

# LEVEL 3 COMMUNICATIONS INC

## **FORM 10-Q** (Quarterly Report)

Filed 08/07/09 for the Period Ending 06/30/09

Address	1025 ELDORADO BOULEVARD BLDG 2000 BROOMFIELD, CO 80021
Telephone	7208881000
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Symbol	LVLT
SIC Code	4813 - Telephone Communications, Except Radiotelephone
Industry	Communications Services
Sector	Services
Fiscal Year	12/31

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

**FORM 10-Q**

(Mark One)

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

For the Quarterly Period Ended June 30, 2009

or

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

For the transition period                      to

Commission file number 0-15658

**LEVEL 3 COMMUNICATIONS, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State of Incorporation)

**47-0210602**  
(I.R.S. Employer  
Identification No.)

**1025 Eldorado Blvd., Broomfield, CO**  
(Address of principal executive offices)

**80021**  
(Zip Code)

**(720) 888-1000**  
(Registrant's telephone number,  
including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐  
(Do not check if a smaller reporting company)

Smaller reporting company ☐

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

The number of shares outstanding of each class of the issuer's common stock, as of June 30, 2009:

Common Stock: **1,634,402,830 shares**

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LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

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**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Operations**  
(unaudited)

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30, 2009</b>	<b>June 30, 2008</b>	<b>June 30, 2009</b>	<b>June 30, 2008</b>
<b>(dollars in millions, except per share data)</b>				
<b>Revenue:</b>				
Communications	\$ 926	\$ 1,072	\$ 1,888	\$ 2,138
Coal Mining	16	18	34	44
Total Revenue	942	1,090	1,922	2,182
<b>Costs and Expenses (exclusive of depreciation and amortization shown separately below):</b>				
<b>Cost of Revenue</b>				
Communications	379	442	769	901
Coal Mining	16	18	33	34
Total Cost of Revenue	395	460	802	935
Depreciation and Amortization	228	234	450	474
Selling, General and Administrative	321	395	659	817
Restructuring Charges	6	4	7	11
Total Costs and Expenses	950	1,093	1,918	2,237
<b>Operating Income (Loss)</b>	<b>(8)</b>	<b>(3)</b>	<b>4</b>	<b>(55)</b>
<b>Other Income (Expense):</b>				
Interest income	1	3	2	9
Interest expense	(152)	(141)	(298)	(285)
Gain on sale of business group, net	—	96	—	96
Gain on extinguishment of debt, net	14	—	14	—
Other, net	12	4	14	7
Total Other Income (Expense)	(125)	(38)	(268)	(173)
<b>Loss Before Income Taxes</b>	<b>(133)</b>	<b>(41)</b>	<b>(264)</b>	<b>(228)</b>
<b>Income Tax Expense</b>	<b>(1)</b>	<b>(1)</b>	<b>(2)</b>	<b>(4)</b>
<b>Net Loss</b>	<b>\$ (134)</b>	<b>\$ (42)</b>	<b>\$ (266)</b>	<b>\$ (232)</b>
<b>Basic and Diluted Loss per Share</b>	<b>\$ (0.08)</b>	<b>\$ (0.03)</b>	<b>\$ (0.16)</b>	<b>\$ (0.15)</b>
<b>Shares Used to Compute Basic and Diluted</b>				
Loss per Share (in thousands):	1,632,254	1,552,778	1,626,584	1,547,325

See accompanying notes to consolidated financial statements. Financial statements for the three and six months ended June 30, 2008 have been adjusted for the retrospective application of FSP APB 14-1 (see Note 9).

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES**  
**Consolidated Balance Sheets**

(dollars in millions, except par value)	June 30, 2009 (unaudited)	December 31, 2008
<i>Assets</i>		
<b>Current Assets:</b>		
Cash and cash equivalents	\$ 630	\$ 768
Restricted cash and securities	2	3
Receivables, less allowances for doubtful accounts of \$18 and \$16, respectively	374	390
Other	111	81
<b>Total Current Assets</b>	<b>1,117</b>	<b>1,242</b>
Property, Plant and Equipment, net	5,939	6,159
Restricted Cash and Securities	125	127
Goodwill	1,432	1,432
Other Intangibles, net	512	559
Other Assets	110	115
<b>Total Assets</b>	<b>\$ 9,235</b>	<b>\$ 9,634</b>
<i>Liabilities and Stockholders' Equity</i>		
<b>Current Liabilities:</b>		
Accounts payable	\$ 336	\$ 365
Current portion of long-term debt	178	186
Accrued payroll and employee benefits	39	105
Accrued interest	132	117
Current portion of deferred revenue	163	168
Other	92	111
<b>Total Current Liabilities</b>	<b>940</b>	<b>1,052</b>
Long-Term Debt, less current portion	6,168	6,245
Deferred Revenue, less current portion	742	719
Other Liabilities	563	597
<b>Total Liabilities</b>	<b>8,413</b>	<b>8,613</b>
<b>Stockholders' Equity:</b>		
Preferred stock, \$.01 par value, authorized 10,000,000 shares: no shares issued or outstanding	—	—
Common stock, \$.01 par value, authorized 2,500,000,000 shares: 1,634,402,830 issued and outstanding at June 30, 2009 and 1,617,615,258 issued and outstanding at December 31, 2008	16	16
Additional paid-in capital	11,534	11,495
Accumulated other comprehensive loss	(23)	(51)
Accumulated deficit	(10,705)	(10,439)
<b>Total Stockholders' Equity</b>	<b>822</b>	<b>1,021</b>
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$ 9,235</b>	<b>\$ 9,634</b>

See accompanying notes to consolidated financial statements. Financial statements as of December 31, 2008 have been adjusted for the retrospective application of FSP APB 14-1 (see Note 9).

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Cash Flows**  
(unaudited)

(dollars in millions)	Six Months Ended	
	June 30, 2009	June 30, 2008
<b>Cash Flows from Operating Activities:</b>		
Net loss	\$ (266)	\$ (232)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	450	474
Non-cash compensation expense attributable to stock awards	25	43
Gain on extinguishment of debt, net	(14)	—
Gain on sale of business group, net	—	(96)
Gain on sale of property, plant and equipment and other assets	—	(1)
Accretion of debt discount and amortization of debt issuance costs	30	26
Accrued interest on long-term debt	15	(11)
Other, net	(7)	6
Changes in working capital items:		
Receivables	19	(22)
Other current assets	(27)	(32)
Payables	(42)	(77)
Deferred revenue	12	(10)
Other current liabilities	(99)	(5)
<b>Net Cash Provided by Operating Activities</b>	<b>96</b>	<b>63</b>
<b>Cash Flows from Investing Activities:</b>		
Capital expenditures	(158)	(219)
Decrease in restricted cash and securities, net	3	2
Proceeds from sale of business group, net	—	123
Proceeds from sale of property, plant and equipment and other assets	—	2
<b>Net Cash Used in Investing Activities</b>	<b>(155)</b>	<b>(92)</b>
<b>Cash Flows from Financing Activities:</b>		
Long term debt borrowings, net of issuance costs	272	—
Payments on and repurchases of long-term debt	(353)	(28)
<b>Net Cash Used in Financing Activities</b>	<b>(81)</b>	<b>(28)</b>
<b>Effect of Exchange Rates on Cash and Cash Equivalents</b>	<b>2</b>	<b>4</b>
<b>Net Change in Cash and Cash Equivalents</b>	<b>(138)</b>	<b>(53)</b>
<b>Cash and Cash Equivalents at Beginning of Period</b>	<b>768</b>	<b>714</b>
<b>Cash and Cash Equivalents at End of Period</b>	<b>\$ 630</b>	<b>\$ 661</b>
<b>Supplemental Disclosure of Cash Flow Information:</b>		
Cash interest paid	\$ 253	\$ 270
Income taxes paid	\$ 4	\$ 3
<b>Noncash Investing and Financing Activities:</b>		
Long-term debt issued in exchange transaction	\$ 196	\$ —
Long-term debt retired in exchange transaction	\$ 204	\$ —

See accompanying notes to consolidated financial statements. Financial statements for the six months ended June 30, 2008 have been adjusted for the retrospective application of FSP APB 14-1 (see Note 9).

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements**

**(1) Summary of Significant Accounting Policies**

Level 3 Communications, Inc. and its subsidiaries (“Level 3” or the “Company”) is a facilities based provider (that is, a provider that owns or leases a substantial portion of the plant, property and equipment necessary to provide its services) of a broad range of integrated communications services. The Company has created its communications network generally by constructing its own assets, but also through a combination of purchasing and leasing other companies and facilities. The Company’s network is an advanced, international, facilities based communications network. The Company designed its network to provide communications services, which employ and take advantage of rapidly improving underlying optical, Internet Protocol, computing and storage technologies.

The Company is also engaged in coal mining through its two 50% owned joint-venture surface mines, one each in Montana and Wyoming.

The consolidated financial statements include the accounts of Level 3 Communications, Inc. and subsidiaries in which it has control, which are enterprises engaged in the communications and coal mining businesses. Fifty-percent-owned mining joint ventures are consolidated on a pro rata basis. All significant intercompany accounts and transactions have been eliminated.

The consolidated balance sheet of Level 3 at December 31, 2008 has been audited. All other financial statements contained herein are unaudited and, in the opinion of management, contain all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of financial position, results of operations and cash flows for the periods presented. The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) and with the instructions to Form 10-Q and Article 10 of Regulation S-X for interim financial information. Accordingly, these statements do not include all of the information and notes required for complete financial statements.

The Company’s accounting policies and certain other disclosures are set forth in the notes to the consolidated financial statements contained in the Company’s Form 10-K for the year ended December 31, 2008. The significant accounting policies set forth in Note 1 to the consolidated financial statements in the Company’s Form 10-K for the year ended December 31, 2008, appropriately present, in all material respects, the current status of the Company’s significant accounting policies, and are incorporated herein by reference, except as disclosed below related to the adoption of Financial Accounting Standards Board (“FASB”) Staff Position (“FSP”) No. APB 14-1, “Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement)” (“FSP APB 14-1”). These financial statements should be read in conjunction with the Company’s audited consolidated financial statements and notes thereto. The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses during the reported period. Actual results could differ from these estimates.

Subsequent events have been evaluated by the Company through August 7, 2009, the date that these financial statements were issued.

The results of operations for the three and six months ended June 30, 2009 are not necessarily indicative of the results expected for the full year 2009.

***Recently Issued Accounting Pronouncements***

In April 2009, the FASB issued FSP SFAS 157-4, “Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly” (“FSP SFAS 157-4”). FSP SFAS 157-4 provides additional guidance for estimating fair value when the volume and level of activity for the asset or liability have significantly decreased. It also includes guidance on identifying circumstances that indicate a transaction is not orderly. FSP SFAS 157-4 was adopted by the Company in the second quarter of 2009 and did not have a material effect on its consolidated results of operations and financial condition.

In April 2009, the FASB issued FSP SFAS 115-2 and SFAS 124-2, “Recognition and Presentation of Other-Than-Temporary Impairments” (“FSP SFAS 115-2 and SFAS 124-2”). FSP SFAS 115-2 and SFAS 124-2 amend the other-than-



temporary impairment guidance in U.S. GAAP for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. FSP SFAS 115-2 and SFAS 124-2 was adopted by the Company in the second quarter of 2009 and did not have a material effect on its consolidated results of operations and financial condition.

In April 2009, the FASB issued FSP SFAS 107-1 and APB 28-1, “Interim Disclosures about Fair Value of Financial Instruments” (“FSP SFAS 107-1 and APB 28-1”). This FSP amends FASB Statement No. 107, “Disclosure about Fair Value of Financial Instruments,” to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This FSP also amends APB Opinion No. 28, “Interim Financial Reporting,” to require disclosures in summarized financial information at interim reporting periods. FSP SFAS 107-1 and APB 28-1 were adopted by the Company in the second quarter of 2009 and did not have a material effect on its consolidated results of operations and financial condition.

In April 2009, the FASB issued FSP SFAS 141(R)-1, “Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies” (“FSP SFAS 141(R)-1”). FSP SFAS 141(R)-1 addresses application issues on initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. FSP SFAS 141(R)-1 is effective for assets or liabilities arising from contingencies in business combinations for which the acquisition date is on or after January 1, 2009. The effect of adopting FSP SFAS 141(R)-1 on the Company’s consolidated results of operations and financial condition will be largely dependent on the size and nature of any business combinations completed on or after January 1, 2009.

## **(2) Dispositions**

**Vyvx Advertising Distribution Business :** On June 5, 2008, Level 3 completed the sale of its Vyvx advertising distribution business to DG FastChannel, Inc. Level 3 has retained ownership of Vyvx’s core broadcast business, including the Vyvx Services Broadcast Business’ content distribution capabilities. The financial results of the Vyvx advertising distribution business are included in the Company’s consolidated results of operations through the date of sale. The disposal of the Vyvx advertising distribution business did not meet the criteria under Statement of Financial Accounting Standards (“SFAS”) No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets” (“SFAS No. 144”) for presentation as discontinued operations since the business was not considered an asset group.

Level 3 recognized a net gain on the sale of the Vyvx advertising distribution business of \$96 million in the three months ended June 30, 2008. The gain is presented in the consolidated statements of operations as “Gain on sale of business group, net.”

## **(3) Loss Per Share**

The Company computes basic net loss per share by dividing net loss for the period by the weighted average number of shares of common stock outstanding during the period. Diluted net loss per share is computed by dividing net loss for the period by the weighted average number of shares of common stock outstanding during the period and including the dilutive effect of common stock that would be issued assuming conversion or exercise of outstanding convertible notes, stock options, stock based compensation awards and other dilutive securities. No such items were included in the computation of diluted loss per share for the three and six months ended June 30, 2009 and June 30, 2008, because the Company incurred a net loss in each of these periods and the effect of inclusion would have been anti-dilutive.

The effect of approximately 545 million and 315 million shares issuable pursuant to the various series of convertible notes outstanding at June 30, 2009 and 2008, respectively, have not been included in the computation of diluted loss per share because their inclusion would have been anti-dilutive to the computation. In addition, the effect of the approximately 42 million and 58 million stock options, outperform stock options, restricted stock units and warrants outstanding at June 30, 2009 and 2008, respectively, have not been included in the computation of diluted loss per share because their inclusion would have been anti-dilutive to the computation.

#### (4) Goodwill

There were no changes in the carrying amount of goodwill during the six months ended June 30, 2009. The Company conducted its annual goodwill impairment analysis at December 31, 2008 and concluded its goodwill was not impaired.

#### (5) Acquired Intangible Assets

Identifiable acquisition-related intangible assets as of June 30, 2009 and December 31, 2008 were as follows (in millions):

	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Net</u>
<b>June 30, 2009</b>			
<i>Finite-Lived Intangible Assets:</i>			
Customer Contracts and Relationships	\$ 743	\$ (366)	\$ 377
Patents and Developed Technology	140	(57)	83
	<u>883</u>	<u>(423)</u>	<u>460</u>
<i>Indefinite-Lived Intangible Assets:</i>			
Vyvx Trade Name	32	—	32
Wireless Licenses	20	—	20
	<u>\$ 935</u>	<u>\$ (423)</u>	<u>\$ 512</u>
<b>December 31, 2008</b>			
<i>Finite-Lived Intangible Assets:</i>			
Customer Contracts and Relationships	\$ 743	\$ (325)	\$ 418
Patents and Developed Technology	141	(52)	89
	<u>884</u>	<u>(377)</u>	<u>507</u>
<i>Indefinite-Lived Intangible Assets:</i>			
Vyvx Trade Name	32	—	32
Wireless Licenses	20	—	20
	<u>\$ 936</u>	<u>\$ (377)</u>	<u>\$ 559</u>

The gross carrying amount of identifiable acquisition-related intangible assets in the table above is subject to change due to foreign currency fluctuations, as a portion of the Company's identifiable acquisition-related intangible assets are related to foreign subsidiaries.

