorded at fair value, the following table provides information regarding their classification in the fair value hierarchy:

<u>Description</u>	<u>December 31, 2009</u>	<u>Fair Value Measurements Using</u>			<u>Total (Losses)(1)</u>
		<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>	
(Dollars in thousands)					
Licenses recorded at fair value	\$57,000	\$—	\$—	\$57,000	\$ (14,000)

<u>Description</u>	<u>December 31, 2008</u>	<u>Fair Value Measurements Using</u>			<u>Total (Losses)(1)</u>
		<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>	
(Dollars in thousands)					
Licenses recorded at fair value	\$1,022,556	\$—	\$—	\$1,022,556	\$(414,376)

(1) These losses represent the excess carrying value of the Licenses over their estimated fair values at the respective impairment testing dates in the fourth quarters of 2009 and 2008. Such amounts are recorded as Loss on impairment of intangible assets in the Consolidated Statement of Operations.

See Note 1—Summary of Significant Accounting Policies and Recent Accounting Pronouncements for information regarding the methods and assumptions used to estimate the fair values for Licenses and a description of the levels in the fair value hierarchy.

On January 1, 2008, TDS elected to measure, as permitted by GAAP, its Deutsche Telekom Ordinary Shares and related collars at fair value in its Consolidated Balance Sheet, and recognize future changes in fair value in its Consolidated Statement of Operations. As a result of this election, TDS recorded an adjustment to increase January 1, 2008 beginning retained earnings by \$502.7 million, net of \$291.2 million of income taxes. This amount reflects an unrealized gain attributable to the Deutsche Telekom Ordinary Shares of \$647.3 million, net of income taxes of \$374.9 million, offset by an unrealized loss on the related forward contracts of \$144.6 million, net of income taxes of \$83.7 million. The unrealized loss on the forward contracts was attributable to the periods from inception to June 2003. During such periods the forward contracts qualified as cash flow hedges and the changes in the fair value were recorded as a component of Accumulated other comprehensive income. There were no tax accounting implications to the Consolidated Balance Sheet or Statement of Operations upon this election other than to reclassify the related tax effects from Accumulated other comprehensive income to beginning Retained earnings, as mentioned above.

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 3 FAIR VALUE MEASUREMENTS (Continued)

The following table details the Gain on investments and financial instruments included in the Consolidated Statement of Operations:

<u>Year Ended December 31,</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
	(Dollars in thousands)		
Gains (losses) on marketable equity securities and derivative instruments			
<u>Deutsche Telekom:</u>			
Gain on disposition of securities(1)	\$—	\$ —	\$ 366,684
Loss on the settlement of variable prepaid forward contracts(1)	—	—	(117,825)
Increase/(decrease) in the fair value of securities (asset)(2)	—	(294,827)	—
(Increase)/decrease in the fair value of the embedded collars in the variable prepaid forward contracts (liability)	—	295,389	(327,169)
	—	562	(78,310)
<u>Vodafone Group Plc:</u>			
Gain on disposition of securities(1)	—	—	178,895
Loss on the settlement of variable prepaid forward contracts(1)	—	—	(7,296)
(Increase) in the fair value of the embedded collars in the variable prepaid forward contracts (liability)	—	—	(24,901)
	—	—	146,698
<u>VeriSign:</u>			
Gain on disposition of securities(1)	—	—	6,234
Increase in the fair value of securities (asset)	—	—	5,171
(Increase) in the fair value of the embedded collars in the variable prepaid forward contracts (liability)	—	—	(4,671)
	—	—	6,734
<u>Rural Cellular Corporation:</u>			
Gain on disposition of securities	—	31,724	—
Other gains (losses)			
Sale of Midwest Wireless Communications, LLC(3) . . .	—	—	6,301
Other	—	(691)	—
	<u>\$—</u>	<u>\$ 31,595</u>	<u>\$ 81,423</u>

(1) TDS and its subsidiaries held Vodafone ADRs, VeriSign Common Shares and Deutsche Telekom Ordinary Shares which were obtained in connection with the sale of non-strategic investments. TDS entered into a number of variable prepaid forward contracts related to the Vodafone, VeriSign and Deutsche Telekom securities that it held. During 2007 and 2008, all forward contracts related to the Vodafone, VeriSign, and Deutsche Telekom securities were settled, and all remaining shares of these securities were sold. As a result, at December 31, 2008, TDS no longer owned Vodafone ADRs, VeriSign Common Shares and Deutsche Telekom Ordinary Shares, and no longer had any liability or other obligations under the related forward contracts.

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 3 FAIR VALUE MEASUREMENTS (Continued)

- (2) On January 1, 2008, TDS elected to record its investment in Deutsche Telekom Ordinary Shares at fair value in the Consolidated Statement of Operations. As a result of this election for the Deutsche Telekom Ordinary Shares, unrealized gains and losses on the shares were recorded in the Consolidated Statement of Operations as a Gain on investments and financial instruments. Prior to January 1, 2008, unrealized gains and losses on the shares were recorded in Accumulated other comprehensive income, a balance sheet account.
- (3) On October 3, 2006, U.S. Cellular completed the sale of its interest in Midwest Wireless Communications, LLC ("Midwest Wireless") and recorded a gain of \$70.4 million in 2006. An additional gain of \$6.3 million was recorded in 2007 in connection with the release of certain proceeds held in escrow at the time of sale.

NOTE 4 INCOME TAXES

Income tax expense is summarized as follows:

<u>Year Ended December 31,</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
	(Dollars in thousands)		
Current			
Federal	\$ 94,803	\$ 448,041	\$ 500,638
State	7,520	18,338	32,190
Foreign	—	1,633	19,273
Deferred			
Federal	24,043	(389,619)	(267,348)
State	7,010	(48,300)	(15,699)
	<u>\$133,376</u>	<u>\$ 30,093</u>	<u>\$ 269,054</u>

A reconciliation of TDS' income tax expense computed at the statutory rate to the reported income tax expense, and the statutory federal income tax expense rate to TDS' effective income tax expense rate, is as follows:

<u>Year Ended December 31,</u>	<u>2009</u>		<u>2008</u>		<u>2007</u>	
	<u>Amount</u>	<u>Rate</u>	<u>Amount</u>	<u>Rate</u>	<u>Amount</u>	<u>Rate</u>
	(Dollars in millions)					
Statutory federal income tax expense and rate	\$135.5	35.0%	\$ 53.6	35.0%	\$239.9	35.0%
State income taxes, net of federal benefit(1)	5.7	1.5	(15.2)	(9.9)	10.6	1.6
Effect of noncontrolling interests(2)	(4.0)	(1.1)	(5.1)	(3.3)	3.0	0.5
Effect of gains (losses) on investments, sales of assets and impairment of assets	—	—	(3.8)	(2.4)	—	—
Effect of federal unrecognized tax benefits	(1.3)	(0.3)	(0.1)	(0.1)	1.5	0.2
Foreign tax	—	—	1.1	0.7	12.5	1.8
Net research tax credit	(0.1)	—	(0.3)	(0.2)	(0.4)	(0.1)
Other differences, net	(2.4)	(0.6)	(0.1)	(0.1)	2.0	0.3
Total income tax expense and rate	<u>\$133.4</u>	<u>34.5%</u>	<u>\$ 30.1</u>	<u>19.7%</u>	<u>\$269.1</u>	<u>39.3%</u>

(1) State income taxes include changes in the valuation allowance which is primarily related to the ability to utilize net operating losses.

(2) Includes a \$4.6 million charge in 2007 related to the write-off of deferred tax assets established in prior years for certain partnerships.

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 4 INCOME TAXES (Continued)

The foreign tax incurred in 2008 and 2007 related to the dividend received from Deutsche Telekom.

TDS' net current deferred income tax asset totaled \$29.9 million and \$27.8 million at December 31, 2009 and 2008, respectively, and primarily represents the deferred tax effects of accrued liabilities and the allowance for doubtful accounts on customer receivables.

TDS' noncurrent deferred income tax assets and liabilities at December 31, 2009 and 2008 and the temporary differences that gave rise to them were as follows:

<u>Year Ended December 31,</u>	<u>2009</u>	<u>2008</u>
	<u>(Dollars in thousands)</u>	
Noncurrent deferred tax assets		
Net operating loss ("NOL") carryforwards	\$ 73,894	\$ 80,946
Other	91,749	89,273
	<u>165,643</u>	<u>170,219</u>
Less valuation allowance	(62,856)	(78,760)
Total noncurrent deferred tax assets	<u>102,787</u>	<u>91,459</u>
Noncurrent deferred tax liabilities		
Property, plant and equipment	379,958	352,011
Partnership investments	63,719	53,217
Licenses	168,845	149,847
Other	8,027	8,007
Total noncurrent deferred tax liabilities	<u>620,549</u>	<u>563,082</u>
Net noncurrent deferred income tax liability	<u>\$517,762</u>	<u>\$471,623</u>

At December 31, 2009, TDS and certain subsidiaries had \$1,263.5 million of state NOL carryforwards (generating a \$69.5 million deferred tax asset) available to offset future taxable income primarily of the individual subsidiaries that generated the losses. The state NOL carryforwards expire between 2010 and 2029. Certain subsidiaries that are not included in the federal consolidated income tax return, but file separate federal tax returns, had federal NOL carryforwards (generating a \$4.3 million deferred tax asset) available to offset future taxable income. The federal NOL carryforwards expire between 2010 and 2029. A valuation allowance was established for certain state NOL carryforwards and federal NOL carryforwards since it is more likely than not that a portion of such carryforwards will expire before they can be utilized.

Effective January 1, 2007, TDS adopted new requirements promulgated under GAAP related to accounting for unrecognized tax benefits. In accordance with these provisions, TDS recognized a cumulative effect adjustment of \$4.4 million, decreasing its liability for unrecognized tax benefits, interest and penalties and increasing the January 1, 2007 balance of Common stockholders' equity. Of this amount, \$20.7 million increased Accumulated other comprehensive income and \$16.3 million represents the cumulative reduction of beginning retained earnings.

At December 31, 2009, TDS had \$45.0 million in unrecognized tax benefits which, if recognized, would reduce income tax expense by \$27.7 million, net of the federal benefit from state income taxes. At December 31, 2008, TDS had \$39.2 million in unrecognized tax benefits, which, if recognized, would reduce income tax expense by \$25.1 million, net of the federal benefit from state income taxes.

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 4 INCOME TAXES (Continued)

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
	(Dollars in thousands)		
Balance at January 1	\$39,234	\$ 42,129	\$28,430
Additions for tax positions of current year	5,349	6,687	6,389
Additions for tax positions of prior years	4,362	4,701	8,696
Reductions for tax positions of prior years	(3,855)	(11,237)	(928)
Reductions for settlements of tax positions	—	(2,884)	(192)
Reductions for lapses in statutes of limitations	(56)	(162)	(266)
Balance at December 31	<u>\$45,034</u>	<u>\$ 39,234</u>	<u>\$42,129</u>

Unrecognized tax benefits are included in Accrued taxes and Other deferred liabilities and credits in the Consolidated Balance Sheet.

As of December 31, 2009, TDS believes it is reasonably possible that unrecognized tax benefits could change significantly in the next twelve months. The nature of the uncertainty primarily relates to the exclusion of certain transactions from certain state income taxes due primarily to anticipated closure of state income tax audits and the expiration of statutes of limitation. It is anticipated that these events could reduce unrecognized tax benefits in the range of \$0.4 million to \$8.9 million.

TDS recognizes accrued interest and penalties related to unrecognized tax benefits in income tax expense. The amounts charged to income tax expense totaled \$2.9 million, \$4.5 million and \$2.1 million in 2009, 2008 and 2007, respectively. Net accrued interest and penalties were \$16.8 million and \$13.3 million at December 31, 2009 and 2008, respectively.

TDS and its subsidiaries file federal and state income tax returns. In 2008, upon completion of the audit of the TDS consolidated group's federal income tax returns for the years 2002 through 2005, the Internal Revenue Service ("IRS") issued a proposed assessment of income tax. TDS protested the proposed assessment. A tentative resolution has been reached with the IRS, which is subject to review by the Joint Committee on Taxation. Under the tentative resolution, the IRS would concede the proposed adjustments and penalties in full. Pursuant to a provision of the Internal Revenue Code, TDS made a \$38 million deposit with the IRS related to this assessment in March 2009 in order to eliminate any potential interest expense subsequent to the deposit. This deposit is included in Other current assets in TDS' Consolidated Balance Sheet at December 31, 2009. Subject to Joint Committee approval of the tentative resolution with the IRS, the deposit made by TDS would be refunded to TDS by the IRS.

NOTE 5 EXTRAORDINARY ITEM

Prior to the third quarter of 2007, TDS Telecom's incumbent local exchange carrier ("ILEC") operations followed the accounting for regulated enterprises prescribed by accounting provisions now included in FASB ASC 980, *Regulated Operations* ("FASB ASC 980"). This accounting recognizes the economic effects of rate-making actions of regulatory bodies in the financial statements of the TDS Telecom ILEC operations.

During 2007, changes in TDS Telecom's business environment caused competitive forces to surpass regulatory forces such that TDS Telecom concluded that it was no longer reasonable to assume that rates set at levels that will recover the enterprise's cost can be charged to its customers.

TDS Telecom has experienced increasing access line losses due to increasing levels of competition across all of the ILEC service areas. Competition intensified in 2007 from cable and wireless operators who extended their investment beyond major markets to enable a broader range of voice and data

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 5 EXTRAORDINARY ITEM (Continued)

services that compete directly with TDS Telecom's service offerings. These alternative telecommunications providers have transformed a pricing structure historically based on the recovery of costs to a pricing structure based on market conditions. Consequently, TDS Telecom has had to alter its strategy to compete in its markets. Specifically, in the third quarter of 2007, TDS Telecom initiated an aggressive program of service bundling and deep discounting and made the decision to voluntarily exit certain revenue pools administered by the FCC-supervised National Exchange Carrier Association in order to achieve additional pricing flexibility to meet competitive pressures.

Based on these material factors impacting its operations, management determined in the third quarter of 2007 that it was no longer appropriate to continue the application of accounting provisions now included in FASB ASC 980 for reporting its financial results. Accordingly, TDS Telecom recorded a non-cash extraordinary gain of \$42.8 million, net of taxes of \$27.0 million, upon discontinuance of the application of accounting provisions now included in FASB ASC 980. The components of the non-cash extraordinary gain were as follows:

	Before Tax Effects	After Tax Effects
	(Dollars in thousands)	
Write off of regulatory cost of removal liability	\$70,107	\$43,018
Write off of other net regulatory assets	(259)	(191)
Total	\$69,848	\$42,827

In conjunction with the discontinuance of the accounting provisions now included in FASB ASC 980, TDS Telecom assessed the useful lives of fixed assets and determined that the impacts of any changes were not significant.