Renewals of intangible assets, in particular the Company's wireless licenses, have occurred routinely and at nominal costs and are expensed as incurred.

Acquired finite-lived intangible asset amortization expense was \$23 million and \$46 million for the three and six months ended June 30, 2009, respectively, and \$25 million and \$51 million for the three and six months ended June 30, 2008, respectively.

As of June 30, 2009, estimated amortization expense for the Company's finite-lived acquisition-related intangible assets over the next five years and thereafter is as follows (in millions):

2009 (remaining six months)	\$	46
2010		92
2011		91
2012		69
2013		51
Thereafter		111
	\$	<u>460</u>

## (6) Restructuring and Contract Termination Costs

During the second quarter of 2009, the Company initiated a workforce reduction of approximately 170 employees, or 3% of the Company's total employee base, and incurred a restructuring charge of \$6 million, all of which related to the communications business. The workforce reductions related to multiple levels within the organization and across multiple locations within North America. The terms of the workforce reduction, including the involuntary termination benefits to be received by affected employees, were communicated by the Company in the second quarter of 2009. The Company paid approximately \$6 million of involuntary termination benefits for affected employees in the second quarter of 2009, of which \$5 million related to the Company's second quarter of 2009 restructuring activities and \$1 million related to prior restructuring activities. The Company has accrued approximately \$1 million of involuntary termination benefits as of June 30, 2009 that are expected to be paid in the third quarter of 2009.

During the fourth quarter of 2008, the Company initiated a workforce reduction of approximately 400 employees, or 7% of the Company's total employee base, and incurred a restructuring charge of \$12 million, all of which related to the communications business. The workforce reductions related to multiple levels within the organization and across multiple locations within North America. The terms of the workforce reduction, including the involuntary termination benefits to be received by affected employees, were communicated by the Company in the fourth quarter of 2008. In the first quarter of 2009, the Company paid approximately \$11 million of involuntary termination benefits for affected employees. The remaining \$1 million of involuntary termination benefits for affected employees was paid in the second quarter of 2009.

The Company has accrued contract termination costs of \$45 million at June 30, 2009 and \$49 million at December 31, 2008, for facility lease costs, primarily in North America, that the Company continues to incur without economic benefit. Accrued contract termination costs are recorded in other liabilities (current and non-current) in the consolidated balance sheets. The Company expects to pay the majority of these costs through 2018. The Company did not incur any new contract termination costs in the three and six months ended June 30, 2009. The Company incurred new contract termination costs of approximately \$2 million in the three and six months ended June 30, 2008 as a result of revisions to the estimated cash flows for certain of the Company's facility subleases. The Company records charges for contract termination costs, including accretion expense, within selling, general and administrative expenses in the consolidated statements of operations.

## (7) Fair Value

The Company's financial instruments consist of cash and cash equivalents, restricted cash and securities, accounts receivable, accounts payable, interest rate swaps, embedded derivative contracts and long-term debt including the current portion. The carrying values of cash and cash equivalents, restricted cash and securities, accounts receivable and accounts payable, approximated their fair values at June 30, 2009 and December 31, 2008. The interest rate swaps and embedded derivative contracts are recorded in the consolidated balance sheets at fair value. See Note 9 for the Company's fair value disclosure regarding its long-term debt.

SFAS No. 157 "Fair Value Measurements" ("SFAS No. 157") defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required to be recorded at fair value, the Company considers the principal or most advantageous market in which it would transact and considers assumptions that market participants would use when pricing the asset or liability, such as inherent risk, transfer restrictions, and risk of nonperformance.

## *Fair Value Hierarchy*

SFAS No. 157 establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. SFAS No. 157 establishes three levels of inputs that may be used to measure fair value:

*Level 1* —Quoted prices in active markets for identical assets or liabilities. As of June 30, 2009, the Company did not have any assets or liabilities measured at fair value using Level 1 inputs.

*Level 2* —Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets with insufficient volume or infrequent transactions (less active markets); or model-derived valuations in which all significant inputs are observable or can be derived principally from or corroborated by observable market data for substantially the full term of the assets or liabilities. Liabilities that are measured at fair value using Level 2 inputs include the Company's interest rate swap agreements and other embedded derivatives.

The interest rate swaps are valued using discounted cash flow techniques that use observable market inputs, such as LIBOR-based yield curves, forward rates, and credit ratings. The embedded derivatives in certain of the Company's convertible debt instruments are valued using inputs that are observable in the market, such as the Company's current and historical stock prices, credit-adjusted interest rates, credit ratings and other contractual terms of the convertible debt.

*Level 3* —Unobservable inputs to the valuation methodology that are significant to the measurement of fair value of assets or liabilities. The Company does not have any assets or liabilities that are measured at fair value using Level 3 inputs.

## *Assets and Liabilities Measured at Fair Value on a Recurring Basis*

Assets and liabilities measured at fair value on a recurring basis consisted of the following types of instruments as of June 30, 2009 (in millions):

	<b>Significant Other Observable Inputs (Level 2)</b>
Interest Rate Swap Liabilities (included in other non-current liabilities)	\$ 89
Embedded Derivatives in Convertible Debt (included in other non-current liabilities)	1
<b>Total Liabilities Measured at Fair Value</b>	<b>\$ 90</b>

## **(8) Cash Flow Hedges**

The Company has floating rate long-term debt (see Note 9). These obligations expose the Company to variability in interest payments due to changes in interest rates. If interest rates increase, interest expense increases. Conversely, if interest rates decrease, interest expense also decreases. In 2007, Level 3 Financing Inc. ("Level 3 Financing"), the Company's wholly owned subsidiary, entered into two interest rate swap agreements to hedge the interest payments on \$1 billion notional amount of floating rate debt. The two interest rate swap agreements are with different counterparties, are for \$500 million each and mature on January 13, 2014. Under the terms of the interest rate swap transactions, the Company receives interest payments based on rolling three month LIBOR terms and pays interest at the fixed rate of 4.93% under one arrangement and 4.92% under the other. The Company has designated the interest rate swap agreements as a cash flow hedge on the interest payments for \$1 billion of floating rate debt. The Company evaluates the effectiveness of the hedge on a quarterly basis. The Company measures effectiveness by offsetting the change in the variable portion of the interest rate swaps with the changes in interest expense paid due to fluctuations in the LIBOR-based interest rate. The Company recognizes any ineffective portion of the hedge in the consolidated statements of operations. Hedge ineffectiveness for the Company's cash flow hedges was not material in any period presented.

The fair value of the interest rate swap agreements was a liability of \$89 million at June 30, 2009 and a liability of \$97 million at December 31, 2008. Unrealized gains of \$23 million and \$8 million for the three and six months ended June 30, 2009, respectively, and \$45 million and \$3 million for the three and six months ended June 30, 2008, respectively, were recorded on the interest rate swap agreements and are included in other comprehensive loss. The change in the fair value of the interest rate swap agreements is reflected in other comprehensive loss due to the fact that the interest rate swap

agreements are designated as an effective cash flow hedge of \$1 billion notional amount of the Company's floating rate debt. See Note 7 for more information regarding the Company's derivative financial instruments.

## (9) Long-Term Debt

As of June 30, 2009 and December 31, 2008, long-term debt was as follows (in millions):

(dollars in millions)	June 30, 2009	December 31, 2008
Senior Secured Term Loan due 2014	\$ 1,680	\$ 1,400
Issue discount on Senior Secured Term Loan due 2014	(2)	—
Senior Notes due 2010 (11.5%)	—	13
Senior Notes due 2011 (10.75%)	3	3
Floating Rate Senior Notes due 2011 (8.279% as of June 30, 2009)	6	6
Senior Notes due 2013 (12.25%)	550	550
Issue discount on Senior Notes due 2013	(2)	(2)
Senior Notes due 2014 (9.25%)	1,250	1,250
Issue premium on Senior Notes due 2014	9	9
Floating Rate Senior Notes due 2015 (5.485% as of June 30, 2009)	300	300
Senior Notes due 2017 (8.75%)	700	700
Convertible Senior Notes due 2010 (2.875%)	49	192
Convertible Senior Notes due 2011 (5.25%)	255	330
Debt discount on 5.25% Convertible Senior Notes due 2011	(59)	(89)
Convertible Senior Notes due 2011 (10.0%)	197	228
Convertible Senior Notes due 2012 (3.5%)	301	326
Debt discount on 3.5% Convertible Senior Notes due 2012	(56)	(69)
Convertible Senior Notes due 2013 (15.0%)	400	400
Convertible Senior Notes due 2015 (7.0%)	200	—
Issue discount on 7.0% Convertible Senior Notes due 2015	(4)	—
Convertible Senior Discount Notes due 2013 (9.0%)	295	295
Convertible Subordinated Notes due 2009 (6.0%)	55	181
Convertible Subordinated Notes due 2010 (6.0%)	119	308
Debt discount due to embedded derivatives in convertible debt	(2)	(4)
Commercial Mortgage due 2010 (6.86%)	68	69
Capital leases	34	35
	6,346	6,431
Less current portion	(178)	(186)
	<u>\$ 6,168</u>	<u>\$ 6,245</u>

The estimated fair value of the Company's long-term debt approximated \$5.7 billion at June 30, 2009 and \$4.0 billion at December 31, 2008. The fair values of the Company's long-term debt were estimated using the average of the bid and ask trading quotes when available or, if not available, primarily using market yields on other Level 3 traded debt of similar characteristics and discounted cash flows for the liability components of the Company's long-term debt and a Black-Scholes valuation model to value the equity portion of the Company's long-term debt.

### Q2 2009 Debt Issuances

During the second quarter of 2009, Level 3 Financing amended and restated its existing senior secured credit facility to increase the borrowings through the creation of a \$280 million Tranche B Term Loan that matures on March 13, 2014 with a current interest rate of LIBOR plus 8.50% per annum, with LIBOR set at a minimum of 3.00%. The net proceeds of the Tranche B Term Loan were approximately \$274 million after deducting a \$2 million original issue discount and \$4 million of debt issuance costs.

Level 3 Financing's obligations under the Tranche B Term Loan are, subject to certain exceptions, secured by certain of the assets of (i) the Company and (ii) certain of the Company's material domestic subsidiaries which are engaged in the communications business. The Company and certain of its subsidiaries have also guaranteed the obligations of Level 3 Financing under the Tranche B Term Loan.

No changes were made to any of the restrictive covenants or events of default contained in the existing senior secured credit facility.

#### *Q2 2009 Debt Exchange*

During the second quarter of 2009, the Company exchanged approximately \$142 million aggregate principal amount of the Company's 6% Convertible Subordinated Notes due 2010 and approximately \$140 million aggregate principal amount of its 2.875% Convertible Senior Notes due 2010 for \$200 million aggregate principal amount of the Company's 7% Convertible Senior Notes due 2015 ("7% Notes") and \$78 million in cash, plus accrued and unpaid interest.

The 7% Notes are senior unsecured obligations of the Company, ranking equal in right of payment with all the Company's existing and future unsubordinated indebtedness. The 7% Notes will mature on March 15, 2015 and pay 7% annual cash interest. Interest on the 7% Notes will be payable on March 15 and September 15 of each year, commencing on September 15, 2009.

The 7% Notes are convertible into shares of the Company's common stock at an initial conversion price of \$1.80 per share (which is equivalent to a conversion rate of 555.5556 shares of Common Stock per \$1,000 principal amount of the 7% Notes), subject to adjustment upon certain events, at any time before the close of business on March 15, 2015. Holders of the 7% Notes may require the Company to repurchase all or any part of the 7% Notes upon the occurrence of a designated event (change of control or a termination of trading) at a price equal to 100% of the principal amount of the 7% Notes, plus accrued and unpaid interest to, but excluding, the repurchase date, if any. In addition, if a holder elects to convert its 7% Notes in connection with certain changes in control, the Company could be required to pay a make-whole premium by increasing the number of shares deliverable upon conversion of such notes. Any make whole premium will have the effect of increasing the number of shares due to holders of the 7% Notes upon conversion.

The Company recognized a net gain on the exchange transaction, after deducting \$1 million in unamortized debt issuance costs, of approximately \$7 million. The gain was recorded in "Gain on extinguishment of debt, net" in the consolidated statements of operations.

#### *Q2 2009 Debt Repurchases*

The Company repurchased approximately \$301 million aggregate principal amount of various issues of its convertible debt at discounts to the principal amount and recognized a net gain on extinguishment of debt of approximately \$7 million. The gain consisted of a \$33 million cash gain, which was partially offset by \$20 million of unamortized debt discount, \$1 million in unamortized debt issuance costs and a \$5 million increase to equity for the component of the convertible debt subject to FSP APB 14-1. The gain was recorded in "Gain on extinguishment of debt, net" in the consolidated statements of operations. Accrued interest paid at the time of repurchase totaled \$8 million.

The second quarter 2009 debt repurchases consisted of the following:

- \$121 million aggregate principal amount of 6% Convertible Subordinated Notes due 2009;
- \$47 million aggregate principal amount of 6% Convertible Subordinated Notes due 2010;
- \$3 million aggregate principal amount of 2.875% Convertible Senior Notes due 2010;
- \$75 million aggregate principal amount of 5.25% Convertible Senior Notes due 2011;
- \$31 million aggregate principal amount of 10% Convertible Senior Notes due 2011; and
- \$24 million aggregate principal amount of 3.5% Convertible Senior Notes due 2012.

*Q2 2009 Debt Redemption*

The Company redeemed the remaining \$13 million aggregate principal amount of 11.5% Senior Notes due 2010 at 100% of the outstanding principal amount in the second quarter of 2009.

*Convertible Debt That May be Settled in Cash Upon Conversion*

On May 9, 2008, the FASB issued FSP APB 14-1, which requires issuers of a certain type of convertible debt to separately account for the debt and equity components of the convertible debt in a way that reflects the issuer's borrowing rate at the date of issuance for similar debt instruments without the conversion feature. FSP APB 14-1 applies to certain of the Company's convertible debt. FSP APB 14-1 was effective for the Company beginning on January 1, 2009 and has been applied retrospectively to all periods presented in the Company's consolidated financial statements. Although the adoption of FSP APB 14-1 does not affect the Company's actual past or future cash flows, the Company expects to incur additional non-cash interest expense as a result of FSP APB 14-1 of approximately \$40 million for the year ended December 31, 2009, \$41 million for the year ended December 31, 2010, \$46 million for the year ended December 31, 2011 and \$10 million for the year ended December 31, 2012, notwithstanding any further debt repurchases, modifications, extinguishments or conversion of its convertible debt subject to FSP APB 14-1 prior to maturity.