NOTE 6 VARIABLE INTEREST ENTITIES (VIEs)

From time to time, the FCC conducts auctions through which additional spectrum is made available for the provision of wireless services. U.S. Cellular, TDS' subsidiary, participated in spectrum auctions indirectly through its interests in Aquinas Wireless L.P. ("Aquinas Wireless"), King Street Wireless L.P. ("King Street Wireless"), Barat Wireless L.P. ("Barat Wireless") and Carroll Wireless L.P. ("Carroll Wireless"), collectively, the "limited partnerships." Each entity qualified as a "designated entity" and thereby was eligible for bid credits with respect to licenses purchased in accordance with the rules defined by the FCC for each auction. In most cases, the bidding credits resulted in a 25% discount from the gross winning bid.

A summary of the auctions in which each entity participated and the auction results for each of these entities are shown in the table below.

	FCC Auction	Auction End Date	Date Applications Granted by FCC	Number of Licenses Won
Aquinas Wireless	78	August 20, 2008	February 16, 2010	5
King Street Wireless	73	March 20, 2008	December 30, 2009	152
Barat Wireless	66	September 18, 2006	April 30, 2007	17
Carroll Wireless	58	February 15, 2005	January 6, 2006	16

Consolidated VIEs

As of December 31, 2009, TDS consolidates the following VIEs under GAAP:

- Aquinas Wireless;

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 6 VARIABLE INTEREST ENTITIES (VIEs) (Continued)

- King Street Wireless and King Street Wireless, Inc., the general partner of King Street Wireless;
- Barat Wireless and Barat Wireless, Inc., the general partner of Barat Wireless; and
- Carroll Wireless and Carroll PCS, Inc., the general partner of Carroll Wireless.

GAAP establishes certain criteria for consolidation of VIEs when voting control is not present. Specifically, for a VIE, as such term is defined by GAAP, an entity, referred to as the primary beneficiary, that absorbs a majority of the VIE's expected gains or losses is required to consolidate such a VIE. TDS holds a variable interest in the entities listed above due to capital contributions and/or advances it has provided to these entities. Given the significance of these contributions and/or advances in relation to the equity investments at risk, TDS was deemed to be the primary beneficiary of these VIEs under GAAP. Accordingly, these VIEs are consolidated because TDS anticipates benefiting from or absorbing a majority of these VIEs' expected gains or losses.

Following is a summary of the capital contributions and advances made to each entity by TDS as of December 31, 2009 (dollars in thousands). The amounts shown in the table below exclude funds provided to these entities solely from the shareholder of the general partner.

Aquinas Wireless	\$ 2,132
King Street Wireless & King Street Wireless, Inc.	300,604
Barat Wireless & Barat Wireless, Inc.	127,485
Carroll Wireless & Carroll PCS, Inc.	130,594
	<u>\$560,815</u>

The following table presents the classification of the consolidated VIEs' assets and liabilities in TDS' Consolidated Balance Sheet.

<u>December 31,</u>	<u>2009</u>	<u>2008</u>
	(Dollars in thousands)	
Assets		
Cash	\$ 679	\$ 684
Other current assets	393	63
Licenses	487,962	487,962
Property, plant and equipment	440	—
Total assets	<u>\$489,474</u>	<u>\$488,709</u>
Liabilities		
Customer deposits and deferred revenues	\$ 70	\$ 63
Total liabilities	<u>\$ 70</u>	<u>\$ 63</u>

Other Related Matters

TDS may agree to make additional capital contributions and/or advances to the VIEs discussed above and/or their general partners to provide additional funding for the development of licenses granted in the various auctions. TDS may finance such amounts with a combination of cash on hand, borrowings under its revolving credit agreement and/or long-term debt. There is no assurance that TDS will be able to obtain additional financing on commercially reasonable terms or at all to provide such financial support.

The general partner of each of these VIEs has the exclusive right to manage, operate and control the limited partnerships and make all decisions to carry on the business of the partnerships; however, the general partner needs consent of the partners to sell or lease certain licenses, to make certain large

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 6 VARIABLE INTEREST ENTITIES (VIEs) (Continued)

expenditures, admit other partners, or liquidate the limited partnerships. Based on the current ownership interests, the general partner would need the consent of the U.S. Cellular subsidiary that is a limited partner in each of the respective partnerships.

The limited partnership agreements also provide the general partner with a put option whereby the general partner may require the limited partner, a subsidiary of U.S. Cellular, to purchase its interest in the limited partnership. The general partner's put options related to its interests in Carroll Wireless, Barat Wireless, King Street Wireless and Aquinas Wireless will become exercisable in 2011, 2017, 2019 and 2020 respectively. The put option price is determined pursuant to a formula that takes into consideration fixed interest rates and the market value of U.S. Cellular's Common Shares. Upon exercise of the put option, the general partner is required to repay borrowings due to U.S. Cellular. If the general partner does not elect to exercise its put option, the general partner may trigger an appraisal process in which the limited partner (a subsidiary of U.S. Cellular) may have the right, but not the obligation, to purchase the general partner's interest in the limited partnership at a price and on other terms and conditions specified in the limited partnership agreement. In accordance with requirements under GAAP, TDS is required to calculate a theoretical redemption value for all of the puts assuming they are exercisable at the end of each reporting period, even though such exercise is not contractually permitted. Pursuant to GAAP, this theoretical redemption value, net of amounts payable to U.S. Cellular for loans (and accrued interest thereon) made by U.S. Cellular to the general partners, is recorded as a component of Noncontrolling interests with redemption features in TDS' Consolidated Balance Sheet. Also per GAAP, changes in the redemption value of the put options, net of interest accrued on the loans, are recorded as a component of Net income attributable to noncontrolling interests, net of tax, in TDS' Consolidated Statements of Operations.

See Note 16—Commitments and Contingencies for additional information related to the participation of Carroll Wireless, Barat Wireless and King Street Wireless in Auction 58, Auction 66 and Auction 73, respectively.

These VIEs are in the process of developing long-term business and financing plans. These entities were formed to participate in FCC auctions of wireless spectrum and to fund, establish, and provide wireless service with respect to any FCC licenses won in the auctions. As such, these entities have risks similar to those described in the "Risk Factors" in TDS' Annual Report on Form 10-K.

NOTE 7 EARNINGS PER SHARE

Basic earnings per share is computed by dividing Net income available to common shareholders of TDS by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing Net income available to common shareholders of TDS by the weighted average number of common shares outstanding during the period adjusted to include the effect of potentially dilutive securities. Potentially dilutive securities include incremental shares issuable upon exercise of outstanding stock options and the vesting of restricted stock units.

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 7 EARNINGS PER SHARE (Continued)

The amounts used in computing earnings per share and the effects of potentially dilutive securities on income and the weighted average number of Common, Special Common and Series A Common Shares are as follows:

<u>Year Ended December 31,</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
	<u>(Dollars and shares in thousands, except earnings per share)</u>		
Basic earnings per share:			
Net income before extraordinary item attributable to TDS shareholders	\$193,902	\$ 93,541	\$343,285
Preferred dividend requirement	(51)	(52)	(52)
Income before extraordinary item attributable to common shareholders	193,851	93,489	343,233
Extraordinary item, net of taxes	—	—	42,827
Net income available to common shareholders of TDS used in basic earnings per share	<u>\$193,851</u>	<u>\$ 93,489</u>	<u>\$386,060</u>
Diluted earnings per share:			
Net income available to common shareholders of TDS used in basic earnings per share	\$193,851	\$ 93,489	\$386,060
Noncontrolling interest adjustment(1)	(455)	(92)	(2,155)
Preferred dividend adjustment(2)	49	—	49
Net income available to common shareholders of TDS used in diluted earnings per share	<u>\$193,445</u>	<u>\$ 93,397</u>	<u>\$383,954</u>
Weighted average number of shares used in basic earnings per share			
Common Shares	51,168	53,028	52,518
Special Common Shares	51,698	56,339	58,660
Series A Common Shares	6,473	6,450	6,446
Total	<u>109,339</u>	<u>115,817</u>	<u>117,624</u>
Effects of dilutive securities:			
Effects of stock options(3)	50	335	1,287
Effects of restricted stock units(4)	144	103	168
Effects of preferred shares(5)	44	—	47
Weighted average number of shares used in diluted earnings per share	<u>109,577</u>	<u>116,255</u>	<u>119,126</u>
Basic earnings per share attributable to TDS shareholders			
Net income before extraordinary item attributable to TDS shareholders	\$ 1.77	\$ 0.81	\$ 2.92
Extraordinary item, net of taxes	—	—	0.36
	<u>\$ 1.77</u>	<u>\$ 0.81</u>	<u>\$ 3.28</u>
Diluted earnings per share attributable to TDS shareholders			
Net income before extraordinary item attributable to TDS shareholders	\$ 1.77	\$ 0.80	\$ 2.86
Extraordinary item, net of taxes	—	—	0.36
	<u>\$ 1.77</u>	<u>\$ 0.80</u>	<u>\$ 3.22</u>

- (1) The noncontrolling income adjustment reflects the additional noncontrolling share of U.S. Cellular's income computed as if all of U.S. Cellular's issuable securities were outstanding.
- (2) The preferred dividend adjustment reflects the dividend reduction in the event any preferred series were dilutive, and therefore converted for shares.
- (3) Stock options exercisable into 813,322 Common Shares and 4,237,872 Special Common Shares in 2009, 336,457 Common Shares and 1,829,969 Special Common Shares in 2008, and 106,570 Common Shares and

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 7 EARNINGS PER SHARE (Continued)

543,538 Special Common Shares in 2007 were not included in computing Diluted earnings per share because their effects were antidilutive.

- (4) Restricted stock units issuable upon vesting into 107,815 Special Common Shares in 2009, 51,503 Special Common Shares in 2008 and 42,389 Special Common Shares in 2007 were not included in computing Diluted earnings per share because their effects were antidilutive.
- (5) Preferred shares redeemable for 48,595 Common Shares in 2008 were not included in computing Diluted earnings per share because their effects were antidilutive.

NOTE 8 ACQUISITIONS, DIVESTITURES AND EXCHANGES

TDS assesses its existing wireless and wireline interests on an ongoing basis with a goal of improving the competitiveness of its operations and maximizing its long-term return on investment. As part of this strategy, TDS reviews attractive opportunities to acquire additional wireless operating markets, telecommunications companies, wireless spectrum and related service businesses. In addition, TDS may seek to divest outright or include in exchanges for other interests those wireless and wireline interests that are not strategic to its long-term success.

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 8 ACQUISITIONS, DIVESTITURES AND EXCHANGES (Continued)

TDS' acquisitions for the years ended 2009, 2008 and 2007 and the allocation of the purchase price for these acquisitions were as follows:

	Purchase price(1)	Allocation of Purchase Price			
		Goodwill(2)	Licenses	Customer lists	Net tangible assets (liabilities)
(Dollars in thousands)					
2009					
U.S. Cellular					
Licenses	\$ 15,750	\$ —	\$ 15,750	\$ —	\$ —
TDS Telecom					
ILEC businesses	10,855	289	—	3,610	6,956
ILEC other	14	14	—	—	—
Total	<u>\$ 26,619</u>	<u>\$ 303</u>	<u>\$ 15,750</u>	<u>\$ 3,610</u>	<u>\$ 6,956</u>
2008					
U.S. Cellular					
FCC Auction 73 licenses(3)	\$300,479	\$ —	\$300,479	\$ —	\$ —
Other licenses	32,340	—	32,340	—	—
Businesses	9,152	2,963	4,803	1,045	341
TDS Telecom					
ILEC businesses	61,199	22,206	—	14,299	24,694
ILEC other	121	121	—	—	—
Total	<u>\$403,291</u>	<u>\$25,290</u>	<u>\$337,622</u>	<u>\$15,344</u>	<u>\$25,035</u>
2007					
U.S. Cellular					
Licenses	\$ 3,195	\$ —	\$ 3,195	\$ —	\$ —
Businesses	18,283	5,864	7,900	1,560	2,959
TDS Telecom					
ILEC Other	200	259	—	—	(59)
Non-reportable segment					
Businesses	2,087	1,522	—	—	565
Total	<u>\$ 23,765</u>	<u>\$ 7,645</u>	<u>\$ 11,095</u>	<u>\$ 1,560</u>	<u>\$ 3,465</u>

(1) Cash amounts paid for the acquisitions may differ from the purchase price due to cash acquired in the transactions and working capital adjustments as of December 31 of the respective year.

(2) \$1.6 million and \$6.9 million of the goodwill was amortizable for income tax purposes in 2008 and 2007, respectively. No transactions resulted in tax amortizable goodwill in 2009.

(3) King Street Wireless L.P., an entity in which a subsidiary of U.S. Cellular is a limited partner with a 90% partnership interest, made these payments. U.S. Cellular loaned these funds to the partnership and the general partner and made direct capital investments to fund the auction payment.

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 9 LICENSES AND GOODWILL

Changes in TDS' licenses and goodwill are presented below. See Note 8—Acquisitions, Divestitures and Exchanges for information regarding transactions which affected licenses and goodwill during the periods.

Licenses

<u>Year Ended December 31,</u>	<u>2009</u>	<u>2008</u>
	<u>(Dollars in thousands)</u>	
Consolidated beginning balance	\$1,441,440	\$1,516,629
U.S. Cellular(1)		
Balance, beginning of year	1,438,640	1,513,829
Acquisitions	15,750	337,622
Impairment	(14,000)	(414,376)
Step acquisition allocation adjustment(1)	—	1,565
Other	(165)	—
	<u>1,585</u>	<u>(75,189)</u>
Balance, end of year	1,440,225	1,438,640
TDS Telecom—CLEC		
Balance, beginning and end of year	2,800	2,800
Net change—consolidated	<u>1,585</u>	<u>(75,189)</u>
Consolidated ending balance	<u>\$1,443,025</u>	<u>\$1,441,440</u>

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 9 LICENSES AND GOODWILL (Continued)

Goodwill

Year Ended December 31,

	<u>2009</u>	<u>2008</u>
	<u>(Dollars in thousands)</u>	
Consolidated beginning balance	\$1,070,419	\$1,042,469
Accumulated impairment losses(2)	(363,340)	(363,340)
	<u>707,079</u>	<u>679,129</u>
<u>U.S. Cellular(1)</u>		
Balance, beginning of year	616,764	610,316
Accumulated impairment losses	(333,900)	(333,900)
	<u>282,864</u>	<u>276,416</u>
Acquisitions	—	2,963
Step acquisition allocation adjustment(1)	—	3,485
Other	458	—
Balance, end of year	<u>617,222</u>	<u>616,764</u>
Accumulated impairment losses	(333,900)	(333,900)
	<u>283,322</u>	<u>282,864</u>
<u>TDS Telecom</u>		
Balance, beginning of year	449,853	428,351
Accumulated impairment losses(2)	(29,440)	(29,440)
	<u>420,413</u>	<u>398,911</u>
Acquisitions	303	22,327
Other	—	(825)
Balance, end of year	<u>450,156</u>	<u>449,853</u>
Accumulated impairment losses	(29,440)	(29,440)
	<u>420,716</u>	<u>420,413</u>
<u>Other(3)</u>		
Balance, beginning and end of year	3,802	3,802
Accumulated impairment losses	—	—
	<u>3,802</u>	<u>3,802</u>
Net change—consolidated	<u>761</u>	<u>27,950</u>
Consolidated ending balance	<u>1,071,180</u>	<u>1,070,419</u>
Accumulated impairment losses	(363,340)	(363,340)
	<u>\$ 707,840</u>	<u>\$ 707,079</u>

(1) Prior to January 1, 2009, TDS accounted for U.S. Cellular's share repurchases as step acquisitions, allocating a portion of the share repurchase value to TDS licenses and goodwill, as required by GAAP in effect at that time. Therefore, prior to January 1, 2009, U.S. Cellular's balances included licenses and goodwill allocated from TDS as a result of step acquisitions. See Note 17—Common Stockholders' Equity for a discussion of U.S. Cellular's purchases of its Common Shares.