The following table illustrates the retrospective effect of adopting FSP APB 14-1 to the consolidated statement of operations for the three and six months ended June 30, 2008 (in millions, except per share data):

	<u>Three Months Ended June 30, 2008</u>		<u>Six Months Ended June 30, 2008</u>	
	<u>As Originally Reported</u>	<u>As Adjusted for Retrospective Application</u>	<u>As Originally Reported</u>	<u>As Adjusted for Retrospective Application</u>
Interest Expense	\$ 132	\$ 141	\$ 267	\$ 285
Net Loss	\$ (33)	\$ (42)	\$ (214)	\$ (232)
Basic and Diluted Loss Per Share	\$ (0.02)	\$ (0.03)	\$ (0.14)	\$ (0.15)

The following table illustrates the retrospective effect of adopting FSP APB 14-1 to the consolidated balance sheet as of December 31, 2008 (in millions):

	<u>As Originally Reported</u>	<u>As Adjusted for Retrospective Application</u>
Other Assets (current portion of debt issuance costs)	\$ 83	\$ 81
Other Assets (non-current portion of debt issuance costs)	\$ 117	\$ 115
Long-Term Debt, less current portion	\$ 6,394	\$ 6,245
Additional paid-in capital	\$ 11,254	\$ 11,495
Accumulated deficit	\$ (10,343)	\$ (10,439)

FSP APB 14-1 is only applicable to the Company's 5.25% Convertible Senior Notes due 2011 and 3.5% Convertible Senior Notes due 2012, as the Company has the right to deliver cash in lieu of shares of its common stock, or a combination of cash and shares of common stock, upon conversion for each of these issuances. The 5.25% Convertible Senior Notes are convertible, at the option of the holders, into approximately 64 million shares of the Company's common stock as of June 30, 2009, at a conversion rate of \$3.98 per share, subject to certain adjustments. The 3.5% Convertible Senior Notes are convertible, at the option of the holders, into approximately 55 million shares of the Company's common stock as of June 30, 2009, at a conversion price of \$5.46 per share, subject to certain adjustments.

The Company recognized total interest expense of approximately \$17 million and \$34 million during the three and six months ended June 30, 2009, respectively, and \$17 million and \$33 million during the three and six months ended June 30, 2008, respectively, related to both the contractual interest coupon and amortization of the discount on the liability component of the Company's 5.25% Convertible Senior Notes and 3.5% Convertible Senior Notes. The effective interest rate on the liability component of the Company's 5.25% Convertible Senior Notes is approximately 17%. The effective interest rate on the liability component of the Company's 3.5% Convertible Senior Notes is approximately 11%. The Company is



amortizing the discount on the liability component of its 5.25% Convertible Senior Notes and 3.5% Convertible Senior Notes over the remaining term of each issuance.

The carrying amount of the equity component, principal amount of the liability component, unamortized debt discount related to the liability component and net carrying amount of the liability component of the Company's convertible debt subject to FSP APB 14-1 as of June 30, 2009 and December 31, 2008 were as follows (in millions):

	<u>June 30, 2009</u>	<u>December 31, 2008</u>
Carrying amount of equity component	\$ 246	\$ 241
Principal amount of liability component	\$ 556	\$ 656
Unamortized discount related to liability component	(115)	(158)
Net carrying amount of liability component	<u>\$ 441</u>	<u>\$ 498</u>

#### *Debt Maturities*

Aggregate future maturities of long-term debt, capital leases and our commercial mortgage (excluding debt discounts, premiums and fair value adjustments) were as follows as of June 30, 2009 (in millions):

2009 (remaining six months)	\$ 58
2010	237
2011	463
2012	304
2013	1,247
Thereafter	4,153
	<u>\$ 6,462</u>

#### **(10) Stock-Based Compensation**

The following table summarizes non-cash compensation expense and capitalized non-cash compensation for the three and six months ended June 30, 2009 and 2008 (in millions):

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
OSO	\$ 1	\$ 3	\$ 2	\$ 7
Restricted Stock	5	10	13	21
401(k) Match Expense	3	8	10	16
	9	21	25	44
Capitalized Noncash Compensation	—	(1)	—	(1)
	<u>\$ 9</u>	<u>\$ 20</u>	<u>\$ 25</u>	<u>\$ 43</u>

The Company capitalizes non-cash compensation for those employees directly involved in the construction of the network, installation of services for customers or development of business support systems. As of June 30, 2009, there were approximately 16 million Outperform Stock Option ("OSO") units outstanding, of which approximately 7 million were exercisable. As of June 30, 2009, there were approximately 22 million nonvested restricted stock and restricted stock units outstanding.



## (11) Comprehensive Loss

The components of total comprehensive loss, net of taxes, were as follows (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Net loss	\$ (134)	\$ (42)	\$ (266)	\$ (232)
Change in cumulative translation adjustment	55	(1)	21	50
Change in unrealized holding loss on available-for-sale investment	—	(2)	—	(4)
Change in unrealized holding loss on interest rate swaps	23	45	8	3
Other, net	—	(1)	(1)	—
Comprehensive loss	<u>\$ (56)</u>	<u>\$ (1)</u>	<u>\$ (238)</u>	<u>\$ (183)</u>

The components of accumulated other comprehensive loss, net of taxes, were as follows (in millions):

	June 30, 2009	December 31, 2008
Cumulative translation adjustment	\$ 118	\$ 97
Accumulated net unrealized holding loss on interest rate swaps	(89)	(97)
Other, net	(52)	(51)
Accumulated other comprehensive loss	<u>\$ (23)</u>	<u>\$ (51)</u>

## (12) Segment Information

SFAS No. 131 “Disclosures about Segments of an Enterprise and Related Information” (“SFAS No. 131”) defines operating segments as components of an enterprise for which separate financial information is available and which is evaluated regularly by the Company’s chief operating decision maker, or decision making group, in deciding how to allocate resources and assess performance. Operating segments are managed separately and represent separate strategic business units that offer different products or services and serve different markets. The Company’s current reportable segments include: communications and coal mining (see Note 1). Other primarily includes corporate assets and overhead not attributable to a specific segment.

Adjusted EBITDA, as defined by the Company, is net income (loss) from the consolidated statements of operations before (1) income taxes, (2) total other income (expense), (3) non-cash impairment charges included within restructuring charges, (4) depreciation and amortization and (5) non-cash stock compensation expense included within selling, general and administrative expenses on the consolidated statements of operations.

Adjusted EBITDA is not a measurement under GAAP and may not be used in the same way by other companies. Management believes that Adjusted EBITDA is an important part of the Company’s internal reporting and is a key measure used by management to evaluate profitability and operating performance of the Company and to make resource allocation decisions. Management believes such measurement is especially important in a capital-intensive industry such as communications. Management also uses Adjusted EBITDA to compare the Company’s performance to that of its competitors and to eliminate certain non-cash and non-operating items in order to consistently measure from period to period its ability to fund capital expenditures, fund growth, service debt and determine bonuses.

Adjusted EBITDA excludes non-cash impairment charges and non-cash stock compensation expense because of the non-cash nature of these items. Adjusted EBITDA also excludes interest income, interest expense, gain on extinguishment of debt, net and income taxes because these items are associated with the Company’s capitalization and tax structures. Adjusted EBITDA also excludes depreciation and amortization expense because these non-cash expenses reflect the effect of capital investments which management believes should be evaluated through cash flow measures. Adjusted EBITDA excludes net other income (expense) because these items are not related to the primary operations of the Company.

There are limitations to using non-GAAP financial measures, including the difficulty associated with comparing companies that use similar performance measures whose calculations may differ from the Company’s calculations.

Additionally, this financial measure does not include certain significant items such as interest income, interest expense, income taxes, depreciation and amortization, non-cash impairment charges, non-cash stock compensation expense, gain on extinguishment of debt, net and other income (expense), net. Adjusted EBITDA should not be considered a substitute for other measures of financial performance reported in accordance with GAAP.

The data presented in the following tables includes information for the three and six months ended June 30, 2009 and 2008 for all statement of operations and cash flow information presented.

Segment information for the Company's Communications and Coal Mining businesses is summarized as follows (in millions):

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
<i>Revenue from external customers:</i>				
Communications	\$ 926	\$ 1,072	\$ 1,888	\$ 2,138
Coal Mining	16	18	34	44
	<u>\$ 942</u>	<u>\$ 1,090</u>	<u>\$ 1,922</u>	<u>\$ 2,182</u>
<i>Adjusted EBITDA:</i>				
Communications	\$ 230	\$ 253	\$ 479	\$ 458
Coal Mining	\$ —	\$ —	\$ 1	\$ 7
Other	\$ (1)	\$ (2)	\$ (1)	\$ (3)

**Communications** revenue consists of:

1) Core Communications Services, which includes Core Network Services and Wholesale Voice Services;

- Core Network Services includes revenue from transport and infrastructure, IP and data services, local and enterprise voice services and Level 3 Vyvx broadcast services.
- Wholesale Voice Services includes revenue from long distance voice services, including domestic voice termination, international voice termination and toll free services.

2) Other Communications Services includes revenue from managed modem and its related reciprocal compensation services and SBC Contract Services.

Communications revenue attributable to each of these services is as follows (in millions):

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
<b>Communications Services:</b>				
Core Network Services Revenue	\$ 707	\$ 797	\$ 1,436	\$ 1,571
Wholesale Voice Services Revenue	170	175	340	359
Total Core Communications Services Revenue	877	972	1,776	1,930
Other Communications Revenue	49	100	112	208
Total Communications Revenue	<u>\$ 926</u>	<u>\$ 1,072</u>	<u>\$ 1,888</u>	<u>\$ 2,138</u>

In order to serve the changing needs of customers in growing markets and to drive growth across the Communications organization, Core Communications Services revenue by customer is also disaggregated into four customer-facing market groups as follows:

- The Wholesale Markets Group targets customers that include the largest national and global service providers, including carriers, cable companies, wireless companies, voice service providers, systems integrators and the federal government. These customers typically integrate Level 3 services into their own products and services to offer to their end user customers.
- The Business Markets Group targets enterprise customers and regional carriers who value a local, professional sales force. Specific customer markets include medium and large businesses, local and regional carriers, state and local government entities, and higher education institutions and consortia.
- The Content Markets Group focuses on serving media and content companies with large and growing bandwidth needs. Customers in this market include video distribution companies, providers of gaming, mega-portals, software service providers, social networking providers, as well as more traditional media distribution companies such as broadcasters, satellite companies, television networks and sports leagues.
- The European Markets Group serves large European consumers of bandwidth, including the largest European and international carriers, large system integrators, voice service providers, cable operators, Internet service providers, content providers, and government and education sectors.

The Company believes that the alignment of Core Communications Services around customer markets should allow it to drive growth while enabling it to better focus on the needs of its customers. Each of these groups is supported by dedicated employees in sales and marketing.

Core Communications Services revenue by customer-facing market group was as follows (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Wholesale Markets Group	\$ 495	\$ 548	\$ 1,008	\$ 1,089
Business Markets Group	218	241	441	481
Content Markets Group	82	100	167	200
European Markets Group	82	83	160	160
<b>Total Core Communications Services</b>	<b>\$ 877</b>	<b>\$ 972</b>	<b>\$ 1,776</b>	<b>\$ 1,930</b>

The following information provides a reconciliation of net loss to Adjusted EBITDA by operating segment, as defined by the Company, for the three and six months ended June 30, 2009 and 2008 (in millions):

**Three Months Ended June 30, 2009**

	Communications	Coal Mining	Other
Net loss	\$ (137)	\$ 14	\$ (11)
Income tax expense	1	—	—
Total other (income) expense	130	(15)	10
Depreciation and amortization expense	227	1	—
Non-cash compensation expense	9	—	—
Adjusted EBITDA	<u>\$ 230</u>	<u>\$ —</u>	<u>\$ (1)</u>

**Six Months Ended June 30, 2009**

	Communications	Coal Mining	Other
Net loss	\$ (270)	\$ 14	\$ (10)
Income tax expense	2	—	—
Total other (income) expense	274	(15)	9
Depreciation and amortization expense	448	2	—
Non-cash compensation expense	25	—	—
Adjusted EBITDA	<u>\$ 479</u>	<u>\$ 1</u>	<u>\$ (1)</u>

**Three Months Ended June 30, 2008**

	Communications	Coal Mining	Other
Net loss	\$ (38)	\$ (2)	\$ (2)
Income tax expense	1	—	—
Total other (income) expense	38	—	—
Depreciation and amortization expense	232	2	—
Non-cash compensation expense	20	—	—
Adjusted EBITDA	<u>\$ 253</u>	<u>\$ —</u>	<u>\$ (2)</u>

**Six Months Ended June 30, 2008**

	Communications	Coal Mining	Other
Net loss	\$ (234)	\$ 4	\$ (2)
Income tax expense	3	—	1
Total other (income) expense	175	—	(2)
Depreciation and amortization expense	471	3	—
Non-cash compensation expense	43	—	—
Adjusted EBITDA	<u>\$ 458</u>	<u>\$ 7</u>	<u>\$ (3)</u>

**(13) Commitments, Contingencies and Other Items**

In April 2002, Level 3 Communications, Inc., and two of its subsidiaries were named as defendants in *Bauer, et. al. v. Level 3 Communications, LLC, et al.*, a purported class action covering 22 states, filed in state court in Madison County, Illinois. In July 2001, Level 3 was named as a defendant in *Koyle, et. al. v. Level 3 Communications, Inc., et. al.*, a purported two state class action filed in the U.S. District Court for the District of Idaho. In November of 2005, the court granted class certification only for the state of Idaho. In September 2002, Level 3 Communications, LLC and Williams Communications, LLC were named as defendants in *Smith et. al. v. Sprint Communications Company, L.P., et al.*, a purported nationwide class action filed in the United States District Court for the Northern District of Illinois. In April 2005, the Smith plaintiffs filed a Fourth Amended Complaint which did not include Level 3 or Williams Communications, Inc. as a party, thus ending both companies' involvement in the Smith case. On February 17, 2005, Level 3 Communications, LLC and Williams Communications, LLC were named as defendants in *McDaniel, et. al., v. Qwest Communications Corporation, et al.*, a purported class action covering 10 states filed in the United States District Court for the Northern District of Illinois. All of these actions involve the companies' right to install its fiber optic cable network in easements and right-of-ways crossing the plaintiffs' land. In general, the companies obtained the rights to construct their networks from railroads, utilities, and others, and have installed their networks along the rights-of-way so granted. Plaintiffs in the purported class actions assert that they are the owners of lands over which the companies' fiber optic cable networks pass, and that the railroads, utilities, and others who granted the companies the right to construct and maintain their networks did not have the legal authority to do so. The complaints seek damages on theories of trespass, unjust enrichment and slander of title and property,

as well as punitive damages. The companies have also received, and may in the future receive, claims and demands related to rights-of-way issues similar to the issues in these cases that may be based on similar or different legal theories.

The Company and its subsidiaries have negotiated a proposed nationwide class settlement affecting persons who own or owned land next to or near railroad rights of way. The United States District Court for the District of Massachusetts in *Kingsborough v. Sprint Communications Co. L.P.* has granted preliminary approval of the proposed settlement which, if finally approved, will resolve all of the pending actions. The proposed settlement will provide cash payments to class members based on various factors that include:

- the length of the right of way where the cable is installed;
- the state where the property is located; and
- how the railroad obtained its property rights.

The proposed settlement will also provide the Company and its subsidiaries with a permanent telecommunications easement, which gives them certain rights over the railroad right of way.