For impairment testing purposes, the additional TDS licenses and goodwill amounts are allocated to the same units of accounting and reporting units used by U.S. Cellular. In 2003, U.S. Cellular's licenses and goodwill impairment tests did not result in an impairment loss on a stand-alone basis. However, when the licenses and goodwill amounts recorded at TDS, as a result of step acquisitions, were added to the U.S. Cellular licenses and goodwill for impairment testing at the TDS consolidated level in 2003, an impairment loss on licenses and goodwill was recorded. Consequently, U.S. Cellular's licenses and goodwill balance reported on a stand-alone basis does not match the TDS consolidated licenses and goodwill balance related to U.S. Cellular.

(2) The entire goodwill balance of \$29.4 million at the TDS Telecom CLEC business segment was impaired in 2004. The remaining goodwill balance at TDS Telecom is attributed to the ILEC business segment.

(3) "Other" consists of goodwill related to Suttle-Straus.

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 9 LICENSES AND GOODWILL (Continued)

See Note 1—Summary of Significant Accounting Policies and Recent Accounting Pronouncements for a description of accounting policies related to licenses and goodwill.

2009 Impairment Assessment

In 2009, TDS completed the required annual impairment assessment of its licenses and goodwill in the fourth quarter. The assessment resulted in no impairment of goodwill and an impairment loss of \$14.0 million on licenses. The entire impairment loss relates to licenses in developed operating markets (built licenses).

2008 Impairment Assessment

In 2008, TDS completed the required annual impairment assessment of its licenses and goodwill in the second quarter. As a result of the deterioration in the credit and financial markets and the decline of the overall economy in the fourth quarter of 2008, TDS performed an interim impairment assessment of licenses and goodwill as of December 31, 2008. The assessment resulted in no impairment of goodwill and an impairment loss of \$414.4 million on licenses. Of the \$414.4 million, \$357.6 million relates to licenses in developed operating markets (built licenses) and \$56.8 million relates to licenses that are not being utilized (unbuilt licenses). The TDS impairment amount exceeded the U.S. Cellular impairment amount recorded on a stand-alone basis due to step acquisition allocation adjustments, which increased the carrying value of licenses at the TDS level.

2007 Impairment Assessment

During 2007, TDS recognized a \$2.1 million impairment of licenses as a result of its annual impairment assessment in the second quarter of 2007. In addition, TDS recognized an impairment of licenses of \$20.8 million in the fourth quarter of 2007 in conjunction with an exchange of licenses with Sprint Nextel. No impairment of goodwill was recognized in 2007.

NOTE 10 MARKETABLE EQUITY SECURITIES AND VARIABLE PREPAID FORWARD CONTRACTS

As of December 31, 2009 and 2008, TDS did not own either marketable equity securities or variable prepaid forward contracts.

Prior to August 7, 2008, TDS and its subsidiaries held 719,396 common shares of Rural Cellular Corporation ("RCC"). On August 7, 2008, RCC was acquired by Verizon Wireless, with shareholders of RCC receiving cash of \$45 per share in exchange for each RCC share owned. As a result of this exchange, TDS received total cash proceeds of \$32.4 million and recognized a pre-tax gain of \$31.7 million in August 2008.

In 2002 and 2003, TDS entered into variable prepaid forward contracts ("forward contracts") related to the Deutsche Telekom Ordinary Shares it held. The economic hedge risk management objective of the forward contracts was to hedge the value of the marketable equity securities from losses due to decreases in the market prices of the securities while retaining a share of gains from increases in the market prices of such securities. The downside risk was hedged at or above the accounting cost basis of the securities. The principal amount of the forward contracts was accounted for as a loan. The forward contracts contained embedded collars that were bifurcated and accounted for as derivatives.

In the first half of 2008, the forward contracts related to 85,969,689 Deutsche Telekom Ordinary Shares were settled through a combination of delivery of 73,462,167 Deutsche Telekom Ordinary Shares relating to the forward contracts and cash payments. TDS sold the remaining 12,507,522 Deutsche Telekom Ordinary Shares and realized cash proceeds of \$226.6 million from the sale. This amount was offset by \$17.4 million and \$47.4 million of cash payments paid to settle the collar (derivative liability) and debt portions of certain variable prepaid forward contracts, respectively, for which cash was delivered upon settlement.

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 10 MARKETABLE EQUITY SECURITIES AND VARIABLE PREPAID FORWARD CONTRACTS (Continued)

During 2007, the forward contracts related to TDS' investments in Vodafone ADRs, VeriSign Common Shares and a portion of the Deutsche Telekom Ordinary Shares matured. TDS delivered a substantial majority of such shares in settlement of the forward contracts and disposed of the remaining shares, which resulted in cash proceeds of \$92.0 million.

NOTE 11 INVESTMENTS IN UNCONSOLIDATED ENTITIES

Investments in unconsolidated entities consist of amounts invested in wireless and wireline entities which are accounted for using either the equity or cost method as shown in the following table:

<u>December 31,</u>	<u>2009</u>	<u>2008</u>
	(Dollars in thousands)	
Equity method investments:		
Capital contributions, loans and advances	\$ 32,244	\$ 32,942
Goodwill	6,630	6,630
Cumulative share of income	798,670	708,239
Cumulative share of distributions	(649,314)	(557,612)
	<u>188,230</u>	<u>190,199</u>
Cost method investments	<u>15,569</u>	<u>15,569</u>
Total investments in unconsolidated entities	<u>\$ 203,799</u>	<u>\$ 205,768</u>

Investments in unconsolidated entities include goodwill and costs in excess of the underlying book value of certain investments.

Equity in earnings of unconsolidated entities totaled \$90.7 million, \$89.8 million and \$91.8 million in 2009, 2008 and 2007, respectively; of those amounts, TDS' investment in the Los Angeles SMSA Limited Partnership ("LA Partnership") contributed \$64.7 million, \$66.1 million and \$71.2 million in 2009, 2008 and 2007, respectively. TDS held a 5.5% ownership interest in the LA Partnership throughout and at the end of each of these years.

The following tables, which are based on information provided in part by third parties, summarize the combined assets, liabilities and equity, and the combined results of operations of TDS' equity method investments:

<u>December 31,</u>	<u>2009</u>	<u>2008</u>
	(Dollars in thousands)	
Assets		
Current	\$ 452,000	\$ 429,000
Due from affiliates	468,000	417,000
Property and other	1,921,000	1,988,000
	<u>\$2,841,000</u>	<u>\$2,834,000</u>
Liabilities and Equity		
Current liabilities	\$ 251,000	\$ 243,000
Deferred credits	71,000	75,000
Long-term liabilities	40,000	44,000
Long-term capital lease obligations	43,000	50,000
Partners' capital and stockholders' equity	2,436,000	2,422,000
	<u>\$2,841,000</u>	<u>\$2,834,000</u>

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 11 INVESTMENTS IN UNCONSOLIDATED ENTITIES (Continued)

<u>Year Ended December 31,</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
	(Dollars in thousands)		
Results of Operations			
Revenues	\$4,815,000	\$4,784,000	\$4,519,000
Operating expenses	<u>3,437,000</u>	<u>3,376,000</u>	<u>3,092,000</u>
Operating income	1,378,000	1,408,000	1,427,000
Other income (expense)	42,000	26,000	32,000
Net income	<u>\$1,420,000</u>	<u>\$1,434,000</u>	<u>\$1,459,000</u>

NOTE 12 PROPERTY, PLANT AND EQUIPMENT

U.S. Cellular's Property, plant and equipment in service and under construction, and related accumulated depreciation, as of December 31, 2009 and 2008 were as follows:

<u>December 31,</u>	<u>Useful Lives</u>	<u>2009</u>	<u>2008</u>
	(Years)	(Dollars in thousands)	
Land	N/A	\$ 26,017	\$ 26,045
Buildings	20	300,285	275,307
Leasehold and land improvements	1-30	976,828	905,936
Cell site equipment	6-25	2,394,222	2,567,271
Switching equipment	1-8	862,826	877,664
Office furniture and equipment	3-5	549,871	527,592
Other operating equipment	5-25	341,988	302,640
System development	3-7	258,073	259,860
Work in process	N/A	174,197	142,068
		<u>5,884,307</u>	<u>5,884,383</u>
Accumulated depreciation		<u>(3,282,969)</u>	<u>(3,264,007)</u>
		<u>\$ 2,601,338</u>	<u>\$ 2,620,376</u>

U.S. Cellular's depreciation and amortization expense related to Property, plant and equipment totaled \$554.9 million, \$560.3 million and \$559.0 million in 2009, 2008 and 2007, respectively.

In 2009, 2008 and 2007, U.S. Cellular's Loss on asset disposals, net included charges of \$15.2 million, \$23.4 million and \$19.4 million, respectively, related to disposals of assets, trade-ins of older assets for replacement assets and other retirements of assets from service. In 2007, U.S. Cellular conducted a physical inventory of its significant cell site and switching assets. As a result, Loss on asset disposals, net also included a charge of \$14.6 million in 2007 reflecting the results of the physical inventory and related valuation and reconciliation.

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Notes to Consolidated Financial Statements

NOTE 12 PROPERTY, PLANT AND EQUIPMENT (Continued)

TDS Telecom's Property, plant and equipment in service and under construction, and related accumulated depreciation, as of December 31, 2009 and 2008 were as follows:

<u>December 31,</u>	<u>Useful Lives</u>	<u>2009</u>	<u>2008</u>
	<u>(Years)</u>	<u>(Dollars in thousands)</u>	
Cable and wire	15-20	\$ 1,375,201	\$ 1,339,110
Central office equipment	5-12	953,211	908,178
Office furniture and equipment	5-10	87,318	93,511
Systems development	5-7	154,258	145,481
Land	N/A	6,557	6,274
Buildings	30	79,352	78,808
Other equipment	10-15	89,116	85,693
Work in process	N/A	46,877	51,648
		<u>2,791,890</u>	<u>2,708,703</u>
Accumulated depreciation		<u>(1,911,512)</u>	<u>(1,790,249)</u>
		<u>\$ 880,378</u>	<u>\$ 918,454</u>

The provision for TDS Telecom's ILEC companies' depreciation as a percentage of depreciable property was 5.8% in 2009, 5.7% in 2008 and 6.0% in 2007. TDS Telecom's depreciation and amortization expense related to Property, plant and equipment totaled \$161.4 million, \$154.5 million and \$156.4 million in 2009, 2008 and 2007, respectively.

Corporate and other Property, plant and equipment in service and under construction, and related accumulated depreciation, as of December 31, 2009 and 2008 were as follows:

<u>December 31,</u>	<u>2009</u>	<u>2008</u>
	<u>(Dollars in thousands)</u>	
Property, plant and equipment	\$ 84,130	\$ 87,302
Accumulated depreciation	<u>(58,001)</u>	<u>(57,208)</u>
Total	<u>\$ 26,129</u>	<u>\$ 30,094</u>

Corporate and other fixed assets consist of assets at the TDS corporate offices and Suttle-Straus. Corporate and other depreciation and amortization expense related to Property, plant and equipment totaled \$7.8 million, \$8.7 million and \$8.8 million in 2009, 2008 and 2007, respectively.

NOTE 13 ASSET RETIREMENT OBLIGATION

Asset retirement obligations are included in Other deferred liabilities and credits in the Consolidated Balance Sheet.

In 2009 and 2008, U.S. Cellular and TDS Telecom performed a review of the assumptions and estimated costs related to asset retirement obligations. The results of the reviews (identified as "Revisions in

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 13 ASSET RETIREMENT OBLIGATION (Continued)

estimated cash outflows”) and other changes in asset retirement obligations during 2009 and 2008 are shown in the table below.

	<u>U.S. Cellular</u>	<u>TDS Telecom</u>	<u>TDS Consolidated</u>
	(Dollars in thousands)		
2009			
Beginning Balance	\$148,982	\$50,551	\$199,533
Additional liabilities accrued	3,935	644	4,579
Revisions in estimated cash outflows	(47)	—	(47)
Acquisitions of assets	—	916	916
Disposition of assets	(1,128)	(388)	(1,516)
Accretion expense	10,923	3,620	14,543
Ending Balance	<u>\$162,665</u>	<u>\$55,343</u>	<u>\$218,008</u>
2008			
Beginning Balance	\$126,844	\$46,624	\$173,468
Additional liabilities accrued	5,310	148	5,458
Revisions in estimated cash outflows	8,321	—	8,321
Acquisitions of assets	419	741	1,160
Disposition of assets	(1,224)	(272)	(1,496)
Accretion expense	9,312	3,310	12,622
Ending Balance	<u>\$148,982</u>	<u>\$50,551</u>	<u>\$199,533</u>

NOTE 14 DEBT

Notes Payable

Prior to June 30, 2009, TDS had a \$600 million revolving credit facility available for general corporate purposes. On June 30, 2009, TDS entered into a new \$400 million revolving credit agreement with certain lenders and other parties. As a result, TDS’ \$600 million revolving credit agreement, which was due to expire in December 2009, was terminated on June 30, 2009 as a condition of entering into the new agreement. The new revolving credit agreement provides TDS with a \$400 million senior revolving credit facility for working capital, acquisitions and other corporate purposes and to refinance any existing debt of TDS. Amounts under the new revolving credit facility may be borrowed, repaid and reborrowed from time to time from and after June 30, 2009 until maturity in June 2012. At December 31, 2009, TDS had no outstanding borrowings and \$3.4 million of outstanding letters of credit under the new revolving credit facility, leaving \$396.6 million available for use. Borrowings under the new revolving credit facility bear interest at the London InterBank Offered Rate (“LIBOR”) (or, at TDS’ option, an alternate “Base Rate” as defined in the new revolving credit agreement) plus a contractual spread based on TDS’ credit rating. TDS may select borrowing periods of either one, two, three or six months (or other period of twelve months or less requested by TDS if approved by the lenders). At December 31, 2009, the one-month LIBOR was 0.23% and the contractual spread was 300 basis points. If TDS provides less than three business days notice of intent to borrow, interest on borrowings is at the Base Rate plus the contractual spread (the Base Rate was 3.25% at December 31, 2009). The new revolving credit facility required TDS to pay fees at an aggregate rate of 1.6% of the total \$400 million facility in 2009. Total fees paid under the new and previous TDS revolving credit facilities were \$7.0 million, \$1.5 million and \$2.4 million in 2009, 2008 and 2007, respectively.

Prior to June 30, 2009, U.S. Cellular had a \$700 million revolving credit facility available for general corporate purposes. On June 30, 2009, U.S. Cellular entered into a new \$300 million revolving credit

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Notes to Consolidated Financial Statements

NOTE 14 DEBT (Continued)

agreement with certain lenders and other parties. As a result, U.S. Cellular's \$700 million revolving credit agreement, which was due to expire in December 2009, was terminated on June 30, 2009 as a condition of entering into the new agreement. The new revolving credit agreement provides U.S. Cellular with a \$300 million senior revolving credit facility for working capital, acquisitions and other corporate purposes and to refinance any existing debt of U.S. Cellular. Amounts under the new revolving credit facility may be borrowed, repaid and reborrowed from time to time from and after June 30, 2009 until maturity in June 2012. At December 31, 2009, U.S. Cellular had no outstanding borrowings and \$0.2 million of outstanding letters of credit under the new revolving credit facility, leaving \$299.8 million available for use. Borrowings under the new revolving credit facility bear interest at the LIBOR (or, at U.S. Cellular's option, an alternate "Base Rate" as defined in the new revolving credit agreement) plus a contractual spread based on U.S. Cellular's credit rating. U.S. Cellular may select borrowing periods of either one, two, three or six months (or other period of twelve months or less requested by U.S. Cellular if approved by the lenders). At December 31, 2009, the one-month LIBOR was 0.23% and the contractual spread was 300 basis points. If U.S. Cellular provides less than three business days notice of intent to borrow, interest on borrowings is at the Base Rate plus the contractual spread (the Base Rate was 3.25% at December 31, 2009). The new revolving credit facility required U.S. Cellular to pay fees at an aggregate rate of 1.7% of the total \$300 million facility in 2009. Total fees paid under the new and previous U.S. Cellular revolving credit facilities were \$5.9 million, \$1.7 million and \$2.8 million in 2009, 2008 and 2007, respectively.

Information concerning notes payable under the TDS and U.S. Cellular new and prior revolving credit facilities is shown in the table below:

<u>Year Ended December 31,</u>	<u>2009</u>	<u>2008</u>
	<u>(Dollars in thousands)</u>	
Balance at the end of the year	\$ —	\$ —
Weighted average interest rate at the end of the year	N/A	N/A
Maximum amount outstanding during the year	\$ —	\$100,000
Average amount outstanding during the year(1)	\$ —	\$ 20,833
Weighted average interest rate during the year(1)	N/A	3.38%

(1) The average was computed based on month-end balances.

TDS' and U.S. Cellular's interest cost on their new revolving credit facilities is subject to increase if their current credit ratings from Standard & Poor's Rating Services, Moody's Investors Service or Fitch Ratings are lowered, and is subject to decrease if the ratings are raised. The new credit facilities would not cease to be available nor would the maturity date accelerate solely as a result of a downgrade in TDS' or U.S. Cellular's credit rating. However, a downgrade in TDS' or U.S. Cellular's credit rating could adversely affect their ability to renew the new credit facilities or obtain access to other credit facilities in the future.

The new revolving credit facilities have commitment fees based on the senior unsecured debt ratings assigned to TDS and U.S. Cellular by certain ratings agencies. The range of the commitment fees is 0.25% to 0.75% of the unused portions of the new revolving credit facilities.

TDS incurred costs of \$10.1 million in conjunction with obtaining the new credit facilities, and such costs are amortized on a straight line basis over the three-year term of the facilities.

The maturity date of any borrowings under the TDS and U.S. Cellular new revolving credit facilities would accelerate in the event of a change in control.

The continued availability of the new revolving credit facilities requires TDS and U.S. Cellular to comply with certain negative and affirmative covenants, maintain certain financial ratios and make

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 14 DEBT (Continued)

representations regarding certain matters at the time of each borrowing. TDS and U.S. Cellular believe they were in compliance as of December 31, 2009 with all covenants and other requirements set forth in the new revolving credit facilities.

In connection with U.S. Cellular's new revolving credit facility, TDS and U.S. Cellular entered into a subordination agreement dated June 30, 2009 together with the administrative agent for the lenders under U.S. Cellular's new revolving credit agreement. Pursuant to this subordination agreement, (a) any consolidated funded indebtedness from U.S. Cellular to TDS will be unsecured and (b) any (i) consolidated funded indebtedness from U.S. Cellular to TDS (other than "refinancing indebtedness" as defined in the subordination agreement) in excess of \$105,000,000, and (ii) refinancing indebtedness in excess of \$250,000,000, will be subordinated and made junior in right of payment to the prior payment in full of obligations to the lenders under U.S. Cellular's new revolving credit agreement. As of December 31, 2009, U.S. Cellular had no outstanding consolidated funded indebtedness or refinancing indebtedness that was subordinated to the revolving credit agreement pursuant to the subordination agreement.

Long-Term Debt

Long-term debt at December 31, 2009 and 2008 was as follows:

<u>December 31,</u>	<u>2009</u>	<u>2008</u>
	<u>(Dollars in thousands)</u>	
Telephone and Data Systems, Inc. (Parent):		
6.625% senior notes, maturing 2045	\$ 116,250	\$ 116,250
7.6% Series A notes, maturing in 2041	500,000	500,000
Purchase contracts, averaging 6.0%, due through 2021	1,097	1,097
Total Parent	<u>617,347</u>	<u>617,347</u>
Subsidiaries:		
U.S. Cellular—		
6.7% senior notes maturing in 2033	544,000	544,000
Unamortized discount	<u>(10,798)</u>	<u>(11,252)</u>
	533,202	532,748
7.5% senior notes, maturing in 2034	330,000	330,000
8.75% senior notes	—	130,000
Obligation on capital leases	4,396	4,146
Other, 9.0%	—	10,000
TDS Telecom—		
Rural Utilities Service ("RUS") and other notes	2,671	3,109
Other Subsidiaries—		
Long-term notes, 2.7% to 10.6%, due through 2012	<u>7,801</u>	<u>9,409</u>
Total Subsidiaries	<u>878,070</u>	<u>1,019,412</u>
Total long-term debt	1,495,417	1,636,759
Less: Current portion of long-term debt	<u>2,509</u>	<u>15,337</u>
Total long-term debt excluding current portion	<u>\$1,492,908</u>	<u>\$1,621,422</u>

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 14 DEBT (Continued)

Telephone and Data Systems, Inc. (Parent)

The unsecured 6.625% senior notes, issued in 2005, are due March 31, 2045. Interest on the notes is payable quarterly. TDS may redeem the notes, in whole or in part, at any time on or after March 31, 2010, at a redemption price equal to 100% of the principal amount redeemed plus accrued and unpaid interest.

The unsecured 7.6% Series A notes, issued in 2001, are due December 1, 2041. Interest is payable quarterly. The notes are redeemable by TDS at any time at 100% of the principal amount plus accrued and unpaid interest.

Subsidiaries—U.S. Cellular

The unsecured 6.7% senior notes are due December 15, 2033. Interest is paid semi-annually. U.S. Cellular may redeem the notes, in whole or in part, at any time prior to maturity at a redemption price equal to the greater of (a) 100% of the principal amount of such notes, plus accrued but unpaid interest, or (b) the sum of the present values of the remaining scheduled payments of principal and interest thereon discounted to the redemption date on a semi-annual basis at the Treasury Rate plus 30 basis points.

The unsecured 7.5% senior notes are due June 15, 2034. Interest on the notes is payable quarterly. U.S. Cellular may redeem the notes, in whole or in part, at any time on or after June 17, 2009, at a redemption price equal to 100% of the principal amount redeemed plus accrued and unpaid interest.

The unsecured 8.75% senior notes were due November 1, 2032. Interest was paid quarterly. U.S. Cellular redeemed the notes in whole at the redemption price equal to 100% of the principal amount plus accrued and unpaid interest on December 24, 2009, which resulted in a total redemption payment of \$131.7 million.

Consolidated

The annual requirements for principal payments on long-term debt are approximately \$2.5 million, \$1.6 million, \$4.9 million, \$0.3 million, \$0.2 million for the years 2010 through 2014, respectively.

The covenants associated with TDS and its subsidiaries' long-term debt obligations, among other things, restrict TDS' ability, subject to certain exclusions, to incur additional liens; enter into sale and leaseback transactions; and sell, consolidate or merge assets.

NOTE 15 EMPLOYEE BENEFIT PLANS

Defined Contribution Plans

TDS sponsors a qualified noncontributory defined contribution pension plan. The plan provides benefits for the employees of TDS Corporate, TDS Telecom and U.S. Cellular. Under this plan, pension costs are calculated separately for each participant and are funded annually. Total pension costs were \$18.8 million, \$16.8 million and \$14.1 million in 2009, 2008 and 2007, respectively. In addition, TDS sponsors a defined contribution retirement savings plan ("401(k)") plan. Total costs incurred from TDS' contributions to the 401(k) plan were \$20.9 million, \$20.6 million and \$17.2 million in 2009, 2008 and 2007, respectively.

TDS also sponsors an unfunded nonqualified deferred supplemental executive retirement plan for certain employees to offset the reduction of benefits caused by the limitation on annual employee compensation under the tax laws.

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 15 EMPLOYEE BENEFIT PLANS (Continued)

Other Post-Retirement Benefits

TDS sponsors a defined benefit post-retirement plan that provides medical benefits and that covers most of the employees of TDS Corporate, TDS Telecom and the subsidiaries of TDS Telecom. The plan is contributory, with retiree contributions adjusted annually. The plan anticipates future cost sharing changes that reflect TDS' intent to increase retiree contributions as a portion of total cost.

In 2009, TDS amended its defined benefit post-retirement plan that provides medical benefits to retirees. Under this plan, TDS provides a subsidy to retirees to pay for various medical plan options. The amendments introduced subsidy caps that will become effective in 2011. For current retirees and future retirees, the amendments reduce the future subsidies by varying amounts. For new employees hired on or after January 1, 2010, the subsidy is eliminated. The plan amendments reduced the plan's benefit obligation by \$26.1 million. This amount is included in TDS' December 31, 2009 Accumulated other comprehensive income as a component of net prior service costs.

The following amounts are included in Accumulated other comprehensive income, before affecting such amounts for income taxes:

<u>December 31,</u>	<u>2009</u>	<u>2008</u>
	(Dollars in thousands)	
Net prior service costs	\$ 33,804	\$ 4,158
Net actuarial loss	(34,765)	(31,871)
	<u>\$ (961)</u>	<u>\$(27,713)</u>

The estimated net actuarial loss and prior service cost gain for the postretirement benefit plans that will be amortized from Accumulated other comprehensive income into net periodic benefit cost during 2010 are \$2.2 million and \$(3.8) million, respectively.

The following amounts are included in Accumulated other comprehensive income ("AOCI"):

<u>December 31, 2009</u>	<u>Before-Tax</u>	<u>Deferred Tax (Expense) or Benefit</u>	<u>Net-of-Tax</u>
	(Dollars in thousands)		
Net actuarial gains (losses)	\$ (4,700)	\$ 2,169	\$ (2,531)
Prior service cost	30,447	(14,054)	16,393
Amortization of prior service costs	(801)	370	(431)
Amortization of actuarial losses	1,806	(833)	973
Total gains (losses) recognized in AOCI	<u>\$ 26,752</u>	<u>\$(12,348)</u>	<u>\$ 14,404</u>

<u>December 31, 2008</u>	<u>Before-Tax</u>	<u>Deferred Tax (Expense) or Benefit</u>	<u>Net-of-Tax</u>
	(Dollars in thousands)		
Net actuarial gains (losses)	\$(13,193)	\$ 4,927	\$ (8,266)
Prior service cost	(355)	133	(222)
Amortization of prior service costs	(830)	310	(520)
Amortization of actuarial losses	968	(362)	606
Total gains (losses) recognized in AOCI	<u>\$(13,410)</u>	<u>\$ 5,008</u>	<u>\$(8,402)</u>

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 15 EMPLOYEE BENEFIT PLANS (Continued)

The following table reconciles the beginning and ending balances of the benefit obligation and the fair value of plan assets for the other post-retirement benefit plans.

<u>December 31,</u>	<u>2009</u>	<u>2008</u>
	<u>(Dollars in thousands)</u>	
Change in benefit obligation		
Benefit obligation at beginning of year	\$ 59,600	\$ 57,078
Acquisition of ILEC	—	971
Service cost	2,140	2,001
Interest cost	3,616	3,451
Plan amendments	(30,447)	355
Actuarial (gain) loss	10,688	(1,651)
Prescription drug subsidy	237	237
Benefits paid	<u>(3,136)</u>	<u>(2,842)</u>
Benefit obligation at end of year	<u>42,698</u>	<u>59,600</u>
Change in plan assets		
Fair value of plan assets at beginning of year	33,612	41,886
Acquisition of ILEC	—	1,774
Actual return (loss) on plan assets	8,788	(11,259)
Employer contribution	3,143	4,053
Benefits paid	<u>(3,136)</u>	<u>(2,842)</u>
Fair value of plan assets at end of year	<u>42,407</u>	<u>33,612</u>
Funded status	<u>\$ (291)</u>	<u>\$(25,988)</u>

The benefit obligations identified above are recorded as a component of Other deferred liabilities and credits in TDS' Consolidated Balance Sheet.

The following table sets forth by level within the fair value hierarchy the plans' assets at fair value, as of December 31, 2009 and 2008. See Note 1—Summary of Significant Accounting Policies and Recent Accounting Pronouncements for definitions of the levels in the fair value hierarchy.