It is still too early for the Company to reach a conclusion as to the ultimate outcome of the proposed settlement of these actions. However, management believes that the Company and its subsidiaries have substantial defenses to the claims asserted in all of these actions (and any similar claims which may be named in the future), and intends to defend them vigorously if a satisfactory form of settlement is not ultimately approved. Additionally, management believes that any resulting liabilities for these actions, beyond amounts reserved, will not materially affect the Company's financial condition or future results of operations, but could affect future cash flows.

In February 2009, Level 3 Communications, Inc., certain of its current officers and a former officer were named as defendants in purported class action lawsuits filed in the United States District Court for the District of Colorado, which have been consolidated as *In re Level 3 Communications, Inc. Securities Litigation (Civil Case No. 09-cv-00200-PAB-CBS)*. The Plaintiffs in each complaint allege, in general, that throughout the purported class period specified in the complaint that the defendants failed to disclose material adverse facts about the Company's integration activities, business and operations. The complaints seek damages based on purported violations of Section 10(b) of the Securities Exchange Act of 1934, Securities and Exchange Commission Rule 10b-5 promulgated thereunder and Section 20(a) of the Securities Exchange Act of 1934. On May 4, 2009, the Court appointed a lead plaintiff in the case, and on June 29, 2009, the lead plaintiff filed a Consolidated Class Action Complaint (the "Complaint"). On July 29, 2009, the Company and the other defendants named in the Complaint filed a motion to dismiss the Complaint with prejudice. The lead plaintiff has until August 28, 2009, to file a response to this motion to dismiss.

It remains too early for the Company to reach a conclusion as to the ultimate outcome of these actions. However, management believes that the Company has substantial defenses to the claims asserted in all of these actions (and any similar claims which may be named in the future), and intends to defend these actions vigorously.

During March 2009, Level 3 Communications, Inc., as a nominal defendant, its directors and certain of its current officers and a former officer were named as defendants in purported stockholder derivative actions in the District Court, Broomfield County, Colorado, which have been consolidated as *In re Level 3 Communications, Inc. Derivative Litigation (Lead Case No. 2009CV59)*. The Plaintiffs allege that during the period specified in the complaints the named defendants failed to disclose material adverse facts about the Company's integration activities, business and operations. The complaints seek damages on behalf of the Company based on purported breaches of fiduciary duties for disseminating false and misleading statements and failing to maintain internal controls; unjust enrichment; abuse of control; gross mismanagement; waste of corporate assets; and, with respect to certain defendants, breach of fiduciary duties in connection with the resignation of Kevin O'Hara. The parties have agreed to a stay of all activities in these actions pending the outcome of the motion to dismiss in the securities litigation described above.

It remains too early for the Company to reach a conclusion as to the ultimate outcome of these derivative actions. However, management believes that the complaints have numerous deficiencies including that each plaintiff failed to make a demand on the Company's Board of Directors before filing the suit.

In March 2009, late April 2009 and early May 2009, Level 3 Communications, Inc., the Level 3 Communications, Inc. 401(k) Plan Committee and certain current and former officers and directors of Level 3 Communications, Inc. were named as defendants in purported class action lawsuits filed in the U.S. District Court for the District of Colorado in *Walter v. Level 3 Communications, Inc., et. al.*, *Dagres v. Level 3 Communications, Inc., et. al.* and *Fragale v. Level 3 Communications, Inc., et. al.* The complaints allege breaches of fiduciary and other duties under the Employee Retirement

Income Security Act (“ERISA”) with respect to investments in the Company’s common stock held in individual participant accounts in the Level 3 Communications, Inc. 401(k) Plan. The complaints claim that those investments were imprudent for reasons that are similar to those alleged in the securities and derivative actions described above.

It remains too early for the Company to reach a conclusion as to the ultimate outcome of these ERISA actions. However, management believes that the Company has substantial defenses to the claims asserted in all of these actions (and any similar claims which may be named in the future), and intends to defend these actions vigorously.

The Company and its subsidiaries are parties to many other legal proceedings. Management believes that any resulting liabilities for these legal proceedings, beyond amounts reserved, will not materially affect the Company’s financial condition or future results of operations, but could affect future cash flows.

#### *Letters of Credit*

It is customary in Level 3’s industries to use various financial instruments in the normal course of business. These instruments include letters of credit. Letters of credit are conditional commitments issued on behalf of Level 3 in accordance with specified terms and conditions. As of June 30, 2009 and December 31, 2008, Level 3 had outstanding letters of credit of approximately \$26 million and \$30 million, respectively, which are collateralized by cash, which is reflected on the consolidated balance sheets as restricted cash and securities.

### **(14) Condensed Consolidating Financial Information**

Level 3 Financing has issued senior notes as described below:

- In October 2003, Level 3 Financing issued \$500 million of 10.75% Senior Notes due 2011. The 10.75% Senior Notes were registered with the Securities and Exchange Commission in 2005. The Company repurchased \$497 million of the 10.75% notes in 2006.
- In March 2006, Level 3 Financing issued \$150 million of Floating Rate Senior Notes due 2011 and \$250 million of 12.25% Senior Notes due 2013. The Company repurchased \$144 million of the Floating Rate Senior Notes due 2011 in 2007.
- In April 2006, Level 3 Financing issued an additional \$300 million of 12.25% Senior Notes due 2013.
- In October 2006, Level 3 Financing issued \$600 million of 9.25% Senior Notes due 2014 and in December 2006 issued an additional \$650 million of 9.25% Senior Notes due 2014.
- In February 2007, Level 3 Financing issued \$700 million of 8.75% Senior Notes due 2017 and \$300 million of Floating Rate Senior Notes due 2015.

The notes discussed above are unsecured obligations of Level 3 Financing; however, they are also jointly and severally and fully and unconditionally guaranteed on an unsecured senior basis by Level 3 Communications, Inc. and Level 3 Communications, LLC.

In addition, Level 3 Financing’s 12.25% Senior Notes due 2013, Floating Rate Senior Notes due 2011 and 9.25% Senior Notes due 2014 are jointly and severally and fully and unconditionally guaranteed by Broadwing Financial Services, Inc., a wholly owned subsidiary of Level 3 Communications, Inc. As a result of this guarantee, the Company has included Broadwing Financial Services, Inc. in the condensed consolidating financial information.

In conjunction with the registration of the 10.75% Senior Notes, Floating Rate Senior Notes due 2011, 12.25% Senior Notes due 2013, 9.25% Senior Notes due 2014, 8.75% Senior Notes due 2017 and Floating Rate Senior Notes due 2015 the accompanying condensed consolidating financial information has been prepared and presented pursuant to SEC Regulation S-X Rule 3-10 “Financial statements of guarantors and affiliates whose securities collateralize an issue registered or being registered.” The operating activities of the separate legal entities included in the Company’s consolidated financial statements are interdependent. The accompanying condensed consolidating financial information presents the results of operations, financial position and cash flows of each legal entity and, on an aggregate basis, the other non-guarantor subsidiaries based on amounts incurred by such entities, and are not intended to present the operating results of those legal entities on a stand-alone basis.

Level 3 Communications, LLC leases equipment and certain facilities from other wholly owned subsidiaries of Level 3 Communications, Inc. These transactions are eliminated in the consolidated results of the Company.

**Condensed Consolidating Statements of Operations**  
**For the three months ended June 30, 2009**  
**(unaudited)**

	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC	Broadwing Financial Services, Inc.	Other Subsidiaries	Eliminations	Total
	(dollars in millions)						
Revenue	\$ —	\$ —	\$ 358	\$ —	\$ 645	\$ (61)	\$ 942
Costs and Expenses:							
Cost of Revenue	—	—	192	—	261	(58)	395
Depreciation and Amortization	—	—	103	—	125	—	228
Selling, General and Administrative	1	—	264	—	59	(3)	321
Restructuring Charges	—	—	6	—	—	—	6
Total Costs and Expenses	1	—	565	—	445	(61)	950
Operating Income (Loss)	(1)	—	(207)	—	200	—	(8)
Other Income (Expense):							
Interest Income	—	—	—	—	1	—	1
Interest Expense	(55)	(94)	—	(1)	(2)	—	(152)
Interest Income (Expense)							
Affiliates, net	199	302	(510)	—	9	—	—
Equity in Net Earnings (Losses) of Subsidiaries	(306)	(514)	115	—	—	705	—
Other, net	29	—	2	—	(5)	—	26
Other Income (Expense)	(133)	(306)	(393)	(1)	3	705	(125)
Income (Loss) Before Income Taxes	(134)	(306)	(600)	(1)	203	705	(133)
Income Tax Benefit (Expense)	—	—	—	—	(1)	—	(1)
Net Income (Loss)	\$ (134)	\$ (306)	\$ (600)	\$ (1)	\$ 202	\$ 705	\$ (134)

**Condensed Consolidating Statements of Operations**  
**For the six months ended June 30, 2009**  
(unaudited)

	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC	Broadwing Financial Services, Inc.	Other Subsidiaries	Eliminations	Total
	(dollars in millions)						
Revenue	\$ —	\$ —	\$ 757	\$ —	\$ 1,288	\$ (123)	\$ 1,922
Costs and Expenses:							
Cost of Revenue	—	—	379	—	540	(117)	802
Depreciation and Amortization	—	—	204	—	246	—	450
Selling, General and Administrative	1	—	545	—	119	(6)	659
Restructuring Charges	—	—	7	—	—	—	7
Total Costs and Expenses	1	—	1,135	—	905	(123)	1,918
Operating Income (Loss)	(1)	—	(378)	—	383	—	4
Other Income (Expense):							
Interest Income	—	—	1	—	1	—	2
Interest Expense	(110)	(182)	(1)	(1)	(4)	—	(298)
Interest Income (Expense) Affiliates, net	406	602	(1,014)	—	6	—	—
Equity in Net Earnings (Losses) of Subsidiaries	(590)	(1,010)	226	—	—	1,374	—
Other, net	29	—	3	—	(4)	—	28
Other Income (Expense)	(265)	(590)	(785)	(1)	(1)	1,374	(268)
Income (Loss) Before Income Taxes	(266)	(590)	(1,163)	(1)	382	1,374	(264)
Income Tax Benefit (Expense)	—	—	—	—	(2)	—	(2)
Net Income (Loss)	<u>\$ (266)</u>	<u>\$ (590)</u>	<u>\$ (1,163)</u>	<u>\$ (1)</u>	<u>\$ 380</u>	<u>\$ 1,374</u>	<u>\$ (266)</u>



**Condensed Consolidating Statements of Operations**  
**For the three months ended June 30, 2008**  
(unaudited)

	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC	Broadwing Financial Services, Inc.	Other Subsidiaries	Eliminations	Total
	(dollars in millions)						
Revenue	\$ —	\$ —	\$ 433	\$ —	\$ 706	\$ (49)	\$ 1,090
Costs and Expenses:							
Cost of Revenue	—	—	167	—	340	(47)	460
Depreciation and Amortization	—	—	90	—	144	—	234
Selling, General and Administrative	—	—	318	—	79	(2)	395
Restructuring Charges	—	—	4	—	—	—	4
Total Costs and Expenses	—	—	579	—	563	(49)	1,093
Operating Income (Loss)	—	—	(146)	—	143	—	(3)
Other Income (Expense):							
Interest Income	—	—	2	—	1	—	3
Interest Expense	(48)	(91)	—	(1)	(1)	—	(141)
Interest Income (Expense)							
Affiliates, net	112	278	(404)	—	14	—	—
Equity in Net Earnings (Losses) of Subsidiaries	(106)	(293)	210	—	—	189	—
Other, net	—	—	2	—	98	—	100
Other Income (Expense)	(42)	(106)	(190)	(1)	112	189	(38)
Income (Loss) Before Income Taxes	(42)	(106)	(336)	(1)	255	189	(41)
Income Tax Expense	—	—	(1)	—	—	—	(1)
Net Income (Loss)	<u>\$ (42)</u>	<u>\$ (106)</u>	<u>\$ (337)</u>	<u>\$ (1)</u>	<u>\$ 255</u>	<u>\$ 189</u>	<u>\$ (42)</u>

Financial statements for the three months ended June 30, 2008 have been adjusted for the retrospective application of FSP APB 14-1 (see Note 9).

**Condensed Consolidating Statements of Operations**  
**For the six months ended June 30, 2008**  
(unaudited)

	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC	Broadwing Financial Services, Inc.	Other Subsidiaries	Eliminations	Total
	(dollars in millions)						
Revenue	\$ —	\$ —	\$ 846	\$ —	\$ 1,436	\$ (100)	\$ 2,182
Costs and Expenses:							
Cost of Revenue	—	—	336	—	694	(95)	935
Depreciation and Amortization	—	—	180	—	294	—	474
Selling, General and Administrative	1	—	665	—	156	(5)	817
Restructuring Charges	—	—	11	—	—	—	11
Total Costs and Expenses	1	—	1,192	—	1,144	(100)	2,237
Operating Income (Loss)	(1)	—	(346)	—	292	—	(55)
Other Income (Expense):							
Interest Income	—	—	6	—	3	—	9
Interest Expense	(97)	(184)	—	(1)	(3)	—	(285)
Interest Income (Expense)							
Affiliates, net	315	551	(893)	—	27	—	—
Equity in Net Earnings (Losses) of Subsidiaries	(446)	(813)	323	—	—	936	—
Other, net	(3)	—	4	—	102	—	103
Other Income (Expense)	(231)	(446)	(560)	(1)	129	936	(173)
Income (Loss) Before Income Taxes	(232)	(446)	(906)	(1)	421	936	(228)
Income Tax Expense	—	—	(2)	—	(2)	—	(4)
Net Income (Loss)	<u>\$ (232)</u>	<u>\$ (446)</u>	<u>\$ (908)</u>	<u>\$ (1)</u>	<u>\$ 419</u>	<u>\$ 936</u>	<u>\$ (232)</u>

Financial statements for the six months ended June 30, 2008 have been adjusted for the retrospective application of FSP APB 14-1 (see Note 9).

**Condensed Consolidating Balance Sheets**  
**June 30, 2009**  
(unaudited)

	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC	Broadwing Financial Services, Inc.	Other Subsidiaries	Eliminations	Total
	(dollars in millions)						
Assets							
Current Assets:							
Cash and cash equivalents	\$ 67	\$ 8	\$ 404	\$ —	\$ 151	\$ —	\$ 630
Restricted cash and securities	—	—	1	—	1	—	2
Receivables, net	—	—	19	—	355	—	374
Due from (to) affiliates	11,136	10,009	(23,370)	15	2,210	—	—
Other	5	9	56	—	41	—	111
Total Current Assets	11,208	10,026	(22,890)	15	2,758	—	1,117
Property, Plant and Equipment, net	—	—	3,050	—	2,889	—	5,939
Restricted Cash and Securities	18	—	24	—	83	—	125
Goodwill and Other Intangibles, net	—	—	511	—	1,433	—	1,944
Investment in Subsidiaries	(8,588)	(14,019)	3,531	—	—	19,076	—
Other Assets	7	75	14	—	14	—	110
Total Assets	<u>\$ 2,645</u>	<u>\$ (3,918)</u>	<u>\$ (15,760)</u>	<u>\$ 15</u>	<u>\$ 7,177</u>	<u>\$ 19,076</u>	<u>\$ 9,235</u>
Liabilities and Stockholders' Equity (Deficit)							
Current Liabilities:							
Accounts payable	\$ 4	\$ —	\$ 140	\$ —	\$ 192	\$ —	\$ 336
Current portion of long-term debt	174	—	1	1	2	—	178
Accrued payroll and employee benefits	—	—	35	—	4	—	39
Accrued interest	41	90	—	—	1	—	132
Current portion of deferred revenue	—	—	99	—	64	—	163
Other	13	1	57	—	21	—	92
Total Current Liabilities	232	91	332	1	284	—	940
Long-Term Debt, less current portion	1,576	4,494	6	18	74	—	6,168
Deferred Revenue, less current portion	—	—	654	—	88	—	742
Other Liabilities	15	89	136	—	323	—	563
Stockholders' Equity (Deficit)	822	(8,592)	(16,888)	(4)	6,408	19,076	822
Total Liabilities and Stockholders' Equity (Deficit)	<u>\$ 2,645</u>	<u>\$ (3,918)</u>	<u>\$ (15,760)</u>	<u>\$ 15</u>	<u>\$ 7,177</u>	<u>\$ 19,076</u>	<u>\$ 9,235</u>

**Condensed Consolidating Balance Sheets**  
**December 31, 2008**

	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC	Broadwing Financial Services, Inc.	Other Subsidiaries	Eliminations	Total
	(dollars in millions)						
<b>Assets</b>							
Current Assets:							
Cash and cash equivalents	\$ 67	\$ 10	\$ 555	\$ —	\$ 136	\$ —	\$ 768
Restricted cash and securities	—	—	1	—	2	—	3
Receivables, net	—	—	73	—	317	—	390
Due from (to) affiliates	11,148	9,306	(22,122)	17	1,651	—	—
Other	4	9	36	—	32	—	81
Total Current Assets	11,219	9,325	(21,457)	17	2,138	—	1,242
Property, Plant and Equipment, net	—	—	3,150	—	3,009	—	6,159
Restricted Cash and Securities	18	—	25	—	84	—	127
Goodwill and Other Intangibles, net	—	—	540	—	1,451	—	1,991
Investment in Subsidiaries	(8,043)	(13,041)	3,484	—	—	17,600	—
Other Assets	9	76	15	—	15	—	115
Total Assets	<u>\$ 3,203</u>	<u>\$ (3,640)</u>	<u>\$ (14,243)</u>	<u>\$ 17</u>	<u>\$ 6,697</u>	<u>\$ 17,600</u>	<u>\$ 9,634</u>
<b>Liabilities and Stockholders' Equity (Deficit)</b>							
Current Liabilities:							
Accounts payable	\$ 3	\$ —	\$ 147	\$ —	\$ 215	\$ —	\$ 365
Current portion of long-term debt	181	—	1	1	3	—	186
Accrued payroll and employee benefits	—	—	97	—	8	—	105
Accrued interest	24	93	—	—	—	—	117
Current portion of deferred revenue	—	—	96	—	72	—	168
Other	—	1	59	—	51	—	111
Total Current Liabilities	208	94	400	1	349	—	1,052
Long-Term Debt, less current portion	1,930	4,216	7	19	73	—	6,245
Deferred Revenue, less current portion	—	—	630	—	89	—	719
Other Liabilities	44	97	284	—	172	—	597
Stockholders' Equity (Deficit)	<u>1,021</u>	<u>(8,047)</u>	<u>(15,564)</u>	<u>(3)</u>	<u>6,014</u>	<u>17,600</u>	<u>1,021</u>
Total Liabilities and Stockholders' Equity (Deficit)	<u>\$ 3,203</u>	<u>\$ (3,640)</u>	<u>\$ (14,243)</u>	<u>\$ 17</u>	<u>\$ 6,697</u>	<u>\$ 17,600</u>	<u>\$ 9,634</u>

Financial statements as of December 31, 2008 have been adjusted for the retrospective application of FSP APB 14-1 (see Note 9).

**Condensed Consolidating Statements of Cash Flows**  
**For the six months ended June 30, 2009**  
(unaudited)

	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC	Broadwing Financial Services, Inc.	Other Subsidiaries	Eliminations	Total
	(dollars in millions)						
Net Cash Provided by (Used in) Operating Activities	\$ (71)	\$ (180)	\$ (110)	\$ (1)	458	\$ —	\$ 96
Cash Flows from Investing Activities:							
Capital expenditures	—	—	(61)	—	(97)	—	(158)
Decrease in restricted cash and securities, net	—	—	2	—	1	—	3
Net Cash Used in Investing Activities	—	—	(59)	—	(96)	—	(155)
Cash Flows from Financing Activities:							
Long-term debt borrowings, net of issuance costs	(2)	274	—	—	—	—	272
Payments on and repurchases of long-term debt	(351)	—	—	—	(2)	—	(353)
Increase (decrease) due from affiliates, net	424	(96)	18	1	(347)	—	—
Net Cash Provided by (Used in) Financing Activities	71	178	18	1	(349)	—	(81)
Effect of Exchange Rates on Cash and Cash Equivalents	—	—	—	—	2	—	2
Net Change in Cash and Cash Equivalents	—	(2)	(151)	—	15	—	(138)
Cash and Cash Equivalents at Beginning of Period	67	10	555	—	136	—	768
Cash and Cash Equivalents at End of Period	\$ 67	\$ 8	\$ 404	\$ —	\$ 151	\$ —	\$ 630

**Condensed Consolidating Statements of Cash Flows**  
**For the six months ended June 30, 2008**  
(unaudited)

	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC	Broadwing Financial Services, Inc.	Other Subsidiaries	Eliminations	Total
	(dollars in millions)						
Net Cash Provided by (Used in) Operating Activities	\$ (79)	\$ (189)	\$ (156)	\$ (1)	488	\$ —	\$ 63
Cash Flows from Investing Activities:							
Capital expenditures	—	—	(77)	—	(142)	—	(219)
Proceeds from sale of business group, net	—	—	—	—	123	—	123
Decrease in restricted cash and securities, net	—	—	2	—	—	—	2
Proceeds from sale of property, plant and equipment and other assets	—	—	1	—	1	—	2
Net Cash Provided by (Used in) Investing Activities	—	—	(74)	—	(18)	—	(92)
Cash Flows from Financing Activities:							
Payments on and repurchases of long-term debt	(26)	—	—	—	(2)	—	(28)
Increase (decrease) due from affiliates, net	105	296	71	1	(473)	—	—
Net Cash Provided by (Used in) Financing Activities	79	296	71	1	(475)	—	(28)
Effect of Exchange Rates on Cash and Cash Equivalents	—	—	2	—	2	—	4
Net Change in Cash and Cash Equivalents	—	107	(157)	—	(3)	—	(53)
Cash and Cash Equivalents at Beginning of Period	—	27	588	—	99	—	714
Cash and Cash Equivalents at End of Period	\$ —	\$ 134	\$ 431	\$ —	\$ 96	\$ —	\$ 661

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion should be read in conjunction with the Level 3 Communications, Inc. and its subsidiaries ("Level 3" or the "Company") consolidated financial statements (including the notes thereto), included elsewhere herein and the Form 10-K for the year ended December 31, 2008 filed with the Securities and Exchange Commission.

This document contains forward looking statements and information that are based on the beliefs of management as well as assumptions made by and information currently available to the Company. When used in this document, the words "anticipate", "believe", "plan", "estimate" and "expect" and similar expressions, as they relate to the Company or its management, are intended to identify forward-looking statements. Such statements reflect the current views of the Company with respect to future events and are subject to certain risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described in this document. For a more detailed description of these risks and factors, please see the Company's Form 10-K for the year ended December 31, 2008 filed with the Securities and Exchange Commission and Item 1A in this Form 10-Q.

Level 3 Communications, Inc., through its operating subsidiaries, is primarily engaged in the communications business, with additional operations in coal mining.

### ***Communications Business***

The Company is a facilities based provider of a broad range of communications services. Revenue for communications services is recognized on a monthly basis as these services are provided. For contracts involving private line, wavelengths and dark fiber services, Level 3 may receive up-front payments for services to be delivered for a period of generally up to 20 years. In these situations, Level 3 defers the revenue and amortizes it on a straight-line basis to earnings over the term of the contract.

Communications revenue consists of:

- Core Communications Services
- Other Communications Services

The two categories of Communications revenue are in different phases of the service life cycle, requiring different levels of investment and focus, and providing different contributions to the Company's Communications Adjusted EBITDA. Management of Level 3 believes that growth in revenue from its Core Communications Services is critical to the long-term success of its communications business. At the same time, the Company believes it must continue to effectively manage the positive cash flows from its Other Communications Services. Core Communications Services includes revenue from Core Network Services and Wholesale Voice Services. Core Network Services revenue represents higher margin services and Wholesale Voice Services represents lower margin services. The Company believes that trends in the communications business are best gauged by looking at revenue trends in Core Network Services. The Company manages Wholesale Voice performance based on gross margin contribution. Core Network Services includes revenue from transport and infrastructure, IP and data services, including content delivery network services, local and enterprise voice services and Level 3 Vyvx broadcast services. Wholesale Voice Services includes revenue from long distance voice services, including domestic voice termination, international voice termination and toll free services. Other Communications Services includes revenue from managed modem and its related reciprocal compensation services and SBC Contract Services, which includes revenue from the "SBC Master Services Agreement", which was obtained in the December 2005 acquisition of WilTel Communications Group, LLC ("WilTel").

### ***Core Communications Services***

The Company's transport and infrastructure services include metropolitan and intercity wavelengths, private line, ethernet private line, dark fiber, colocation services, professional services and transoceanic services. Growth in transport and infrastructure revenue is largely dependent on increased demand for bandwidth services and available capital of companies requiring communications capacity for their own use or in providing capacity as a service provider to their customers. These expenditures may be in the form of monthly payments or up-front payments for private line, wavelength or dark fiber services. The Company is focused on providing end-to-end transport services to its customers to directly connect customer locations with a private network. Pricing for end-to-end metropolitan transport services have been relatively stable. For intercity transport services, the Company continues to experience pricing pressure for point-to-point locations, particularly in

locations where a large number of carriers co-locate their facilities. An increase in demand may be partially offset by declines in unit pricing.

IP and data services primarily include the Company's high speed Internet access service, dedicated Internet access ("DIA") service, ATM and frame relay services, IP and ethernet virtual private network ("VPN") services, and content delivery network ("CDN") services, which includes streaming services. Level 3's Internet access service is a high quality and high-speed Internet access service offered in a variety of capacities. The Company's VPN services permit businesses of any size to replace multiple networks with a single, cost-effective solution that greatly simplifies the converged transmission of voice, video, and data. This convergence to a single platform can be obtained without sacrificing the quality of service or security levels of traditional ATM and frame relay offerings. VPN services also permit customers to prioritize network application traffic so that high priority applications, such as voice and video, are not compromised in performance by the flow of low priority applications such as email. The IP market is generally characterized by price compression and high unit growth rates depending upon the type of service. The Company has experienced price compression for its high-speed IP services and expects that pricing for such services will continue to decline in 2009.

The Company believes that one of the largest sources of future incremental demand for the Company's Core Communications Services will be from customers that are seeking to distribute their feature rich content or video over the Internet. Revenue growth in this area is dependent on the continued increase in usage by both enterprises and consumers and the pricing environment. An increase in the reliability and security of information transmitted over the Internet and declines in the cost to transmit data have resulted in increased utilization of e-commerce or web based services by businesses.

The Company's Core Network Services also include local and enterprise voice services. Local voice services are primarily components that enable other service providers to deliver business or consumer-ready voice products to their end customers. Enterprise voice services are business-grade voice services that the Company sells directly to its business customers.

The Company, through its Level 3 Vyvx business, provides transport services for the audio and video programming of its customers over the Company's fiber-optic network and via satellite. It uses the Company's fiber-optic network to carry live traditional broadcast and cable television events from the site of the event to the network control centers of the broadcasters of the event.

For live events where the location is not known in advance, such as breaking news stories in remote locations, the Company provides an integrated satellite and fiber-optic network-based service to transmit the content to its customers. Most of Level 3 Vyvx's customers for these services contract for the service on an event-by-event basis; however, there are some customers who have purchased a dedicated point-to-point service which enables these customers to transmit programming at any time.

On June 5, 2008, Level 3 completed the sale of its Vyvx advertising distribution business to DG FastChannel, Inc. and received gross proceeds at closing of approximately \$129 million in cash. Level 3 has retained ownership of Vyvx's core broadcast business, including the Vyvx Services Broadcast Business' content distribution capabilities. The financial results of the Vyvx advertising distribution business are included in the Company's consolidated results of operations through the date of sale on June 5, 2008.

Prior to the sale of the Vyvx advertising distribution business, Level 3 Vyvx distributed advertising spots to radio and television stations throughout the U.S., both electronically and in physical form. Customers for these services utilized a network-based method for aggregating, managing, storing and distributing content for content owners and rights holders.

The Company has developed its content delivery network services business primarily through acquisitions made in 2007. The Company believes that one of the largest sources of future incremental demand for communications services will be derived from customers that are seeking to distribute their feature rich content or video over the Internet.

The Company offers Wholesale Voice Services that target large and existing markets. The revenue potential for Wholesale Voice Services is large; however, the pricing and margins are expected to continue to decline over time as a result of new low-cost IP and optical-based technologies. In addition, the market for Wholesale Voice Services is being targeted by many competitors, several of which are larger and have more financial resources than the Company.



### Core Communications Services Market Groups

In order to serve the changing needs of customers in growing markets and to drive growth across the Communications organization, Core Communications Services revenue by customer is also disaggregated into four customer-facing market groups as follows:

- The Wholesale Markets Group targets customers that include the largest national and global service providers, including carriers, cable companies, wireless companies, voice service providers, systems integrators and the federal government. These customers typically integrate Level 3 services into their own products and services to offer to their end user customers.
- The Business Markets Group targets enterprise customers and regional carriers who value a local, professional sales force. Specific customer markets include medium and large businesses, local and regional carriers, state and local government entities, and higher education institutions and consortia.
- The Content Markets Group focuses on serving media and content companies with large and growing bandwidth needs. Customers in this market include video distribution companies, providers of gaming, mega-portals, software service providers, social networking providers, as well as more traditional media distribution companies such as broadcasters, satellite companies, television networks and sports leagues.
- The European Markets Group serves large European consumers of bandwidth, including the largest European and international carriers, large system integrators, voice service providers, cable operators, Internet service providers, content providers, and government and education sectors.

The Company believes that the alignment of Core Communications Services around customer markets should allow it to drive growth while enabling it to better focus on the needs of its customers. Each of these groups is supported by dedicated employees in sales and marketing.

Core Communications Services revenue by customer-facing market group was as follows (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Wholesale Markets Group	\$ 495	\$ 548	\$ 1,008	\$ 1,089
Business Markets Group	218	241	441	481
Content Markets Group	82	100	167	200
European Markets Group	82	83	160	160
<b>Total Core Communications Services</b>	<b>\$ 877</b>	<b>\$ 972</b>	<b>\$ 1,776</b>	<b>\$ 1,930</b>

The classification of customers within each customer-facing market group can change based upon sales team assignments, merger and acquisition activity by customers and other factors. There were no material re-classification changes in revenue by market group during the three and six month periods ended June 30, 2009.