<u>December 31, 2009</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
	<u>(Dollars in thousands)</u>			
Mutual funds				
Corporate bond	\$10,986	\$ —	\$ —	\$10,986
International growth	8,112	—	—	8,112
Money market	2,208	—	—	2,208
US large cap	17,333	—	—	17,333
US small cap	3,735	—	—	3,735
Other	—	—	33	33
Total plan assets at fair value	<u>\$42,374</u>	<u>\$ —</u>	<u>\$ 33</u>	<u>\$42,407</u>

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 15 EMPLOYEE BENEFIT PLANS (Continued)

<u>December 31, 2008</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
	(Dollars in thousands)			
Mutual funds				
Corporate bond	\$ 8,728	\$ —	\$ —	\$ 8,728
International growth	6,058	—	—	6,058
Money market	1,652	—	—	1,652
US large cap	13,449	—	—	13,449
US small cap	3,152	—	—	3,152
Other	—	—	573	573
Total plan assets at fair value	<u>\$33,039</u>	<u>\$ —</u>	<u>\$ 573</u>	<u>\$33,612</u>

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. A financial instrument's level within the fair value hierarchy is not representative of its expected performance or its overall risk profile, and therefore Level 3 assets are not necessarily higher risk than Level 2 assets or Level 1 assets.

Mutual funds are valued based on the closing price reported on the active market on which the individual securities are traded. The investment strategy for each type of mutual fund is identified below:

Corporate bond—The funds seek to achieve a maximum total return, consistent with preservation of capital and prudent investment management by investing in a wide spectrum of fixed income instruments including bonds, debt securities and other similar instruments issued by U.S., non-U.S. and private-sector entities.

International growth—The funds seek to provide long-term capital appreciation by investing in the stocks of companies located outside the United States that are considered to have the potential for above-average capital appreciation.

Money market—The fund seeks as high a level of current income as is consistent with the preservation of capital and the maintenance of liquidity by investing in a diversified portfolio of high-quality, dollar-denominated short-term debt securities.

US large cap—The funds seek to track the performance of several benchmark indices that measure the investment return of large-capitalization stocks. The fund attempts to replicate the indices by investing substantially all of its assets in the stocks that make up the various indices in approximately the same proportion as the weighting in the indices.

US small cap—The fund seeks to track the performance of a benchmark index that measures the investment return of small-capitalization stocks. The fund attempts to replicate the index by investing substantially all of its assets in the stocks that make up the index in approximately the same proportion as the weighting in the index.

The following table summarizes how plan assets are invested.

<u>Investment Category</u>	<u>Target Asset Allocation</u>	<u>Allocation of Plan Assets At December 31,</u>	
		<u>2009</u>	<u>2008</u>
U.S. equities	50%	49.7%	51.1%
International equities	20%	19.1%	18.0%
Debt securities	30%	31.2%	30.9%

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 15 EMPLOYEE BENEFIT PLANS (Continued)

The post-retirement benefit fund engages multiple asset managers to ensure proper diversification of the investment portfolio within each asset category. The investment objective is to meet or exceed the rate of return of a performance index comprised of 50% Dow Jones U.S. Total Stock Market Index, 20% FTSE All World (excluding U.S.) Stock Index, and 30% Barclays Capital Aggregate Bond Index. The three-year and five-year average rates of return for TDS' post-retirement benefit fund are (0.4)% and 3.6%, respectively.

The post-retirement benefit fund does not hold any debt or equity securities issued by TDS, U.S. Cellular or any related parties.

TDS is not required to set aside current funds for its future retiree health and life insurance benefits. The decision to contribute to the plan assets is based upon several factors, including the funded status of the plan, market conditions, alternative investment opportunities, tax benefits and other circumstances. In accordance with applicable income tax regulations, total accumulated contributions to fund the costs of future retiree medical benefits are restricted to an amount not to exceed 25% of the total accumulated contributions to the trust. An additional contribution equal to a reasonable amortization of the past service cost may be made without regard to the 25% limitation. TDS does not expect to make a contribution to the plan in 2010.

Net periodic benefit cost recorded in the Consolidated Statement of Operations includes the following components:

<u>Year Ended December 31,</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
	<u>(Dollars in thousands)</u>		
Service cost	\$ 2,140	\$ 2,001	\$ 2,437
Interest cost on accumulated post-retirement benefit obligation	3,616	3,451	3,432
Expected return on plan assets	(2,800)	(3,585)	(3,284)
Amortization of:			
Unrecognized prior service cost(1)	(801)	(830)	(830)
Unrecognized net loss(2)	1,806	968	1,362
Net post-retirement cost	<u>\$ 3,961</u>	<u>\$ 2,005</u>	<u>\$ 3,117</u>

(1) Based on straight-line amortization over the average time remaining before active employees become fully eligible for plan benefits.

(2) Based on straight-line amortization over the average time remaining before active employees retire.

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 15 EMPLOYEE BENEFIT PLANS (Continued)

The following assumptions were used to determine benefit obligations and net periodic benefit cost:

<u>December 31,</u>	<u>2009</u>	<u>2008</u>
Benefit obligations		
Discount rate	5.60%	6.20%
Net periodic benefit cost		
Discount rate	6.20%	6.20%
Expected return on plan assets	8.25%	8.50%

In determining the discount rate for 2009 and 2008, TDS used a hypothetical Aa spot yield curve represented by a series of annualized individual discount rates from six months to thirty years. Each discount rate in the curve was derived by using a hypothetical zero coupon bond from an equal weighting of the bonds in distinct maturity groups. Only those bonds with yields to maturity in the top half of each maturity group were used to construct the yield curve. This yield curve, when populated with projected cash flows that represent the expected timing and amount of TDS plan benefit payments, produces a single effective interest discount rate that is used to measure the plan's liabilities.

A 1% increase or decrease in the discount rate would have the following effects:

	<u>One Percent</u>	
	<u>Increase</u>	<u>Decrease</u>
	<u>(Dollars in thousands)</u>	
Effect on total net periodic postretirement benefit cost	\$ (500)	\$ 500
Effect on post-retirement benefit obligation	\$(4,800)	\$5,500

The measurement date for actuarial determination was December 31, 2009. For measurement purposes, the annual rate of increase in the per capita cost of covered health care benefits was assumed for 2009 to be 8.7% for plan participants aged 65 and above, and 7.7% for participants under age 65. For all participants the 2009 annual rate of increase is expected to decrease to 5.0% by 2020. The 2008 expected rate of increase was 9.3% for plan participants aged 65 and above, and 8.0% for participants under age 65, decreasing to 5.0% by 2015.

A 1% increase or decrease in assumed health care cost trend rates would have the following effects:

	<u>One Percent</u>	
	<u>Increase</u>	<u>Decrease</u>
	<u>(Dollars in thousands)</u>	
Effect on total service and interest cost components	\$ 42	\$ (41)
Effect on post-retirement benefit obligation	\$588	\$(564)

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 15 EMPLOYEE BENEFIT PLANS (Continued)

The following estimated future benefit payments, which reflect expected future service, are expected to be paid:

<u>Year</u>	<u>Estimated Future Post-Retirement Benefit Payments</u> (Dollars in thousands)
2010	\$ 2,356
2011	2,302
2012	2,216
2013	2,223
2014	2,213
Thereafter	13,218

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act") was enacted. The Act expanded Medicare coverage, primarily by adding a prescription drug benefit for Medicare-eligible participants starting in 2006. The Act provided employers currently sponsoring prescription drug programs for Medicare-eligible participants with a range of options for coordinating with the new government-sponsored program to potentially reduce employers' costs. One alternative allowed employers to receive a subsidy from the federal government for all retirees enrolled in the employer-sponsored prescription drug plan. The plan qualifies for and receives this federal subsidy on an annual basis.

TDS' accumulated postretirement benefit obligation ("APBO") has been reduced by approximately \$2.7 million and \$15.9 million as of December 31, 2009 and December 31, 2008 as a result of this subsidy. Prior to the amendments made to the plan in 2009 related to the subsidy provided by TDS to retirees, that are described above, the plan was projected to remain eligible for the Medicare subsidy reimbursement indefinitely. After the amendments, the plan is only projected to remain eligible for the Medicare subsidy through the year 2016.

The effect of the Medicare subsidy reduced TDS' 2009, 2008 and 2007 net periodic postretirement benefit cost by \$2.3 million, \$1.9 million and \$2.7 million, respectively. TDS received a Medicare subsidy of \$0.2 million for 2007 in 2009 and \$0.2 million for 2006 in 2008. During 2010 and 2011, TDS expects to receive Medicare subsidies of \$0.3 million and \$0.3 million for 2008 and 2009, respectively.

NOTE 16 COMMITMENTS AND CONTINGENCIES

Lease Commitments

TDS and its subsidiaries have leases for certain plant facilities, office space, retail store sites, cell sites and data-processing equipment which are accounted for as operating leases. Certain leases have renewal options and/or fixed rental increases. Renewal options that are reasonably assured of exercise are included in determining the lease term. Any rent abatements or lease incentives, in addition to fixed rental increases, are included in the calculation of rent expense and calculated on a straight-line basis over the defined lease term.

TDS accounts for certain lease agreements as capital leases. The short- and long-term portions of capital lease obligations totaled \$0.3 million and \$4.7 million, respectively, as of December 31, 2009 and \$0.7 million and \$3.9 million, respectively, as of December 31, 2008. The short- and long-term portions of capital lease obligations are included in Current portion of long-term debt and Long-term debt in the Consolidated Balance Sheet.

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 16 COMMITMENTS AND CONTINGENCIES (Continued)

As of December 31, 2009, future minimum rental payments required under operating and capital leases and rental receipts expected under operating leases that have noncancellable lease terms in excess of one year were as follows:

	<u>Operating Leases— Future Minimum Rental Payments</u>	<u>Operating Leases— Future Minimum Rental Receipts</u>	<u>Capital Leases— Future Minimum Rental Payments</u>
	(Dollars in thousands)		
2010	\$ 148,002	\$29,988	\$ 799
2011	131,411	24,694	817
2012	105,824	19,151	658
2013	85,964	12,278	554
2014	62,981	6,105	563
Thereafter	<u>566,049</u>	<u>959</u>	<u>6,252</u>
Total	<u>\$1,100,231</u>	<u>\$93,175</u>	9,643
Less: Interest expense			<u>(4,595)</u>
Present value of minimum lease payments			5,048
Less: Current portion of obligations under capital leases			<u>(336)</u>
Long-term portion of obligations under capital leases			<u>\$4,712</u>

For 2009, 2008 and 2007, rent expense for noncancellable long-term leases was \$162.5 million, \$154.3 million and \$147.4 million, respectively; and rent expense under cancelable short-term leases was \$11.5 million, \$12.7 million and \$12.8 million, respectively. During 2009, TDS recorded a \$6.5 million out-of-period adjustment to correct rent expense. Management does not believe that the adjustment is material to the current year or any prior year earnings, earnings trends or financial statement line items. The adjustment was recorded in the quarter ended December 31, 2009 and no prior periods were adjusted. The impact of the out-of-period adjustment on the affected line items in the Consolidated Statement of Operations in 2009 is as follows:

<u>(Amounts in thousands)</u>	<u>Increase (Decrease)</u>
Cost of services and products	\$(5,813)
Selling, general and administrative	(696)
Total operating expenses	(6,509)
Operating income	6,509
Income before income taxes	6,509

Rental revenue totaled \$31.8 million, \$26.8 million and \$23.8 million in 2009, 2008 and 2007, respectively.

Indemnifications

TDS enters into agreements in the normal course of business that provide for indemnification of counterparties. These agreements include certain asset sales and financings with other parties. The terms of the indemnification vary by agreement. The events or circumstances that would require TDS to perform under these indemnities are transaction specific; however, these agreements may require TDS to indemnify the counterparty for costs and losses incurred from litigation or claims arising from the underlying transaction. TDS is unable to estimate the maximum potential liability for these types of indemnifications as the amounts are dependent on the outcome of future events, the nature and

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 16 COMMITMENTS AND CONTINGENCIES (Continued)

likelihood of which cannot be determined at this time. Historically, TDS has not made any significant indemnification payments under such agreements.

Legal Proceedings

In February 2009, the United States Department of Justice (“DOJ”) notified TDS and U.S. Cellular, a subsidiary of TDS, that each was a named defendant in a civil action brought by a private party in the U.S. District Court for the District of Columbia under the “qui tam” provisions of the federal False Claims Act. TDS and U.S. Cellular were advised that the complaint seeks return of approximately \$165 million of bid credits from certain FCC auctions and requests treble damages. The complaint was under seal while the DOJ considered whether to intervene in the proceeding. On October 13, 2009, TDS and U.S. Cellular were advised that the DOJ had determined not to intervene in the proceeding. As a result of the complaint, the DOJ had investigated TDS’ and U.S. Cellular’s participation in certain spectrum auctions conducted by the FCC between 2005 and 2008, through Carroll Wireless, L.P., Barat Wireless, L.P., and King Street Wireless, L.P. Carroll Wireless, L.P., Barat Wireless, L.P. and King Street Wireless, L.P. were winning bidders in Auction 58, Auction 66 and Auction 73, respectively. These limited partnerships received a 25% bid credit in the applicable auction price under FCC rules. The DOJ investigated whether these limited partnerships qualified for the 25% bid credit in auction price considering their arrangements with TDS and U.S. Cellular. In addition, on October 13, 2009, the District Court unsealed the complaint. At that time, the District Court also ordered that, if the private party plaintiff decides to pursue the matter, it must serve the complaint on TDS and U.S. Cellular within 120 days. On January 12, 2010, the private party plaintiff filed a request to voluntarily dismiss the complaint and, on January 13, 2010, the U.S. District Court for the District of Columbia issued an order dismissing the complaint. The FCC sent a letter to King Street Wireless, L.P. requesting that it submit to the FCC a written response to the allegations in the complaint. King Street Wireless, L.P. made this submission as requested by the FCC on May 8, 2009. Following completion of its review of the matter, on December 30, 2009, the FCC issued a public notice announcing the grant to King Street Wireless, L.P. of all licenses with respect to which it had been the high bidder in Auction 73.

TDS is involved or may be involved from time to time in legal proceedings before the FCC, other regulatory authorities, and/or various state and federal courts. If TDS believes that a loss arising from such legal proceedings is probable and can be reasonably estimated, an amount is accrued in the financial statements for the estimated loss. If only a range of loss can be determined, the best estimate within that range is accrued; if none of the estimates within that range is better than another, the low end of the range is accrued. The assessment of the expected outcomes of legal proceedings is a highly subjective process that requires judgments about future events. The legal proceedings are reviewed at least quarterly to determine the adequacy of accruals and related financial statement disclosures. The ultimate outcomes of legal proceedings could differ materially from amounts accrued in the financial statements.

NOTE 17 COMMON STOCKHOLDERS’ EQUITY

Tax-Deferred Savings Plan

TDS has reserved 45,000 Common Shares and 45,000 Special Common Shares at December 31, 2009, for issuance under the TDS Tax-Deferred Savings Plan, a qualified profit-sharing plan pursuant to Sections 401(a) and 401(k) of the Internal Revenue Code. Participating employees have the option of investing their contributions and TDS’ contributions in a TDS Common Share fund, a TDS Special Common Share fund, a U.S. Cellular Common Share fund or certain unaffiliated funds.

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 17 COMMON STOCKHOLDERS' EQUITY (Continued)

Common Stock

The holders of Common Shares and Special Common Shares are entitled to one vote per share. The holders of Common Shares have full voting rights; the holders of Special Common Shares have limited voting rights. Other than the election of directors, the Special Common Shares have no votes except as otherwise required by law. The holders of Series A Common Shares are entitled to ten votes per share. Series A Common Shares are convertible, on a share for share basis, into Common Shares or Special Common Shares. TDS has reserved 6,492,000 Common Shares and 6,730,000 Special Common Shares at December 31, 2009, for possible issuance upon such conversion.

The following table summarizes the number of Common, Special Common and Series A Common Shares issued and repurchased.

	Common Shares	Special Common Shares	Common Treasury Shares	Special Common Treasury Shares	Series A Common Shares
(Shares in thousands)					
Balance December 31, 2006(1)	57,042	63,425	(5,160)	(5,160)	6,445
Repurchase of shares	—	—	—	(2,077)	—
Conversion of Series A Common Shares	10	—	—	—	(10)
Dividend reinvestment, incentive and compensation plans	13	5	1,243	2,041	7
Balance December 31, 2007	57,065	63,430	(3,917)	(5,196)	6,442
Repurchase of shares	—	—	(1,556)	(4,306)	—
Conversion of Series A Common Shares	4	—	—	—	(4)
Dividend reinvestment, incentive and compensation plans	13	12	38	150	23
Balance December 31, 2008	57,082	63,442	(5,435)	(9,352)	6,461
Repurchase of shares	—	—	(1,854)	(4,520)	—
Dividend reinvestment, incentive and compensation plans	—	—	12	155	31
Balance December 31, 2009	57,082	63,442	(7,277)	(13,717)	6,492

(1) Previously, shares of TDS held by its subsidiary were not reflected as issued shares and treasury shares in the consolidated financial statements. Effective January 1, 2009, these shares are reflected as treasury shares pursuant to the adoption of new required provisions under GAAP related to the accounting and reporting for noncontrolling interests. See Note 2—Noncontrolling Interests for additional details on changes to accounting and reporting for noncontrolling interests.

Share Repurchase Programs

On November 19, 2009, the Board of Directors of TDS authorized a new \$250 million stock repurchase program for both TDS Common and Special Common Shares from time to time pursuant to open market purchases, block transactions, private purchases or otherwise, depending on market conditions. This new authorization will expire on November 19, 2012.

On November 17, 2009, the Board of Directors of U.S. Cellular authorized the repurchase of up to 1,300,000 Common Shares on an annual basis beginning in 2009 and continuing each year thereafter, on a cumulative basis. These purchases will be made pursuant to open market purchases, block

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 17 COMMON STOCKHOLDERS' EQUITY (Continued)

purchases, private purchases, or otherwise, depending on market prices and other conditions. This authorization does not have an expiration date.

Share repurchases made under these authorizations and prior authorizations, were as follows:

<u>Year Ended December 31,</u>	<u>Number of Shares</u>	<u>Average Cost Per Share</u>	<u>Amount(2)</u>
	(Dollars amounts and shares in thousands)		
2009			
U.S. Cellular Common Shares	887	\$37.86	\$ 33,585
TDS Common Shares	1,854	29.71	55,103
TDS Special Common Shares	4,520	26.88	121,497
2008			
U.S. Cellular Common Shares	600	\$54.87	\$ 32,920
TDS Common Shares	1,556	28.69	44,624
TDS Special Common Shares	4,306	35.99	154,983
2007			
U.S. Cellular Common Shares	—	\$ —	\$ —
U.S. Cellular Common Shares purchased through ASR transactions(1)	1,006	82.85	83,348
TDS Common Shares	—	—	—
TDS Special Common Shares	2,077	60.99	126,668

(1) TDS received \$4.6 million in 2008 as a final cash settlement of U.S. Cellular Common Share repurchases executed in 2007 through accelerated share repurchase transactions with an investment banking firm.

(2) Amounts reported on the Consolidated Statement of Cash Flows may differ from these amounts due to repurchases and subsequent cash settlements occurring in different years.

TDS' ownership percentage of U.S. Cellular increases upon U.S. Cellular share repurchases. Prior to January 1, 2009, TDS accounted for U.S. Cellular's purchases of U.S. Cellular Common Shares as step acquisitions using purchase accounting, as required by GAAP in effect at that time. See Note 9—Licenses and Goodwill for details on the amounts allocated to goodwill and intangible assets related to the repurchase of U.S. Cellular Common Shares in 2008. Subsequent to January 1, 2009, TDS accounts for U.S. Cellular's purchases of U.S. Cellular Common Shares as equity transactions. See Note 1—Summary of Significant Accounting Policies and Recent Accounting Pronouncements for additional information on the adoption of the revised provisions under GAAP for business combinations and Note 2—Noncontrolling Interests for additional information on the adoption of revised provisions related to the accounting for noncontrolling interests.

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 17 COMMON STOCKHOLDERS' EQUITY (Continued)

Accumulated Other Comprehensive Income

The changes in the cumulative balance of Accumulated other comprehensive income were as follows:

<u>Year Ended December 31,</u>	<u>2009</u>	<u>2008</u>
	<u>(Dollars in thousands)</u>	
Marketable equity securities		
Balance, beginning of period (prior to the adjustment)	\$ 608	\$ 665,377
Cumulative effect adjustment related to fair value accounting(1)	—	(647,260)
Balance, beginning of period (including the adjustment)	608	18,117
Add (deduct):		
Unrealized gain on marketable equity securities	—	654
Deferred income taxes	—	(251)
	—	403
Unrealized gains/(losses) of equity method companies	(302)	221
Noncontrolling share of unrealized gains	—	(17)
Net change in unrealized gains/(losses)	(302)	607
Recognized gain on sale of marketable equity securities(2)	—	(31,725)
Deferred income taxes	—	11,647
	—	(20,078)
Noncontrolling share of recognized gain	—	1,962
Net recognized gain	—	(18,116)
Net change in marketable equity securities	(302)	(19,454)
Net change attributable to noncontrolling interests	—	1,945
Net change attributable to TDS stockholders	(302)	(17,509)
Balance, end of period	<u>\$ 306</u>	<u>\$ 608</u>
Derivative instruments		
Balance, beginning of period (prior to the adjustment)	\$ —	\$(144,583)
Cumulative effect adjustment related to fair value accounting(1)	—	144,583
Balance, beginning of period (including the adjustment)	—	—
Net change in derivative instruments	—	—
Balance, end of period	<u>\$ —</u>	<u>\$ —</u>
Retirement plan		
Balance, beginning of period	\$(17,420)	\$ (9,018)
Add (deduct):		
Amounts included in net periodic benefit cost for the period		
Net actuarial loss	(4,700)	(13,193)
Prior service cost	30,447	(355)
Amortization of prior service cost	(801)	(830)
Amortization of unrecognized net loss	1,806	968
	26,752	(13,410)
Deferred income taxes	(12,348)	5,008
Net change in retirement plan	14,404	(8,402)
Balance, end of period	<u>\$ (3,016)</u>	<u>\$ (17,420)</u>

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 17 COMMON STOCKHOLDERS' EQUITY (Continued)

<u>Year Ended December 31,</u>	<u>2009</u>	<u>2008</u>
	(Dollars in thousands)	
Accumulated other comprehensive income		
Balance, beginning of period (prior to the adjustment)	\$(16,812)	\$ 511,776
Cumulative effect adjustment related to fair value accounting(1)	—	(502,677)
Balance, beginning of period (including the adjustment)	(16,812)	9,099
Add (deduct):		
Net change in marketable equity securities and equity method investments . .	(302)	(19,454)
Net change in derivative instruments	—	—
Net change in retirement plan	14,404	(8,402)
Net change included in comprehensive income	14,102	(27,856)
Less: Net change attributable to noncontrolling interests	—	1,945
Net change attributable to TDS stockholders	14,102	(25,911)
Balance, end of period	<u>\$ (2,710)</u>	<u>\$ (16,812)</u>

- (1) As permitted under GAAP, TDS elected to adopt fair value accounting for its investment in Deutsche Telekom Ordinary Shares and for the "collar" portions of the variable prepaid forward contracts related to such Deutsche Telekom Ordinary Shares as of January 1, 2008. This election, referred to as the fair value option, was made in order to better align the financial statement presentation of the unrealized gains and losses attributable to these items with their underlying economics. Entities which elect the fair value option are required to record a cumulative-effect adjustment to beginning retained earnings at the date of adoption. In subsequent periods, for those instruments for which the fair value option is elected, unrealized gains and losses are recorded in the Statement of Operations. See Note 3—Fair Value Measurements for additional details related to the cumulative effect adjustment related to fair value accounting.
- (2) See Note 10—Marketable Equity Securities and Variable Prepaid Forward Contracts for additional details on the disposition of marketable equity securities.

NOTE 18 STOCK-BASED COMPENSATION

TDS Consolidated

The following table summarizes stock-based compensation expense recognized during 2009, 2008 and 2007:

<u>Year Ended December 31,</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
	(Dollars in thousands)		
Stock option awards	\$ 17,075	\$10,013	\$ 18,961
Restricted stock unit awards	13,823	11,125	12,400
Deferred compensation matching stock unit awards	281	389	155
Employee stock purchase plans	471	469	229
Awards under non-employee directors' compensation plan	836	697	146
Total stock-based compensation, before income taxes	32,486	22,693	31,891
Income tax benefit	(12,228)	(8,354)	(11,783)
Total stock-based compensation expense, net of income taxes	<u>\$ 20,258</u>	<u>\$14,339</u>	<u>\$ 20,108</u>

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 18 STOCK-BASED COMPENSATION (Continued)

At December 31, 2009, unrecognized compensation cost for all stock-based compensation awards was \$31.4 million. The unrecognized compensation cost for stock-based compensation awards at December 31, 2009, is expected to be recognized over a weighted average period of 1.3 years.

In 2009, 2008 and 2007, stock-based compensation expense of \$30.0 million, \$21.0 million and \$30.0 million, respectively, was recorded in Selling, general and administrative expense and \$2.5 million, \$1.7 million and \$1.9 million, respectively, was recorded in Cost of services and products.

TDS' tax benefits from the exercise of stock options and other awards totaled \$3.5 million in 2009.

TDS (excluding U.S. Cellular)

The information in this section relates to stock-based compensation plans using the equity instruments of TDS. Participants in these plans are generally employees of TDS Corporate and TDS Telecom, although U.S. Cellular employees are eligible to participate in the TDS Employee Stock Purchase Plan. Information related to plans using the equity instruments of U.S. Cellular are shown in the U.S. Cellular section following the TDS section.

Under the TDS 2004 Long-Term Incentive Plan, TDS may grant fixed and performance-based incentive and non-qualified stock options, restricted stock, restricted stock units, and deferred compensation stock unit awards to key employees. TDS had reserved 1,960,000 Common Shares and 9,221,000 Special Common Shares at December 31, 2009 for equity awards granted and to be granted under this plan. At December 31, 2009 the only types of awards outstanding are fixed non-qualified stock option awards, restricted stock unit awards, and deferred compensation stock unit awards. As of December 31, 2009, TDS also had reserved 119,000 Special Common Shares under an employee stock purchase plan. The maximum number of TDS Common Shares and TDS Special Common Shares that may be issued to employees under all stock-based compensation plans in effect at December 31, 2009 was 1,960,000 and 9,340,000 shares, respectively. TDS has also created a Non-Employee Directors' Plan under which it has reserved 92,000 TDS Special Common Shares as of December 31, 2009 for issuance as compensation to members of the Board of Directors who are not employees of TDS. When shares are issued upon stock option exercises or restricted stock unit vesting, TDS uses treasury shares.

Long-Term Incentive Plan—Stock Options—Stock options granted to key employees are exercisable over a specified period not in excess of ten years. Stock options generally vest over periods up to three years from the date of grant. Stock options outstanding at December 31, 2009 expire between 2010 and 2019. However, vested stock options typically expire 30 days after the effective date of an employee's termination of employment for reasons other than retirement. Employees who leave at the age of retirement have 90 days (or one year if they satisfy certain requirements) within which to exercise their vested stock options. The exercise price of the option generally equals the market value of TDS common stock on the date of grant.

TDS options granted in 2007 became exercisable on December 15, 2007. TDS options granted in 2008 and 2009 become exercisable with respect to one-third of the number of shares subject to the option on each of the first, second and third anniversaries of the grant date. As a result of this change, the expense related to options granted in 2008 and 2009 will be reflected over a three year period, instead of entirely in the year of grant as in 2007. As a result, the amount of expense recognized related to stock option awards in 2009 and 2008 is lower than the corresponding expense amount recognized in 2007.

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 18 STOCK-BASED COMPENSATION (Continued)

TDS estimated the fair value of stock options granted in 2009, 2008 and 2007 using the Black-Scholes valuation model and the assumptions shown in the table below:

	2009	2008	2007
Expected life	5.1 Years	5.0 Years	4.0 Years
Expected annual volatility rate	43.01%	25.95%	19.50%
Dividend yield	1.60%	1.16%	0.70%
Risk-free interest rate	2.46%	3.06%	4.70%
Estimated annual forfeiture rate	1.88%	1.88%	1.00%

Any employee with stock options granted prior to the date of the TDS Special Common Share dividend on May 13, 2005, receives one Common Share and one Special Common Share per tandem option exercised. Each tandem option is exercisable at its original exercise price. TDS options granted after the distribution of the TDS Special Common Share dividend will receive one Special Common Share per option exercised.

A summary of TDS stock options (total and portion exercisable) and changes during the three years ended December 31, 2009, is presented in the tables and narrative below:

<u>Tandem Options</u>	<u>Number of Tandem Options(1)</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Grant Date Fair Value</u>	<u>Aggregate Intrinsic Value</u>	<u>Weighted Average Remaining Contractual Life (in years)</u>
Outstanding at December 31, 2006	2,254,000	\$76.59			
(2,193,000 exercisable)		76.89			
Exercised	(1,205,000)	74.21		\$58,233,000	
Forfeited	(1,000)	65.96			
Expired	(11,000)	77.69			
Outstanding at December 31, 2007	1,037,000	\$79.25			
(1,037,000 exercisable)		79.25			
Exercised	(48,000)	42.88		\$ 2,873,000	
Forfeited	—	—			
Expired	(2,000)	81.26			
Outstanding at December 31, 2008	987,000	\$81.03			
(987,000 exercisable)		81.03			
Exercised	(6,000)	49.84		\$ 50,000	
Forfeited	—	—			
Expired	(80,000)	75.44			
Outstanding at December 31, 2009	901,000	\$81.73		\$ 2,144,000	2.9
(901,000 exercisable)		\$81.73		\$ 2,144,000	2.9

(1) Upon exercise, each tandem option is converted into one TDS Common Share and one TDS Special Common Share.