### Other Communications Services

The Company's Other Communications Services are mature services that are not critical areas of emphasis for the Company. Other Communications Services includes revenue from managed modem and its related reciprocal compensation services and SBC Contract Services, which includes revenue derived under the SBC Master Services Agreement that was obtained in the WilTel acquisition. The Company and its customers continue to see consumers migrate from narrow band dial-up services to higher speed broadband services as the narrow band market matures. As a result of the continued migration away from dial-up services, managed modem revenue declined to \$14 million in the three months ended June 30, 2009 compared to \$28 million in the three months ended June 30, 2008. In addition, managed modem revenue declined to \$32 million in the six months ended June 30, 2009 compared to \$58 million in the six months ended June 30, 2008. Managed modem revenue approximated \$103 million in 2008 and \$158 million in 2007.

The Company receives compensation from other carriers when it terminates traffic originating on those carriers' networks. This reciprocal compensation is based on interconnection agreements with the respective carriers or rates mandated by the FCC. The Company has interconnection agreements in place for the majority of traffic subject to reciprocal compensation. In addition, a majority of the Company's existing reciprocal compensation revenue is associated with agreements that are in effect through 2009 or beyond. The Company continues to negotiate new interconnection agreements.

or amendments to its existing interconnection agreements with local carriers as needed. The Company earns the majority of its reciprocal compensation revenue from providing managed modem services. The Company also receives reciprocal compensation from its voice services, which is reported within Core Network Services revenue.

### *Communications Business Strategy and Objectives*

The Company's management continues to review all existing lines of business and service offerings to determine how those lines of business and service offerings enhance the Company's focus on delivery of communications services and meeting its financial objectives. To the extent that certain lines of business, business groups or service offerings are not considered to be compatible with the delivery of the Company's services or with meeting its financial objectives, Level 3 may exit those lines of business or stop offering those services.

The Company is focusing its attention on the following operational and financial objectives:

- increasing sales;
- improving the customer experience to increase customer retention and reducing customer churn;
- achieving sustainable generation of positive cash flows from operations in excess of capital expenditures;
- reducing network costs and operating expenses;
- growing Core Communications Services revenue, particularly Core Network Services revenue;
- continuing to show improvements in Adjusted EBITDA as a percentage of revenue;
- continuing to implement its metro network strategy, including leveraging its existing network assets to expand its addressable market;
- localizing certain decision making and interaction with its mid-market enterprise customers;
- completing the integration of acquired businesses;
- growing its content delivery network services;
- managing cash flows provided by its Other Communications Services; and
- refinancing its future debt maturities.

The Company's management believes the introduction of new services or technologies, as well as the further development of existing technologies, may reduce the cost or increase the supply of certain services similar to those provided by Level 3. The ability of the Company to anticipate, adapt and invest in these technology changes in a timely manner may affect the Company's future success.

The Company strategically expanded its presence in metropolitan markets and began offering services to enterprise customers through its Business Markets Group. This strategy allowed the Company to terminate traffic over its owned facilities rather than paying third parties to terminate the traffic. The expansion into new metro markets also provided additional opportunities to sell services to bandwidth intensive businesses on the Company's national and international networks. In order to expedite the expansion of its metro business, Level 3 acquired Progress Telecom, ICG Communications, TelCove and Looking Glass in 2006 and Broadwing in 2007. Level 3 also strategically expanded its content delivery network services with the acquisitions of the CDN Business of SAVVIS and Servecast in 2007. The results of operations attributable to each acquisition are included in the consolidated financial statements from the date of acquisition.

Level 3 will continue to evaluate acquisition opportunities and could make additional acquisitions in the future.

The successful integration of acquired businesses into Level 3 is important to the success of Level 3. The Company must continue to identify synergies and integrate acquired networks and support organizations, while maintaining the service quality levels expected by customers to realize the anticipated benefits of these acquisitions. Successful integration of these acquired businesses continues to depend on the Company's ability to manage these operations, realize opportunities for revenue growth presented by strengthened service offerings and expanded geographic market coverage, and to eliminate redundant and excess costs to fully realize the expected synergies. If the Company is not able to efficiently and effectively continue to integrate the acquired businesses or operations, the Company may experience material negative consequences to its business, financial condition or results of operations.

The Company has taken steps to improve its existing processes and systems to reduce service activation times and improve its service management. The Company continues to realize improvements in its service management and believes it has implemented sufficient improvements in service activation capabilities to match installation capacity to customer demand for services.

The Company has ongoing process and system development work that is being implemented as part of the integration efforts that have and are expected to further improve the full spectrum of the customer experience, including service activation and service management systems and processes utilized by acquired companies as well as various operational efficiency improvements. The Company completed the foundation of its processes and systems development objectives at the end of 2008 and is now focused on operational efficiency improvements.

Recent changes in the economic environment and uncertainty in the global financial markets have required the Company to manage its cost structure and operating expenses carefully and to concentrate its capital expenditures on those technologies and assets that enable the Company to further develop its Core Communications Services. In addition, the Company's operating results and financial condition could be negatively affected if as a result of economic conditions:

- customers defer or forgo purchases of the Company's services, including, but not limited to, as a result of our largest customers more aggressively managing their network costs and spend;
- customers are unable to make timely payments to the Company;
- the demand for, and prices of, the Company's services are reduced as a result of actions by the Company's competitors or otherwise;
- key suppliers upon which the Company relies are unable to provide the Company with the materials it needs for its network on a timely basis; or
- the Company's financial counterparties, insurance providers or other contractual counterparties are unable to, or do not meet, their contractual commitments to the Company.

For example, the Company's revenue and operating results were negatively affected in the first half of 2009 primarily as a result of the recent macroeconomic environment.

In addition to the operational objectives mentioned above, the Company has also been focused on improving its liquidity, financial condition, and extending the maturity dates of certain debt.

During the second quarter of 2009, Level 3 Financing, Inc. ("Level 3 Financing"), a wholly owned subsidiary of the Company, amended and restated its existing senior secured credit facility to increase the borrowings through the creation of a \$280 million Tranche B Term Loan that matures on March 13, 2014 with a current interest rate of LIBOR plus 8.50% per annum, with LIBOR set at a minimum of 3.00%.

During the second quarter of 2009, the Company exchanged approximately \$142 million aggregate principal amount of the Company's 6% Convertible Subordinated Notes due 2010 and approximately \$140 million aggregate principal amount of its 2.875% Convertible Senior Notes due 2010 for \$200 million aggregate principal amount of the Company's 7% Convertible Senior Notes due 2015 and \$78 million in cash, plus accrued and unpaid interest.

During the second quarter of 2009, the Company repurchased approximately \$301 million aggregate principal amount of various issues of its convertible debt as follows:

- \$121 million aggregate principal amount of 6% Convertible Subordinated Notes due 2009;

- \$47 million aggregate principal amount of 6% Convertible Subordinated Notes due 2010;
- \$3 million aggregate principal amount of 2.875% Convertible Senior Notes due 2010;
- \$75 million aggregate principal amount of 5.25% Convertible Senior Notes due 2011;
- \$31 million aggregate principal amount of 10% Convertible Senior Notes due 2011; and
- \$24 million aggregate principal amount of 3.5% Convertible Senior Notes due 2012

In addition, during the second quarter of 2009, the Company redeemed at par \$13 million aggregate principal amount of 11.5% Senior Notes due 2010.

The Company will continue to look for opportunities to improve its financial position and focus its resources on growing revenue and managing costs for the communications business.

### ***Coal Mining***

Level 3, through its two 50% owned joint-venture surface mines, one each in Montana and Wyoming, sells coal primarily through long-term contracts with public utilities. The long-term contracts for the delivery of coal establish the price, volume, and quality requirements of the coal to be delivered. Revenue under these and other contracts is generally recognized when coal is shipped to the customer.

### **Critical Accounting Policies**

Except for the adoption of FSP APB 14-1, the significant accounting policies set forth in Note 1 to the consolidated financial statements in the Company's Form 10-K for the year ended December 31, 2008 appropriately present, in all material respects, the current status of the Company's critical accounting policies, and are incorporated herein by reference.

### **Recently Issued Accounting Pronouncements**

In April 2009, the FASB issued FSP SFAS 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly" ("FSP SFAS 157-4"). FSP SFAS 157-4 provides additional guidance for estimating fair value when the volume and level of activity for the asset or liability have significantly decreased. It also includes guidance on identifying circumstances that indicate a transaction is not orderly. FSP SFAS 157-4 was adopted by the Company in the second quarter of 2009 and did not have a material effect on its consolidated results of operations and financial condition.

In April 2009, the FASB issued FSP SFAS 115-2 and SFAS 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments" ("FSP SFAS 115-2 and SFAS 124-2"). FSP SFAS 115-2 and SFAS 124-2 amend the other-than-temporary impairment guidance in U.S. GAAP for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. FSP SFAS 115-2 and SFAS 124-2 was adopted by the Company in the second quarter of 2009 and did not have a material effect on its consolidated results of operations and financial condition.

In April 2009, the FASB issued FSP SFAS 107-1 and APB 28-1, "Interim Disclosures about Fair Value of Financial Instruments" ("FSP SFAS 107-1 and APB 28-1"). This FSP amends FASB Statement No. 107, "Disclosure about Fair Value of Financial Instruments," to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This FSP also amends APB Opinion No. 28, "Interim Financial Reporting," to require disclosures in summarized financial information at interim reporting periods. FSP SFAS 107-1 and APB 28-1 were adopted by the Company in the second quarter of 2009 and did not have a material effect on its consolidated results of operations and financial condition.

In April 2009, the FASB issued FSP SFAS 141(R)-1, "Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies" ("FSP SFAS 141(R)-1"). FSP SFAS 141(R)-1 addresses application issues on initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. FSP SFAS 141(R)-1 is effective for assets or liabilities

arising from contingencies in business combinations for which the acquisition date is on or after January 1, 2009. The effect of adopting FSP SFAS 141(R)-1 on the Company's consolidated results of operations and financial condition will be largely dependent on the size and nature of any business combinations completed on or after January 1, 2009.

### Results of Operations for the Three and Six Months Ended June 30 , 2009 and 2008 :

(dollars in millions)	Three Months Ended			Six Months Ended		
	June 30, 2009	June 30, 2008	Change %	June 30, 2009	June 30, 2008	Change %
<b>Revenue:</b>						
Communications	\$ 926	\$ 1,072	-14%	\$ 1,888	\$ 2,138	-12%
Coal Mining	16	18	-11%	34	44	-23%
Total revenue	942	1,090	-14%	1,922	2,182	-12%
<b>Costs and Expenses (exclusive of depreciation and amortization shown separately below):</b>						
<b>Cost of Revenue</b>						
Communications	379	442	-14%	769	901	-15%
Coal Mining	16	18	-11%	33	34	-3%
Total Cost of Revenue	395	460	-14%	802	935	-14%
Depreciation and Amortization	228	234	-3%	450	474	-5%
Selling, General and Administrative	321	395	-19%	659	817	-19%
Restructuring Charges	6	4	50%	7	11	-36%
Total Costs and Expenses	950	1,093	-13%	1,918	2,237	-14%
Operating Income (Loss)	(8)	(3)	-167%	4	(55)	—
<b>Other Income (Expense):</b>						
Interest income	1	3	-67%	2	9	-78%
Interest expense	(152)	(141)	-8%	(298)	(285)	-5%
Gain on sale of business group, net	—	96	—	—	96	—
Gain on extinguishment of debt, net	14	—	—	14	—	—
Other, net	12	4	200%	14	7	100%
Total Other Income (Expense)	(125)	(38)	-229%	(268)	(173)	-55%
Loss Before Income Taxes	(133)	(41)	-224%	(264)	(228)	-16%
Income Tax Expense	(1)	(1)	0%	(2)	(4)	50%
Net Loss	<u>\$ (134)</u>	<u>\$ (42)</u>	-219%	<u>\$ (266)</u>	<u>\$ (232)</u>	-15%

**Communications** revenue consists of:

- 1) Core Communications Services, which includes Core Network Services and Wholesale Voice Services;
  - Core Network Services includes revenue from transport and infrastructure, IP and data services, local and enterprise voice services and Level 3 Vyvx broadcast services.
  - Wholesale Voice Services includes revenue from long distance voice services, including domestic voice termination, international voice termination and toll free services.
- 2) Other Communications Services includes revenue from managed modem and its related reciprocal compensation services and SBC Contract Services.

Communications revenue attributable to each of these services is as follows (in millions):

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
<b>Communications Services:</b>				
Core Network Services Revenue	\$ 707	\$ 797	\$ 1,436	\$ 1,571
Wholesale Voice Services Revenue	170	175	340	359
Total Core Communications Services Revenue	877	972	1,776	1,930
Other Communications Revenue	49	100	112	208
Total Communications Revenue	<u>\$ 926</u>	<u>\$ 1,072</u>	<u>\$ 1,888</u>	<u>\$ 2,138</u>

***Comparisons of the Three and Six Months Ended June 30, 2009 to the Three and Six Months Ended June 30, 2008***

**Communications Revenue** decreased 14% in the second quarter of 2009 compared to the second quarter of 2008 and 12% in the six months ended June 30, 2009 compared to the same period in 2008. Contributing to these declines in Communications revenue was a decrease in Core Communications Services revenue, which included declines in the Company's Core Network Services and Wholesale Voice Services revenue and is generally the result of macroeconomic conditions driving increasing customer turnover in the Company's business, usage declines, and customers delaying network investment purchases or optimizing their own networks for communications services.

The Company experienced declines within Core Network Services in the three and six months ended June 30, 2009 compared to the same periods of 2008, including transport, Vyvx broadcast services, local voice and enterprise voice services. The decrease in transport revenue is primarily the result of macroeconomic conditions causing customers to optimize their own networks as opposed to utilizing the Company's network and delays in customer sales cycles. The decrease in Vyvx broadcast services is primarily the result of macroeconomic conditions causing lower usage as customers generally cut back on the number of broadcasting events they covered. The decrease in local voice and enterprise voice services is primarily the result of macroeconomic conditions causing lower voice usage. In addition, revenue associated with the Vyvx advertising distribution business declined in three and six months ended June 30, 2009 compared to the same periods of 2008, as on June 5, 2008, the Company completed the sale of the Vyvx advertising distribution business and therefore did not record any Vyvx advertising distribution revenue subsequent to the date of sale. Revenue attributable to the Vyvx advertising distribution business was \$6 million in the second quarter of 2008 and \$15 million in the six months ended June 30, 2008. Partially offsetting the decreases in transport, Vyvx broadcast services, Vyvx advertising distribution, local voice and enterprise voice revenue were increases in colocation revenue in the three and six months ended June 30, 2009 compared to the same periods of 2008. The Company continues to experience strong demand for infrastructure services for complex nationwide solutions and colocation capacity in large markets.

The decrease in Wholesale Voice Services revenue is primarily attributable to a decrease in domestic and international voice termination services, which was caused by pricing declines and lower usage. Partially offsetting the decrease in domestic and international voice termination revenue was an increase in toll free revenue due to higher traffic attributable to conferencing provider customers. The Company continues to concentrate its sales efforts on maintaining incremental gross margins in the 30% range for these services. The Company expects to experience some volatility in revenue as a result of this strategy.



Other Communications Revenue declined to \$49 million and \$112 million in the three and six months ended June 30, 2009, respectively, from \$100 million and \$208 million in the three and six months ended June 30, 2008, respectively. The decrease is primarily the result of a decline in managed modem revenue as a result of the continued migration from narrow band dial-up services to higher speed broadband services by end user customers, especially in large metropolitan areas. In addition, the Company renewed contracts with certain of its managed modem customers during the quarter at reduced prices. The Company expects managed modem revenue to continue to decline in the future due to an increase in the number of subscribers migrating to broadband services and potential additional pricing concessions in 2009 as contracts are renewed.