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Notes to Consolidated Financial Statements

NOTE 18 STOCK-BASED COMPENSATION (Continued)

<u>Special Common Share Options</u>	<u>Number of Options</u>	<u>Weighted Average Exercise Prices</u>	<u>Weighted Average Grant Date Fair Value</u>	<u>Aggregate Intrinsic Value</u>	<u>Weighted Average Remaining Contractual Life (in years)</u>
Outstanding at December 31, 2006	1,402,000	\$40.15			
(1,400,000 exercisable)		40.15			
Granted	873,000	59.45	\$13.20		
Exercised	(824,000)	38.59		\$16,543,000	
Forfeited	(4,000)	59.45			
Outstanding at December 31, 2007	1,447,000	\$52.63			
(1,446,000 exercisable)		52.63			
Granted	1,189,000	35.35	\$ 8.85		
Exercised	(4,000)	38.11		\$ 48,965	
Forfeited	(3,000)	35.35			
Expired	(15,000)	59.45			
Outstanding at December 31, 2008	2,614,000	\$44.77			
(1,428,000 exercisable)		52.59			
Granted	1,399,000	26.95	\$ 9.60		
Exercised	—	—		\$ —	
Forfeited	(68,000)	31.19			
Expired	(85,000)	48.81			
Outstanding at December 31, 2009	3,860,000	\$38.46		\$ 4,439,000	8.4
(1,732,000 exercisable)		\$48.91		\$ —	7.5

The aggregate intrinsic value in the tables above represents the total pre-tax intrinsic value (the difference between TDS' closing stock prices and the exercise price, multiplied by the number of in-the-money options) that was received by the option holders upon exercise or that would have been received by option holders had all options been exercised on December 31, 2009.

Long-Term Incentive Plan—Restricted Stock Units—TDS also grants restricted stock unit awards to key employees. Each restricted stock unit outstanding is convertible into one Special Common Share upon the vesting of such restricted stock units. The restricted stock unit awards currently outstanding were granted in 2008 and 2009 and will vest in December 2010 and 2011, respectively.

TDS estimates the fair value of restricted stock units based on the closing market price of TDS shares on the date of grant. The fair value is then recognized as compensation cost on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period.

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Notes to Consolidated Financial Statements

NOTE 18 STOCK-BASED COMPENSATION (Continued)

A summary of TDS nonvested restricted stock units and changes during the year ended December 31, 2009 is presented in the table below.

<u>Special Common Restricted Stock Units</u>	<u>Number</u>	<u>Weighted Average Grant Date Fair Value</u>
Nonvested at December 31, 2008	237,000	\$44.63
Granted	192,000	26.95
Vested	(87,000)	59.45
Forfeited	(17,000)	36.35
Nonvested at December 31, 2009	<u>325,000</u>	\$30.58

The total fair values as of the respective vesting dates of restricted stock units vested during 2009, 2008 and 2007 were \$2.6 million, \$2.5 million and \$10.9 million, respectively. The weighted average grant date fair value of restricted stock units granted in 2009, 2008 and 2007 was \$26.95, \$35.35 and \$59.45, respectively.

Long-Term Incentive Plan—Deferred Compensation Stock Units—Certain TDS employees may elect to defer receipt of all or a portion of their annual bonuses and to receive stock unit matches on the amount deferred up to \$400,000. Deferred compensation, which is immediately vested, is deemed to be invested in TDS Common Share units or TDS Special Common Share units. TDS match amounts depend on the amount of annual bonus that is deferred into stock units. Participants receive a 25% stock unit match for amounts deferred up to 50% of their total annual bonus and a 33% match for amounts that exceed 50% of their total annual bonus. The matched stock units vest ratably at a rate of one-third per year over three years. When fully vested and upon distribution, employees will receive the vested TDS Common Shares and/or TDS Special Common Shares, as applicable.

TDS estimates the fair value of deferred compensation matching stock units based on the closing market price of TDS shares on the date of grant. The fair value of the matched stock units is then recognized as compensation cost using an accelerated attribution method over the requisite service periods of the awards, which is generally the vesting period.

A summary of TDS' nonvested deferred compensation stock units and changes during the year ended December 31, 2009 is presented in the table below.

<u>Special Common Deferred Compensation Stock Units</u>	<u>Number</u>	<u>Weighted Average Grant Date Fair Value</u>
Nonvested at December 31, 2008	2,600	\$41.67
Granted	4,500	23.35
Vested	(3,000)	33.74
Nonvested at December 31, 2009	<u>4,100</u>	\$27.20

The total fair values as of the respective vesting dates of deferred compensation stock units vested during 2009, 2008 and 2007 were \$0.1 million, \$0.1 million and \$0.1 million, respectively. The weighted average grant date fair value of deferred compensation stock units granted in 2009, 2008 and 2007 was \$23.35, \$38.60 and \$52.58, respectively.

Employee Stock Purchase Plan—The TDS 2009 Employee Stock Purchase Plan became effective January 1, 2009 and will terminate December 31, 2013. Under this plan, eligible employees of TDS and

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 18 STOCK-BASED COMPENSATION (Continued)

its subsidiaries may purchase a limited number of TDS Special Common Shares on a quarterly basis. During 2008 and 2007, the 2003 Employee Stock Purchase Plan was effective but terminated December 31, 2008.

Under these plans, the per share cost to each participant is 85% of the market value of the Common Shares or Special Common Shares as of the issuance date. The employee stock purchase plans are considered compensatory plans; therefore recognition of compensation costs for stock issued under these plans is required. Compensation cost is measured as the difference between the cost of the shares to the plan participants and the fair market value of the shares on the date of issuance.

Compensation of Non-Employee Directors—TDS issued 15,000, 8,400 and 3,500 Special Common Shares under its Non-Employee Directors' plan in 2009, 2008 and 2007, respectively.

Dividend Reinvestment Plans—TDS had reserved 442,000 Common Shares and 289,000 Special Common Shares at December 31, 2009, for issuance under Automatic Dividend Reinvestment and Stock Purchase Plans and 138,000 Series A Common Shares for issuance under the Series A Common Share Automatic Dividend Reinvestment Plan. These plans enable holders of TDS' Common Shares, Special Common Shares and Preferred Shares to reinvest cash dividends in Common Shares and Special Common Shares and holders of Series A Common Shares to reinvest cash dividends in Series A Common Shares. The purchase price of the shares is 95% of the market value, based on the average of the daily high and low sales prices for TDS' Common Shares and Special Common Shares on the New York Stock Exchange for the ten trading days preceding the date on which the purchase is made. These plans are considered non-compensatory plans, therefore no compensation expense is recognized for stock issued under these plans.

U.S. Cellular

The information in this section relates to stock-based compensation plans using the equity instruments of U.S. Cellular. Participants in these plans are employees of U.S. Cellular. Information related to plans using the equity instruments of TDS are shown in the previous section.

U.S. Cellular has established the following stock-based compensation plans: a long-term incentive plan, an employee stock purchase plan, and a non-employee director compensation plan. Also, U.S. Cellular employees are eligible to participate in the TDS employee stock purchase plan.

Under the U.S. Cellular 2005 Long-Term Incentive Plan, U.S. Cellular may grant fixed and performance-based incentive and non-qualified stock options, restricted stock, restricted stock units, and deferred compensation stock unit awards to key employees. At December 31, 2009, the only types of awards outstanding are fixed non-qualified stock option awards, restricted stock unit awards, and deferred compensation stock unit awards.

At December 31, 2009, U.S. Cellular had reserved 6,266,000 Common Shares for equity awards granted and to be granted under the long-term incentive plan, and also had reserved 83,000 Common Shares for issuance to employees under an employee stock purchase plan. The maximum number of U.S. Cellular Common Shares that may be issued to employees under all stock-based compensation plans in effect at December 31, 2009, was 6,349,000.

U.S. Cellular also has established a Non-Employee Director Compensation Plan under which it has reserved 48,000 Common Shares for issuance as compensation to members of the Board of Directors who are not employees of U.S. Cellular or TDS.

U.S. Cellular uses treasury stock to satisfy requirements for Common Shares issued pursuant to its various stock-based compensation plans.

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Notes to Consolidated Financial Statements

NOTE 18 STOCK-BASED COMPENSATION (Continued)

Long-Term Incentive Plan—Stock Options—Stock options granted to key employees are exercisable over a specified period not in excess of ten years. Stock options generally vest over periods of between three and five years from the date of grant. Stock options outstanding at December 31, 2009 expire between 2010 and 2019. However, vested stock options typically expire 30 days after the effective date of an employee's termination of employment for reasons other than retirement. Employees who leave at the age of retirement have 90 days (or one year if they satisfy certain requirements) within which to exercise their vested stock options. The exercise price of the option generally equals the market value of U.S. Cellular Common Shares on the date of grant.

U.S. Cellular estimated the fair value of stock options granted during 2009, 2008, and 2007 using the Black-Scholes valuation model and the assumptions shown in the table below.

	2009	2008	2007
Expected life	3.9 Years	3.7 Years	3.1 Years
Expected volatility	40.3%-44.2%	28.1%-40.3%	22.5%-25.7%
Dividend yield	0%	0%	0%
Risk-free interest rate	1.2%-2.2%	1.2%-3.5%	3.3%-4.8%
Estimated annual forfeiture rate	6.89%	11.29%	9.60%

A summary of U.S. Cellular stock options outstanding (total and portion exercisable) and changes during the three years ended December 31, 2009, is presented in the table below:

	Number of Options	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value	Weighted Average Remaining Contractual Life (in years)
Outstanding at December 31, 2006 (1,430,000 exercisable)	2,571,000	\$44.07 42.15			
Granted	477,000	74.29	\$16.74		
Exercised	(1,523,000)	45.53		\$55,912,000	
Forfeited	(122,000)	57.05			
Expired	(4,000)	34.44			
Outstanding at December 31, 2007 (544,000 exercisable)	1,399,000	\$51.65 38.21			
Granted	685,000	56.99	\$14.08		
Exercised	(415,000)	37.90		\$ 7,487,000	
Forfeited	(38,000)	61.40			
Expired	(5,000)	63.56			
Outstanding at December 31, 2008 (624,000 exercisable)	1,626,000	\$57.15 51.56			
Granted	748,000	34.21	\$11.75		
Exercised	(181,000)	34.01		\$ 821,000	
Forfeited	(130,000)	47.98			
Expired	(34,000)	56.84			
Outstanding at December 31, 2009 (1,046,000 exercisable)	2,029,000	\$51.37 \$54.40		\$ 5,438,000 \$ 1,436,000	7.0 5.6

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between U.S. Cellular's closing stock price and the exercise price multiplied by the number of

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NOTE 18 STOCK-BASED COMPENSATION (Continued)

in-the-money options) that was received by the option holders upon exercise or that would have been received by option holders had all options been exercised on December 31, 2009.

Long-Term Incentive Plan—Restricted Stock Units—U.S. Cellular grants restricted stock unit awards, which generally vest after three years, to key employees.

U.S. Cellular estimates the fair value of restricted stock units based on the closing market price of U.S. Cellular shares on the date of grant. The fair value is then recognized as compensation cost on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period. Awards granted under this plan prior to 2005 were classified as liability awards due to a plan provision which allowed participants to elect tax withholding in excess of minimum statutory tax rates. In 2005, this provision was removed from the plan and, thus, awards after 2005 have been classified as equity awards (except for awards that may be settled in stock or cash at the option of the recipient, which are classified as liability awards). All restricted stock units that were classified as liability awards vested prior to 2008.

A summary of U.S. Cellular nonvested restricted stock units at December 31, 2009 and changes during the year then ended is presented in the table below:

<u>Equity Classified Awards</u>	<u>Number</u>	<u>Weighted Average Grant Date Fair Value</u>
Nonvested at December 31, 2008	457,000	\$61.51
Granted	291,000	33.00
Vested	(114,000)	58.88
Forfeited	(53,000)	51.29
Nonvested at December 31, 2009	<u>581,000</u>	\$48.68

The total fair value of liability classified restricted stock units that vested during 2007 was \$4.3 million. The total fair value of equity classified restricted stock units that vested during 2009, 2008 and 2007 was \$4.2 million, \$8.3 million and \$0.5 million, respectively, as of the respective vesting dates. The weighted average grant date fair value of restricted stock units granted in 2009, 2008 and 2007 was \$33.00, \$56.12 and \$74.09, respectively.

Long-Term Incentive Plan—Deferred Compensation Stock Units—Certain U.S. Cellular employees may elect to defer receipt of all or a portion of their annual bonuses and to receive a company matching contribution on the amount deferred. All bonus compensation that is deferred by employees electing to participate is immediately vested and is deemed to be invested in U.S. Cellular Common Share stock units. Upon distribution of such stock units, participants will receive U.S. Cellular Common Shares. The amount of U.S. Cellular's matching contribution depends on the portion of the annual bonus that is deferred. Participants receive a 25% match for amounts deferred up to 50% of their total annual bonus and a 33% match for amounts that exceed 50% of their total annual bonus; such matching contributions also are deemed to be invested in U.S. Cellular Common Share stock units. The matching contribution stock units vest ratably at a rate of one-third per year over three years. Upon vesting and distribution of such matching contribution stock units, participants will receive U.S. Cellular Common Shares.

U.S. Cellular estimates the fair value of deferred compensation matching contribution stock units based on the closing market price of U.S. Cellular Common Shares on the date of match. The fair value of such matching contribution stock units is then recognized as compensation cost using an accelerated attribution method over the requisite service periods of the awards, which is generally the vesting period.

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 18 STOCK-BASED COMPENSATION (Continued)

A summary of U.S. Cellular nonvested deferred compensation stock units at December 31, 2009 and changes during the year then ended is presented in the table below:

	<u>Number</u>	<u>Weighted Average Grant Date Fair Value</u>
Nonvested at December 31, 2008	3,600	\$59.65
Granted	3,700	33.58
Vested	<u>(3,400)</u>	51.83
Nonvested at December 31, 2009	<u>3,900</u>	\$41.73

The total fair value of deferred compensation stock units that vested during 2009, 2008 and 2007 was \$0.1 million, \$0.1 million and \$0.2 million, respectively. The weighted average grant date fair value of deferred compensation stock units granted in 2009, 2008 and 2007 was \$33.58, \$56.23 and \$70.55, respectively.

Employee Stock Purchase Plan—The U.S. Cellular 2009 Employee Stock Purchase Plan became effective January 1, 2009 and will terminate December 31, 2013. Under this plan, eligible employees of U.S. Cellular and its subsidiaries may purchase a limited number of U.S. Cellular Common Shares on a quarterly basis. During 2008 and 2007, the 2003 Employee Stock Purchase Plan was effective but terminated December 31, 2008. U.S. Cellular employees are also eligible to participate in the TDS Employee Stock Purchase Plan.