Reciprocal compensation revenue from managed modem services also declined in the three and six months ended June 30, 2009 compared to same periods of 2008 as a result of the continuing decline in demand for managed modem services. The Company has historically earned the majority of its reciprocal compensation revenue from managed modem services, although the Company continues to generate a portion of its reciprocal compensation revenue from voice services, which is reported within Core Network Services revenue. To the extent the Company is unable to sign new interconnection agreements or signs new agreements containing lower rates, or there is a significant decline in the Company's managed modem dial-up business, or FCC or state regulations change such that carriers are not required to compensate other carriers for terminating ISP-bound traffic, reciprocal compensation revenue may experience further declines over time.

Also contributing to the decrease in Other Communications revenue was lower SBC Contract Services revenue as a result of the migration of the SBC traffic to the AT&T network and the satisfaction by SBC of its gross margin commitment under the SBC Master Services Agreement in the first half of 2008. During the second quarter of 2008, the gross margin commitment on the SBC Master Services Agreement was satisfied; however AT&T, Inc. ("AT&T"), which merged with SBC in 2005, continues to purchase services from Level 3 under the SBC Master Services Agreement as it continues to migrate the services provided under the agreement to its own network facilities. The SBC Master Services Agreement was an agreement between SBC Services Inc. and WilTel and was obtained in the WilTel acquisition.

**Coal mining** revenue decreased to \$16 million in the second quarter 2009 from \$18 million in the second quarter 2008 primarily as a result of lower volumes of coal sold.

Coal mining revenue decreased to \$34 million in the six months ended June 30, 2009 from \$44 million in the six months ended June 30, 2008, primarily as a result of a long-term supply contract that enabled a customer to buyout future coal purchase commitments with the Company in the first quarter of 2008. The Company did not have any further obligations with respect to future coal commitments under the contract, and therefore recognized the transaction as revenue in the first quarter of 2008.

**Cost of Revenue** for the communications business includes leased capacity, right-of-way costs, access charges, satellite transponder lease costs, and other third party costs directly attributable to the network, but excludes depreciation and amortization and related impairment expenses. Prior to the sale of the Vyvx advertising distribution business, the Company included in communications cost of revenue package delivery costs and the blank tape media costs associated with this business.

Cost of revenue for the communications business, as a percentage of communications revenue was 41% in the three and six months ended June 30, 2009, respectively, and 41% and 42% in the three and six months ended June 30, 2008, respectively. Overall, communications cost of revenue as a percentage of communications revenue has been trending down as the Company has been able to derive synergies from acquisitions to eliminate some of the costs associated with duplicate circuits serving the same markets. In addition, the continued reduction in SBC Contract Services revenue has positively influenced communications cost of revenue as a percentage of communications revenue, as the gross margins for SBC Contract Services revenue are lower than the gross margins for Core Communications Services revenue. Partially offsetting this downward trend in communications cost of revenue as a percentage of communications revenue have been increases in Wholesale Voice Services revenue as a percentage of total communications revenue and lower managed modem revenue. The incremental gross margins for Wholesale Voice Services revenue are in the 30% range versus 80% for Core Network Services revenue, and the gross margin for managed modem revenue is generally higher than for Core Network Services revenue. In addition, cost of revenue as a percentage of communications revenue could increase in periods in which volumes are lower as our fixed costs would become dilutive to our gross margin.

**Coal mining** cost of revenue decreased to \$16 million in the second quarter of 2009 from \$18 million in the second quarter of 2008 primarily as a result of lower volumes of coal sold.

Coal mining cost of revenue totaled \$33 million, or 97% of coal mining revenue, in the six months ended June 30, 2009 compared to \$34 million, or 77% of coal mining revenue, in the six months ended June 30, 2008. This increase in coal mining cost of revenue as a percentage of coal mining revenue is the result of the buyout by a coal customer of future coal purchase commitments resulting in the recognition of revenue with no associated costs in the first quarter of 2008.

**Depreciation and Amortization** expense decreased 3% to \$228 million in the second quarter of 2009 from \$234 million in the second quarter of 2008 and decreased 5% to \$450 million in the six months ended June 30, 2009 from \$474 million in the six months ended June 30, 2008. These decreases were primarily attributable to reduced depreciation expense associated with shorter-lived fixed assets becoming fully depreciated. Also contributing to the decrease was reduced amortization expense on intangible assets due to the disposal of \$22 million of carrying value of amortizable intangible assets in the Vyvx advertising distribution sale and certain of the Company's amortizable intangible assets becoming fully amortized in 2008.

The Company expects depreciation and amortization expense of between \$900 million to \$920 million in 2009 based on the Company's current expectations of the timing and amounts of capital expenditures in 2009.

**Selling, General and Administrative** expenses include salaries, wages and related benefits (including non-cash, stock based compensation expenses), property taxes, travel, insurance, rent, contract maintenance, advertising, accretion expense on asset retirement obligations and other administrative expenses. Selling, general and administrative expenses also include certain network related expenses such as network facility rent, utilities and maintenance costs.

Selling, general and administrative expenses decreased 19% to \$321 million in the second quarter of 2009 from \$395 million in the second quarter of 2008 and decreased 19% to \$659 million in the six months ended June 30, 2009 from \$817 million in the six months ended June 30, 2008. The decreases are primarily attributable to a reduction in employee compensation and related costs due to a lower average headcount, which decreased approximately 16% in the second quarter of 2009 compared to the second quarter of 2008 and 18% in the six months ended June 30, 2009 compared to the six months ended June 30, 2008. Also contributing to the reduction in employee compensation and related costs were lower bonus expenses, as a result of the reduction in the Company's revenue performance.

The decreases in selling, general and administrative expenses were also the result of synergies that have been achieved as a result of acquisition integration efforts and the Company's focus on reducing operating expenses. Specifically, decreases in professional fees and vendor services, network related administrative expenses and lower accretion on asset retirement obligations all contributed to the decrease in selling, general and administrative expenses in the second quarter of 2009 compared to the second quarter of 2008 and in the six months ended June 30, 2009 compared to the six months ended June 30, 2008.

Included in selling, general and administrative expenses in the three and six months ended June 30, 2009 were \$9 million and \$25 million, respectively, of non-cash, stock-based compensation expenses related to grants of outperform stock options and restricted stock units and restricted stock shares. This compares to \$20 million and \$43 million of non-cash, stock-based compensation expenses recognized in the three and six months ended June 30, 2008, respectively. These decreases in non-cash, stock-based compensation expense are primarily due to lower headcount, higher estimated forfeiture rates given the Company's continued organizational structure optimization efforts and a reduction in the Company's 401(k) stock-based matching contribution, as the Company changed its matching contribution policy in the first quarter of 2009.

The Company expects to continue its focus on reducing selling, general and administrative expenses in 2009.

**Restructuring Charges** increased to \$6 million in the second quarter of 2009 from \$4 million in the second quarter of 2008 primarily as a result of the timing of the Company's workforce reduction activities. During the second quarter of 2009, the Company initiated a workforce reduction of approximately 170 employees, or 3% of the Company's total employee base, and incurred a restructuring charge of \$6 million, all of which related to the communications business.

Restructuring Charges decreased to \$7 million in the six months ended June, 30 2009 from \$11 million in same period of 2008 primarily as a result of the timing of the Company's workforce reduction activities. The Company may experience further restructuring charges in 2009 in connection with the continued integration of acquired businesses and the possible need to adjust its cost structure if revenue performance continues to decline due to the negative effects of the current economy or other reasons. Additional restructuring activities could result in further headcount reductions.

**Adjusted EBITDA**, as defined by the Company, is net income (loss) from the consolidated statements of operations before (1) income taxes, (2) total other income (expense), (3) non-cash impairment charges included within restructuring



charges, (4) depreciation and amortization and (5) non-cash stock compensation expense included within selling, general and administrative expenses in the consolidated statements of operations.

Adjusted EBITDA is not a measurement under GAAP and may not be used in the same way by other companies. Management believes that Adjusted EBITDA is an important part of the Company's internal reporting and is a key measure used by management to evaluate profitability and operating performance of the Company and to make resource allocation decisions. Management believes such measurement is especially important in a capital-intensive industry such as telecommunications. Management also uses Adjusted EBITDA to compare the Company's performance to that of its competitors and to eliminate certain non-cash and non-operating items in order to consistently measure from period to period its ability to fund capital expenditures, fund growth, service debt and determine bonuses.

Adjusted EBITDA excludes non-cash impairment charges and non-cash stock compensation expense because of the non-cash nature of these items. Adjusted EBITDA also excludes interest income, interest expense, gain on extinguishment of debt, net and income taxes because these items are associated with the Company's capitalization and tax structures. Adjusted EBITDA also excludes depreciation and amortization expense because these non-cash expenses reflect the effect of capital investments which management believes should be evaluated through cash flow measures. Adjusted EBITDA excludes net other income (expense) because these items are not related to the primary operations of the Company.

There are limitations to using non-GAAP financial measures, including the difficulty associated with comparing companies that use similar performance measures whose calculations may differ from the Company's calculations. Additionally, this financial measure does not include certain significant items such as interest income, interest expense, income taxes, depreciation and amortization, non-cash impairment charges, non-cash stock compensation expense, gain on extinguishment of debt, net and other income (expense), net. Adjusted EBITDA should not be considered a substitute for other measures of financial performance reported in accordance with GAAP.

Note 12 of the Notes to Consolidated Financial Statements provides a reconciliation of Adjusted EBITDA for each of the Company's reportable operating segments.

Adjusted EBITDA for the communications business was \$230 million in the second quarter of 2009 compared to \$253 million in the second quarter of 2008. The decrease in Adjusted EBITDA for the communications business is primarily attributable to a reduction in the communications business revenue, partially offset by the benefits of continued operating expense reductions.

Adjusted EBITDA for the communications business was \$479 million in the six months ended June 30, 2009 compared to \$458 million in the six months ended June 30, 2008. The increase in Adjusted EBITDA for the communications business is primarily attributable to the growth in the Company's operating income as a result of the benefits of continued operating expense reductions, largely offset by declines in Communications business revenue.

**Interest Income** decreased to \$1 million in the second quarter of 2009 from \$3 million in the second quarter of 2008 and to \$2 million in the six months ended June 30, 2009 from \$9 million in the six months ended June 30, 2008. The decreases are primarily due to a decrease in the average returns on the Company's investment portfolio, partially offset by an increase in the average invested balance during the three and six months ended June 30, 2009.

The Company invests its funds primarily in government and government agency securities, money market funds and commercial paper depending on liquidity requirements. The Company's investment strategy generally provides lower yields on the funds than would be obtained on alternative investments, but reduces the risk to principal in the short term prior to these funds being used in the Company's business.

**Interest Expense** increased 8% to \$152 million in the second quarter of 2009 from \$141 million in the second quarter of 2008 and increased 5% to \$298 million in the six months ended June 30, 2009 from \$285 million in the same period in 2008. Interest expense increased primarily as a result of the issuance of the \$ 400 million aggregate principal amount of 15% Convertible Senior Notes in December 2008, the issuance of the \$280 million Tranche B Term Loan in the second quarter of 2009 and the issuance of \$200 million of 7% Convertible Senior Notes in the second quarter of 2009. These increases in interest expense were partially offset by the Company's second quarter 2009 and fourth quarter 2008 debt exchanges, debt repurchases and debt repayment transactions. See Note 9 of the Notes to Consolidated Financial Statements for more details regarding the Company's financing activities.

The Company expects annual interest expense in 2009 to approximate \$600 million based on the Company's outstanding debt as of June 30, 2009 and current interest rates on the Company's variable rate debt.

**Gain on Sale of Business Group, Net** totaled \$96 million for the three and six months ended June 30, 2008 compared to zero for the same periods in 2009. On June 5, 2008, Level 3 completed the sale of its Vyvx advertising distribution business to DG FastChannel, Inc. and recognized a net gain on the sale of \$96 million in the second quarter of 2008. See Note 2 of the Notes to Consolidated Financial Statements for more details.

**Gain on Extinguishment of Debt , Net** totaled \$14 million in the three and six months ended June 30, 2009 and zero in the three and six months ended June 30, 2008. The 2009 gain on extinguishment of debt consisted of a net gain of \$7 million as a result of the debt exchange transaction completed in the second quarter of 2009 and a net gain of \$7 million as a result of the debt repurchase transactions completed in the second quarter of 2009. See Note 9 of the Notes to Consolidated Financial Statements for more details regarding the Company's financing activities.

The Company may enter into additional transactions in the future to repurchase or exchange existing debt that may result in gains or losses on the extinguishment of debt.

**Other, net** was \$12 million in the second quarter of 2009 compared to \$4 million in the second quarter of 2008 and \$14 million in the six months ended June 30, 2009 compared to \$7 million in the six months ended June 30, 2008. Other, net is primarily comprised of gains and losses on the sale of non-operating assets, realized foreign currency gains and losses and other income.

**Income Tax Expense** was \$1 million in the second quarter of 2009 and 2008, \$2 million in the six months ended June 30, 2009 and \$4 million in the six months ended June 30, 2008 and primarily relates to state income taxes.

The Company incurs income tax expense attributable to income in various Level 3 subsidiaries, including the coal business, that are required to file state or foreign income tax returns on a separate legal entity basis. The Company also recognizes accrued interest and penalties in income tax expense related to uncertain tax benefits that have not been recognized in the Company's tax returns.

#### Financial Condition — June 30, 2009

Cash flows provided by (used in) operating activities, investing activities and financing activities for the six months ended June 30, 2009 and 2008 are summarized as follows:

	Six Months Ended		Change
	2009	2008	
Net Cash Provided by Operating Activities	\$ 96	\$ 63	\$ 33
Net Cash Used in Investing Activities	(155)	(92)	(63)
Net Cash Used in Financing Activities	(81)	(28)	(53)
Effect of Exchange Rates on Cash and Cash Equivalents	2	4	(2)
Net Change in Cash and Cash Equivalents	<u>\$ (138)</u>	<u>\$ (53)</u>	<u>\$ (85)</u>

#### Operating Activities

Cash provided by operating activities increased by \$33 million in the six months ended June 30, 2009 compared to the six months ended June 30, 2008. The increase in cash provided by operating activities was primarily due to a reduction in the use of working capital items and lower interest payments. Reductions in the use of working capital items was primarily due to changes in accounts payable, accounts receivable, deferred revenue and other current assets, partially offset by changes in other current liabilities.

#### Investing Activities

Cash used in investing activities increased by \$63 million in the six months ended June 30, 2009 compared to the six months ended June 30, 2008 primarily as a result of the \$123 million of net proceeds received from the sale of the Vyvx advertising distribution business in the second quarter of 2008. Partially offsetting this increase was a reduction in capital expenditures, which totaled \$158 million in the six months ended June 30, 2009 compared to \$219 million in the six months

ended June 30, 2008. The reduction in capital expenditures is primarily the result of a decline in success-based capital spending as a result of the decline in Communications revenue in the first six months of 2009.

### ***Financing Activities***

Cash used in financing activities increased by \$53 million in the six months ended June 30, 2009 compared to the six months ended June 30, 2008 as a result of an increase in debt repurchases, net of new issuances. See Note 9 of the Notes to Consolidated Financial Statements for more details regarding the Company's debt transaction activities.

### **Liquidity and Capital Resources**

The Company incurred net losses of \$134 million and \$266 million in the three and six months ended June 30, 2009, respectively. This compares to net losses of \$42 million and \$232 million in the three and six months ended June 30, 2008, respectively. The Company used \$158 million for capital expenditures and generated \$96 million in cash flows from operating activities in six months ended June 30, 2009. This compares to \$219 million of cash used for capital expenditures and \$63 million of cash flows provided by operating activities in the six months ended June 30, 2008.

Cash interest payments for 2009 are expected to be approximately \$515 million, less than the \$531 million made in 2008 based on current debt outstanding, current interest rates on the Company's variable rate debt and the financing and other capital markets transactions completed through June 30, 2009. Capital expenditures for 2009 are expected to be lower than the \$449 million in 2008 as the Company expects to continue to efficiently manage its capital expenditure requirements. The Company expects to invest in base capital expenditures (estimated capital required to keep the network operating efficiently and support new service development) with the remaining capital expenditures expected to be success-based, or tied to incremental revenue. As of June 30, 2009, the Company had long-term debt contractual obligations, including capital lease and commercial mortgage obligations and excluding premium and discounts on debt and fair value adjustments of approximately \$58 million that mature in the remainder of 2009 and \$237 million that mature in 2010. The Company's commercial mortgage obligation matures in 2010, but may be extended to 2015 at the election of the Company.

Level 3 had \$630 million of cash and cash equivalents on hand at June 30, 2009. In addition, \$127 million of current and non-current restricted cash and securities are used to collateralize outstanding letters of credit, long-term debt, certain operating obligations of the Company and certain reclamation liabilities associated with the coal mining business. Based on information available at this time, the Company believes that its current liquidity and anticipated future cash flows from operations will be sufficient to fund its business for at least the next twelve months.

The Company may elect to secure additional capital in the future, at acceptable terms, to improve its liquidity or fund acquisitions. In addition, in an effort to reduce future cash interest payments as well as future amounts due at maturity or to extend debt maturities, Level 3 or its affiliates may, from time to time, issue new debt, enter into debt for debt, debt for equity or cash or other transactions to purchase its outstanding debt securities in the open market or through privately negotiated transactions. Level 3 will evaluate any such transactions in light of then existing market conditions and the possible dilutive effect to stockholders. The amounts involved in any such transaction, individually or in the aggregate, may be material. See Note 9 of the Notes to Consolidated Financial Statements for more details regarding the Company's financing activities.

In addition to raising capital through the debt and equity markets, the Company may sell or dispose of existing businesses, investments or other non-core assets. For example, in 2008, Level 3 completed the sale of its Vyvx advertising distribution business and the sale of certain of its smaller long distance voice customers and received aggregate net cash proceeds of \$124 million.

Consolidation of the communications industry may continue. In recent years, Level 3 participated in the consolidation of the communications industry with the acquisitions of several companies. Level 3 will continue to evaluate consolidation opportunities and could make additional acquisitions in the future.

## **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

### ***Interest Rate Risk***

Level 3 is subject to market risks arising from changes in interest rates and foreign exchange rates. As of June 30, 2009, the Company had borrowed a total of \$2.0 billion primarily under a Senior Secured Term Loan due 2014 and Floating Rate Senior Notes due 2015 that currently bear interest at LIBOR rates plus an applicable margin. As the LIBOR rates

fluctuate, so too will the interest expense on amounts borrowed under the debt instruments. The weighted average interest rate on the variable rate instruments at June 30, 2009, was approximately 4.7%.

In March 2007, Level 3 Financing, Inc., the Company's wholly owned subsidiary, entered into two interest rate swap agreements to hedge the interest payments on \$1 billion notional amount of floating rate debt. The two interest rate swap agreements are with different counterparties and are for \$500 million each. The interest rate swap agreements were effective beginning in 2007 and mature in January 2014. Under the terms of the interest rate swap agreements, Level 3 receives interest payments based on rolling three month LIBOR terms and pays interest at the fixed rate of 4.93% under one arrangement and 4.92% under the other. Level 3 has designated the interest rate swap agreements as a cash flow hedge on the interest payments for \$1 billion of floating rate debt.

The remaining, or unhedged, variable rate debt has a weighted average interest rate of 6.0% at June 30, 2009. A hypothetical increase in the weighted average rate by 1% point (i.e. a weighted average rate of 7.0%) would increase the Company's annual interest expense by approximately \$10 million. At June 30, 2009, the Company had \$4.5 billion (excluding fair value adjustments, discounts and premiums) of fixed rate debt bearing a weighted average interest rate of 9.1%. A decline in interest rates in the future will not benefit the Company with respect to the fixed rate debt due to the terms and conditions of the indentures relating to that debt that would require the Company to repurchase the debt at specified premiums if redeemed early.

Indicated changes in interest rates are based on hypothetical movements and are not necessarily indicative of the actual results that may occur. Future earnings and losses will be affected by actual fluctuations in interest rates and foreign currency rates.

#### *Foreign Currency Exchange Rate Risk*

The Company conducts a portion of its business in currencies other than the U.S. dollar, the currency in which the Company's consolidated financial statements are reported. Correspondingly, the Company's operating results could be adversely affected by foreign currency exchange rate volatility relative to the U.S. dollar. The Company's European subsidiaries use the local currency as their functional currency, as the majority of their revenue and purchases are transacted in their local currencies. Although the Company continues to evaluate strategies to mitigate risks related to the effect of fluctuations in currency exchange rates, the Company will likely recognize gains or losses from international transactions. Changes in foreign currency rates could adversely effect the Company's operating results.

#### **Item 4. Controls and Procedures**

(a) *Disclosure controls and procedures.* The Company's Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the Company's disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as of June 30, 2009. Based upon such review, the Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective and are designed to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in reports it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

(b) *Internal controls.* There were no changes in the Company's internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13a-15 or 15d-15 that occurred during the second quarter of 2009 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II - OTHER INFORMATION

### Item 1 Legal Proceedings

The Company has provided an update to legal proceedings involving the Company in Note 13 of the Notes to Consolidated Financial Statements contained in Part I, Item 1, of this Form 10-Q. This disclosure is hereby incorporated by reference to this Item 1.

### Item 1A Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, “Item 1A. Risk Factors” in Level 3’s Form 10-K for the year ended December 31, 2008, which could materially affect Level 3’s business, financial condition or future results. The risks described in Level 3’s Form 10-K are not the only risks facing the Company. Additional risks and uncertainties not currently known to Level 3 or that it currently deems to be immaterial also may materially adversely affect Level 3’s business, financial condition and/or operating results. The Risk Factors included in the Company’s Form 10-K for the year ended December 31, 2008, have not materially changed other than as set forth below.

**We need to increase the network traffic and resulting revenue from the services that we offer to become and/or remain profitable.**

We must increase the network traffic and resulting revenue from our data, voice, content and infrastructure services at acceptable margins in order to realize our targets for anticipated revenue growth, cash flow and operating performance. If:

- we do not maintain or improve our current relationships with existing key customers;
- we do not develop new large volume and enterprise customers; or
- our customers determine to obtain these services from either their own network or from one of our competitors;

we may not be able to increase our revenue at acceptable margins, which would adversely affect our ability to become and/or remain profitable.

**Level 3 has substantial debt, which may hinder its growth and put Level 3 at a competitive disadvantage.**

Level 3’s substantial debt may have important consequences, including the following:

- the ability to obtain additional financing for acquisitions, working capital, investments and capital or other expenditures could be impaired or financing may not be available on acceptable terms;
- a substantial portion of Level 3’s cash flows will be used to make principal and interest payments on outstanding debt, reducing the funds that would otherwise be available for operations and future business opportunities;
- a substantial decrease in cash flows from operating activities or an increase in expenses could make it difficult to meet debt service requirements and force modifications to operations;
- Level 3 has more debt than certain of its competitors, which may place Level 3 at a competitive disadvantage; and
- substantial debt may make Level 3 more vulnerable to a downturn in business or the economy generally.

Level 3 has substantial deficiencies of earnings to cover fixed charges of approximately \$264 million for the six months ended June 30, 2009. Level 3 had deficiencies of earnings to cover fixed charges of \$264 million for the fiscal year ended December 31, 2008, \$1.1 billion for the fiscal year ended December 31, 2007, \$742 million for the fiscal year ended December 31, 2006, \$647 million for the fiscal year ended December 31, 2005 and \$410 million for the fiscal year ended December 31, 2004.

**Level 3 may not be able to repay its existing debt; failure to do so or refinance the debt could prevent Level 3 from implementing its strategy and realizing anticipated profits.**

If Level 3 were unable to refinance its debt or to raise additional capital on acceptable terms, Level 3’s ability to operate its business would be impaired. As of June 30, 2009, aggregate future maturities of long-term debt, capital leases and our commercial mortgage (excluding debt discounts, premiums and fair value adjustments) approximated \$6.5 billion and stockholders’ equity approximated \$822 million. Of this long-term debt, approximately \$58 million is due to mature in the remainder of 2009, approximately \$237 million is due to mature in 2010 and approximately \$463 million is due to mature in 2011, in each case excluding debt discounts, premiums and fair value adjustments.

Level 3’s ability to make interest and principal payments on its debt and borrow additional funds on favorable terms depends on the future performance of the business. If Level 3 does not have enough cash flow in the future to make interest or principal payments on its debt, Level 3 may be required to refinance all or a part of its debt or to raise additional capital. Level 3 cannot be sure that it will be able to refinance its debt or raise additional capital on acceptable terms.



#### Item 4. Submission of Matters to a Vote of Security Holders

At the Company's annual meeting of stockholders held on May 19, 2009, the following matters were submitted to a vote:

1. Election of 13 Directors to the Board of Directors of Level 3 Communications, Inc. for a one-year term until the 2010 Annual Meeting of Stockholders:

	In Favor	Withheld
Walter Scott, Jr.	1,437,212,959	43,681,987
James Q. Crowe	1,436,141,275	44,753,671
R. Douglas Bradbury	1,437,918,027	42,976,919
Douglas C. Eby	1,416,646,597	64,248,349
James O. Ellis, Jr.	1,445,168,542	35,726,404
Richard R. Jaros	1,437,067,221	43,827,725
Robert E. Julian	1,431,436,581	49,458,365
Michael J. Mahoney	1,445,528,469	35,366,477
Charles C. Miller, III	1,429,580,550	51,314,396
Arun Netravali	1,445,279,932	35,615,014
John T. Reed	1,398,815,624	82,079,322
Michael B. Yanney	1,436,631,157	44,263,789
Albert C. Yates	1,444,827,328	36,067,618

Each of the 13 Directors was re-elected to the Board of Directors of Level 3 Communications, Inc. for a one year term.

2. To approve the grant to the Level 3 Board of Directors of discretionary authority to amend the Company's Restated Certificate of Incorporation to effect a reverse stock split at one of four ratios:

Affirmative votes	1,403,070,892
Negative votes	74,149,878
Abstain	3,674,176
Broker non-vote	—

The proposal to grant the Board of Directors of Level 3 Communications, Inc. the discretionary authority to amend the Company's Restated Certificate of Incorporation to effect a reverse stock split at one of four ratios was approved.

3. To adopt an amendment to the Company's Restated Certificate of Incorporation to increase the number of authorized shares of Level 3 common stock, par value \$.01 per share from 2.25 billion to 2.5 billion:

Affirmative votes	1,380,611,597
Negative votes	93,229,819
Abstain	7,053,530
Broker non-vote	—

The proposal to adopt an amendment to the Company's Restated Certificate of Incorporation to increase the number of authorized shares from 2.25 billion to 2.5 billion was approved.

**Item 6. Exhibits**

Exhibits filed as a part of this report are listed below.

- 3 Certificate of Amendment of Restated Certificate of Incorporation of Level 3 Communications, Inc. (incorporated by reference to Exhibit 3.2 of Level 3 Communications, Inc.'s Registration Statement on Form S-3 (SEC File No. 333-160493) filed with the Securities and Exchange Commission on July 9, 2009).
- 12 Statements Re Computation of Ratios
- 31.1 Rule 13a-14(a)/15d-14(a) Certification of the Chief Executive Officer
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of the Chief Financial Officer
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

LEVEL 3 COMMUNICATIONS, INC.

Dated: August 7, 2009

/s/ Eric J. Mortensen

Eric J. Mortensen  
Senior Vice President, Controller  
and Principal Accounting Officer



## STATEMENTS RE COMPUTATION OF RATIOS

STATEMENT REGARDING COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES AND  
PREFERRED STOCK DIVIDENDS

LEVEL 3 COMMUNICATIONS, INC.

	Six Months Ended June 30,		Fiscal Year Ended				
	2009	2008	2008	2007	2006	2005	2004
Loss from Continuing Operations Before Taxes	\$ (264)	\$ (228)	\$ (312)	\$ (1,168)	\$ (810)	\$ (715)	\$ (478)
Interest on Debt, Net of Capitalized Interest	298	285	570	609	670	543	486
Amortization of Capitalized Interest	—	25	48	68	68	68	68
Interest Expense Portion of Rental Expense	34	32	68	63	44	25	29
Earnings (Losses) Available for Fixed Charges	\$ 68	\$ 114	\$ 374	\$ (428)	\$ (28)	\$ (79)	\$ 105
Interest on Debt	\$ 298	\$ 285	\$ 570	\$ 609	\$ 670	\$ 543	\$ 486
Preferred Dividends	—	—	—	—	—	—	—
Interest Expense Portion of Rental Expense	34	32	68	63	44	25	29
Total Fixed Charges	\$ 332	\$ 317	\$ 638	\$ 672	\$ 714	\$ 568	\$ 515
Ratio of Earnings to Fixed Charges	—	—	—	—	—	—	—
Deficiency	\$ (264)	\$ (203)	\$ (264)	\$ (1,100)	\$ (742)	\$ (647)	\$ (410)

Financial information for periods prior to January 1, 2009 contained in the table above have been adjusted for the retrospective application of FSP APB 14-1.

**CERTIFICATIONS\***

I, James Q. Crowe, certify that:

1. I have reviewed this Form 10-Q of Level 3 Communications, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 7, 2009

/s/ James Q. Crowe

James Q. Crowe  
Chief Executive Officer

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\* Provide a separate certification for each principal executive officer and principal financial officer of the registrant. See Rules 13a-14(a) and 15d-14(a).

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**CERTIFICATIONS\***

I, Sunit S. Patel, certify that:

1. I have reviewed this Form 10-Q of Level 3 Communications, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 7, 2009

/s/ Sunit S. Patel

Sunit S. Patel

Chief Financial Officer

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\* Provide a separate certification for each principal executive officer and principal financial officer of the registrant. See Rules 13a-14(a) and 15d-14(a).

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**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Form 10-Q of Level 3 Communications, Inc. (the "Company") for the three and six months ended June 30, 2009 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James Q. Crowe, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- 1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- 2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ James Q. Crowe

James Q. Crowe  
Chief Executive Officer  
August 7, 2009

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**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Form 10-Q of Level 3 Communications, Inc. (the "Company") for the three and six months ended June 30, 2009 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Sunit S. Patel, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- 1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- 2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Sunit S. Patel

Sunit S. Patel  
Chief Financial Officer  
August 7, 2009

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