Under these plans, the per share cost to participants is 85% of the market value of the U.S. Cellular Common Shares, TDS Common Shares or TDS Special Common Shares as of the issuance date. The employee stock purchase plans are considered compensatory plans; therefore, recognition of compensation cost for stock issued under these plans is required. Compensation cost is measured as the difference between the cost of the shares to plan participants and the market value of the shares on the date of issuance.

Compensation of Non-Employee Directors—U.S. Cellular issued 5,200 and 700 Common Shares in 2009 and 2007, respectively, under its Non-Employee Director Compensation Plan. No Common Shares were issued under this plan in 2008.

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 19 BUSINESS SEGMENT INFORMATION

U.S. Cellular and TDS Telecom are billed for all services they receive from TDS, consisting primarily of information processing and general management services. Such billings are based on expenses specifically identified to U.S. Cellular and TDS Telecom and on allocations of common expenses.

Management believes the method used to allocate common expenses is reasonable and that all expenses and costs applicable to U.S. Cellular and TDS Telecom are reflected in the accompanying business segment information on a basis that is representative of what they would have been if U.S. Cellular and TDS Telecom operated on a stand-alone basis.

Financial data for TDS' business segments for 2009, 2008 and 2007 is as follows.

Year Ended or at December 31, 2009	U.S. Cellular	TDS Telecom		Non- Reportable Segment(1)	Other Reconciling Items(2)	Total
		ILEC	CLEC			
						(Dollars in thousands)
Operating revenues	\$4,214,611	\$ 599,527	\$199,375	\$46,714	\$ (39,553)	\$5,020,674
Cost of services and products	1,539,610	194,030	104,057	36,573	(9,844)	1,864,426
Selling, general and administrative expense	1,748,760	171,250	67,283	7,126	(27,712)	1,966,707
Operating income before certain non-cash items(3)	926,241	234,247	28,035	3,015	(1,997)	1,189,541
Depreciation, amortization and accretion expense	570,658	142,913	24,403	2,542	9,454	749,970
Loss on impairment of intangible assets	14,000	—	—	—	—	14,000
Loss on asset disposals, net	15,176	1,949	452	100	88	17,765
Operating income (loss)	326,407	89,385	3,180	373	(11,539)	407,806
Significant non-operating items:						
Equity in earnings of unconsolidated entities	96,800	17	—	—	(6,085)	90,732
Investments in unconsolidated entities	161,481	3,660	—	—	38,658	203,799
Total assets	5,745,217	1,463,275	125,508	24,372	250,412	7,608,784
Capital expenditures	\$ 546,758	\$ 98,297	\$ 22,240	\$ 346	\$ 3,524	\$ 671,165

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 19 BUSINESS SEGMENT INFORMATION (Continued)

<u>Year Ended or at December 31, 2008</u>	<u>U.S. Cellular</u>	<u>TDS Telecom</u>		<u>Non- Reportable Segment(1)</u>	<u>Other Reconciling Items(2)</u>	<u>Total</u>
		<u>ILEC</u>	<u>CLEC</u>			
						(Dollars in thousands)
Operating revenues	\$4,243,185	\$ 611,034	\$220,002	\$53,170	\$ (35,372)	\$5,092,019
Cost of services and products	1,527,463	184,285	109,457	40,381	(7,900)	1,853,686
Selling, general and administrative expense	1,701,050	166,787	69,040	9,251	(24,698)	1,921,430
Operating income before certain non-cash items(3)	1,014,672	259,962	41,505	3,538	(2,774)	1,316,903
Depreciation, amortization and accretion expense	576,931	134,935	23,431	2,909	11,871	750,077
Loss on impairment of intangible assets	386,653	—	—	—	27,723	414,376
Loss on asset disposals, net	23,378	466	391	—	61	24,296
Operating income (loss)	27,710	124,561	17,683	629	(42,429)	128,154
Significant non-operating items:						
Equity in earnings of unconsolidated entities	91,981	22	—	—	(2,191)	89,812
Gain (loss) on investments and financial instruments	16,628	17,758	—	—	(2,791)	31,595
Investments in unconsolidated entities	156,637	6,517	—	—	42,614	205,768
Total assets	5,566,042	1,397,414	127,673	26,733	534,554	7,652,416
Capital expenditures	\$ 585,590	\$ 120,927	\$ 19,832	\$ 1,362	\$ 7,212	\$ 734,923

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 19 BUSINESS SEGMENT INFORMATION (Continued)

Year Ended or at December 31, 2007	U.S. Cellular	TDS Telecom		Non- Reportable Segment(1)	Other Reconciling Items(2)	Total
		ILEC	CLEC			
						(Dollars in thousands)
Operating revenues	\$3,946,264	\$ 629,983	\$236,529	\$48,016	\$ (31,808)	\$4,828,984
Cost of services and products	1,354,372	193,761	116,612	36,225	(7,439)	1,693,531
Selling, general and administrative expense	1,558,568	175,392	82,083	8,145	(23,708)	1,800,480
Operating income before certain non-cash items(3)	1,033,324	260,830	37,834	3,646	(661)	1,334,973
Depreciation, amortization and accretion expense	578,186	133,440	24,022	2,665	9,823	748,136
Loss on impairment of intangible assets	24,923	—	—	—	—	24,923
Loss on asset disposals, net	34,016	—	—	—	—	34,016
Operating income (loss)	396,199	127,390	13,812	981	(10,484)	527,898
Significant non-operating items:						
Equity in earnings of unconsolidated entities	90,033	70	—	—	1,728	91,831
Gain (loss) on investments and financial instruments	132,599	—	—	—	(51,176)	81,423
Marketable equity securities	16,352	—	—	—	1,901,542	1,917,894
Investments in unconsolidated entities	157,693	3,677	—	—	45,048	206,418
Total assets	5,611,874	1,679,838	145,864	27,792	2,428,775	9,894,143
Capital expenditures	\$ 565,495	\$ 111,806	\$ 16,374	\$ 1,461	\$ 4,430	\$ 699,566

(1) Represents Suttle-Straus.

(2) Consists of the corporate operations, intercompany eliminations and other corporate investments.

(3) The amount of Operating income before certain non-cash items is a segment measure reported to the chief operating decision maker for purposes of making decisions about allocating resources to the segments and assessing their performance. The non-cash items excluded from this subtotal are Depreciation, amortization and accretion, Loss on asset disposals, net (if any) and Loss on impairment of intangible assets (if any). This amount may also be commonly referred to by management as operating cash flow.

NOTE 20 SUPPLEMENTAL CASH FLOW DISCLOSURES

Following are supplemental cash flow disclosures regarding interest paid and income taxes paid.

Year Ended December 31,	2009	2008	2007
	(Dollars in thousands)		
Interest paid	\$130,084	\$136,156	\$196,696
Income taxes paid	53,009	470,033	500,899

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 20 SUPPLEMENTAL CASH FLOW DISCLOSURES (Continued)

Following are supplemental cash flow disclosures regarding transactions related to stock-based compensation awards:

TDS:

<u>Year Ended December 31,</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
	(Dollars in thousands)		
Common Shares withheld(1)	—	11,028	38,805
Special Common Shares withheld(1)	26,999	44,873	59,432
Aggregate value of Common Shares withheld	\$ —	\$ 559	\$ 2,531
Aggregate value of Special Common Shares withheld	811	1,575	3,563
Cash receipts upon exercise of stock options	\$ 1,630	\$ 2,628	\$119,087
Cash disbursements for payment of taxes(2)	(811)	(1,219)	(5,482)
Net cash receipts from exercise of stock options and vesting of other stock awards	<u>\$ 819</u>	<u>\$ 1,409</u>	<u>\$113,605</u>

U.S. Cellular:

<u>Year Ended December 31,</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
	(Dollars in thousands)		
Common Shares withheld(1)	200,025	368,231	716,446
Aggregate value of Common Shares withheld	\$ 7,622	\$ 20,055	\$ 59,969
Cash receipts upon exercise of stock options	\$ 1,572	\$ 3,588	\$ 23,582
Cash disbursements for payment of taxes(2)	(1,654)	(5,876)	(13,509)
Net cash receipts (disbursements) from exercise of stock options and vesting of other stock awards	<u>\$ (82)</u>	<u>\$ (2,288)</u>	<u>\$ 10,073</u>

- (1) Such shares were withheld to cover the exercise price of stock options, if applicable, and required tax withholdings.
- (2) In certain situations, TDS and U.S. Cellular withhold shares that are issuable upon the exercise of stock options or the vesting of restricted shares to cover, and with a value equivalent to, the exercise price and/or the amount of taxes required to be withheld from the stock award holder at the time of the exercise or vesting. TDS and U.S. Cellular then pay the amount of the required tax withholdings to the taxing authorities in cash.

NOTE 21 CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The following persons are partners of Sidley Austin LLP, the principal law firm of TDS and its subsidiaries: Walter C.D. Carlson, a trustee and beneficiary of a voting trust that controls TDS, the non-executive Chairman of the Board and member of the Board of Directors of TDS and a director of U.S. Cellular, a subsidiary of TDS; William S. DeCarlo, the General Counsel of TDS and an Assistant Secretary of TDS and certain subsidiaries of TDS; and Stephen P. Fitzell, the General Counsel of U.S. Cellular and TDS Telecommunications Corporation and an Assistant Secretary of certain subsidiaries of TDS. Walter C.D. Carlson does not provide legal services to TDS or its subsidiaries. TDS, U.S. Cellular and their subsidiaries incurred legal costs from Sidley Austin LLP of \$13.8 million in 2009, \$12.0 million in 2008 and \$11.2 million in 2007.

Telephone and Data Systems, Inc.
Notes to Consolidated Financial Statements

NOTE 21 CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS (Continued)

On May 29, 2009, TDS repurchased 1,730,200 Special Common Shares at the then current market price on the New York Stock Exchange ("NYSE") for a total price of \$48.2 million, or an average of \$27.89 per Special Common Share including broker fees, from an affiliate of Southeastern Asset Management, Inc. ("SEAM"). In addition, on July 20, 2009, TDS repurchased 405,000 Special Common Shares from SEAM at a price below the then current market price on the NYSE for a total price of \$10.5 million, or an average of \$25.87 per Special Common Share including broker fees.

At the time, SEAM was a shareholder of more than 5% of TDS Special Common Shares and Common Shares, and currently continues to hold more than 5% of the Special Common Shares. See "Security Ownership by Certain Beneficial Owners" in TDS' Notice of Annual Meeting and Proxy Statement filed with the SEC on April 28, 2009 for further information about SEAM and its interest in TDS. These transactions were not solicited by TDS and TDS did not enter into any agreements with SEAM. The May 29, 2009 transaction was effected by TDS' broker pursuant to TDS' existing institutional brokerage account agreement on the NYSE in compliance with Rule 10b-18 under the Securities Exchange Act of 1934, as amended ("Exchange Act"). The July 20, 2009 transaction was made by TDS' broker pursuant to an agreement entered into pursuant to Rule 10b5-1 under the Exchange Act and was effected on the NYSE in compliance with Rule 10b-18. The repurchases were made under TDS' existing share repurchase authorization.

The Audit Committee of the Board of Directors is responsible for the review and evaluation of all related party transactions, as such term is defined by the rules of the New York Stock Exchange.

Telephone and Data Systems, Inc.

REPORTS OF MANAGEMENT

Management's Responsibility for Financial Statements

Management of Telephone and Data Systems, Inc. has the responsibility for preparing the accompanying consolidated financial statements and for their integrity and objectivity. The statements were prepared in accordance with accounting principles generally accepted in the United States of America and, in management's opinion, were fairly presented. The financial statements included amounts that were based on management's best estimates and judgments. Management also prepared the other information in the annual report and is responsible for its accuracy and consistency with the financial statements.

PricewaterhouseCoopers LLP, an independent registered public accounting firm, has audited these consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States) and has expressed herein its unqualified opinion on these financial statements.

/s/ LeRoy T. Carlson, Jr.

LeRoy T. Carlson, Jr.
President and
Chief Executive Officer
(Principal Executive Officer)

/s/ Kenneth R. Meyers

Kenneth R. Meyers
Executive Vice President and
Chief Financial Officer
(Principal Financial Officer)

/s/ Douglas D. Shuma

Douglas D. Shuma
Senior Vice President and
Controller
(Principal Accounting Officer)

Telephone and Data Systems, Inc.

Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. TDS' internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America ("GAAP"). TDS' internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that receipts and expenditures of the issuer are being made only in accordance with authorizations of management and, where required, the Board of Directors of the issuer; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the issuer's assets that could have a material effect on the interim or annual consolidated financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of TDS' management, including its Chief Executive Officer and Chief Financial Officer, TDS conducted an evaluation of the effectiveness of its internal control over financial reporting as of December 31, 2009, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Management has concluded that TDS maintained effective internal control over financial reporting as of December 31, 2009 based on criteria established in *Internal Control—Integrated Framework* issued by the COSO.

The effectiveness of TDS' internal control over financial reporting as of December 31, 2009 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in the firm's report included herein.

/s/ LeRoy T. Carlson, Jr.

LeRoy T. Carlson, Jr.
President and
Chief Executive Officer
(Principal Executive Officer)

/s/ Kenneth R. Meyers

Kenneth R. Meyers
Executive Vice President and
Chief Financial Officer
(Principal Financial Officer)

/s/ Douglas D. Shuma

Douglas D. Shuma
Senior Vice President and
Controller
(Principal Accounting Officer)

Telephone and Data Systems, Inc. and Subsidiaries

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Telephone and Data Systems, Inc.:

In our opinion, based on our audits and the report of other auditors, the accompanying consolidated balance sheets and the related consolidated statements of operations, comprehensive income, changes in equity, and cash flows present fairly, in all material respects, the financial position of Telephone and Data Systems, Inc. and its subsidiaries at December 31, 2009 and 2008, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2009 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, based on our audit and the report of other auditors, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We did not audit the financial statements of Los Angeles SMSA Limited Partnership, a 5.5% owned entity accounted for by the equity method of accounting. The consolidated financial statements of Telephone and Data Systems, Inc. reflect an investment in this partnership of \$116,000,000 and \$117,300,000 as of December 31, 2009 and 2008, respectively, and equity earnings of \$64,700,000, \$66,100,000, and \$71,200,000, respectively for each of the three years in the period ended December 31, 2009. The financial statements of Los Angeles SMSA Limited Partnership were audited by other auditors whose report thereon has been furnished to us, and our opinion on the financial statements expressed herein, insofar as it relates to the amounts included for Los Angeles SMSA Limited Partnership, is based solely on the report of the other auditors. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Notes 1, 2, 3 and 4 to the consolidated financial statements, the Company changed the manner in which it accounts for noncontrolling interests and business combinations in 2009, financial assets and liabilities in 2008, and the manner in which it accounts for uncertain tax positions in 2007.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance

Telephone and Data Systems, Inc. and Subsidiaries

regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP

Chicago, Illinois
February 25, 2010