

# LEVEL 3 COMMUNICATIONS INC

## FORM 10-K (Annual Report)

Filed 03/19/02 for the Period Ending 12/31/01

Address	1025 ELDORADO BOULEVARD BLDG 2000 BROOMFIELD, CO 80021
Telephone	7208881000
CIK	0000794323
Symbol	LVLT
SIC Code	4813 - Telephone Communications, Except Radiotelephone
Industry	Communications Services
Sector	Services
Fiscal Year	12/31

# LEVEL 3 COMMUNICATIONS INC

## FORM 10-K (Annual Report)

Filed 3/19/2002 For Period Ending 12/31/2001

Address	1025 ELDORADO BOULEVARD BLDG 2000 BROOMFIELD, Colorado 80021
Telephone	720-888-1000
CIK	0000794323
Industry	Communications Services
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Fiscal Year	12/31

# FORM 10-K

## SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

(Mark One)

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

For the fiscal year ended December 31, 2001

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 0-15658

### Level 3 Communications, Inc.

(Exact name of Registrant as specified in its charter)

Delaware

(State or other jurisdiction of  
incorporation or organization)

47-0210602

(I.R.S. Employer  
Identification No.)

1025 Eldorado Boulevard, Broomfield, Colorado  
(Address of principal executive offices)

80021  
(Zip code)

(720) 888-1000

(Registrant's telephone number including area code)

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

None

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

Common Stock, par value \$.01 per share

Rights to Purchase Series A Junior Participating Preferred Stock, par value  
\$.01 per share

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

(Cover continued on next page)

(Cover continued from prior page)

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

Title Outstanding Common Stock, par value \$.01 per share 392,676,814 as of March 8, 2002

#### **DOCUMENTS INCORPORATED BY REFERENCE**

List hereunder the following documents if incorporated by reference and the Part of the Form 10-K (e.g., Part I, Part II, etc.) into which the document is incorporated: (1) Any annual report to security holders; (2) Any proxy or information statement; and (3) Any prospectus filed pursuant to Rule 424(b) or (c) under the Securities Act of 1933. The listed documents should be clearly described for identification purposes (e.g., annual report to security holders for fiscal year ended December 24, 1980).

Portions of the Company's Definitive Proxy Statement for the 2002 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K

(End of cover)

## Cautionary Factors That May Affect Future Results (Cautionary Statements Under the Private Securities Litigation Reform Act of 1995)

This report 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 Level 3 Communications, Inc. and its subsidiaries ("Level 3" or the "Company"). When used in this report, the words "anticipate", "believe", "plans", "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. These forward-looking statements include, among others, statements concerning:

- o the Company's communications and information services business, its advantages and the Company's strategy for implementing the business plan;
- o anticipated growth and recovery of the communications and information services industry;
- o plans to devote significant management time and capital resources to the Company's business;
- o expectations as to the Company's future revenues, margins, expenses and capital requirements;
- o anticipated dates on which the Company will begin providing certain services or reach specific milestones in the development and implementation of its business; and
- o other statements of expectations, beliefs, future plans and strategies, anticipated developments and other matters that are not historical facts.

These forward-looking statements are subject to risks and uncertainties, including financial, regulatory, environmental, industry growth and trend projections, that could cause actual events or results to differ materially from those expressed or implied by the statements. The most important factors that could prevent Level 3 from achieving its stated goals include, but are not limited to, the Company's failure to:

- o achieve and sustain profitability based on the implementation of its advanced, international, facilities based communications network based on optical and Internet Protocol technologies;
- o overcome significant early operating losses;
- o produce sufficient capital to fund its business;
- o develop financial and management controls, as well as additional controls of operating expenses as well as other costs;
- o attract and retain qualified management and other personnel;
- o successfully complete commercial testing of new technology and Company information systems to support new products and services, including voice transmission services;
- o ability to meet all of the terms and conditions of the Company's debt obligations;
- o negotiate new and maintain existing peering agreements; and
- o develop and implement effective business support systems for processing customer orders and provisioning.

The Company undertakes no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise. Further disclosures that the Company makes on related subjects in its additional filings with the Securities and Exchange Commission should be consulted. For further information regarding the risks and uncertainties that may affect the Company's future results, please review our Current Report on Form 8-K/A filed with the Securities and Exchange Commission on November 9, 1999.

## ITEM 1. BUSINESS

Level 3 Communications, Inc. and its subsidiaries ("Level 3" or the "Company") engage in the communications, information services and coal mining businesses through ownership of operating subsidiaries and substantial equity positions in public companies. In late 1997, the Company announced the business plan to increase substantially its information services business and to expand the range of services it offers by building an advanced, international, facilities based communications network based on Internet Protocol technology (the "Business Plan").

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, generally by constructing its own assets, but also through a combination of purchasing and leasing of facilities, the Level 3 Network - an advanced, international, facilities based communications network. The Company has designed the Level 3 Network to provide communications services, which employ and leverage rapidly improving underlying optical and Internet Protocol technologies.

**Market and Technology Opportunity.** The Company believes that ongoing technology advances in both optical and Internet Protocol technologies are revolutionizing the communications industry and will facilitate rapid decreases in unit costs for communications service providers that are able to most effectively leverage these technology advances. Service providers that can effectively leverage technology advances and rapidly reduce unit costs will be able to offer significantly lower prices, which, the Company believes, will drive substantial increases in the demand for communications services. The Company believes that there are two primary factors driving this market dynamic, which it refers to as "Silicon Economics":

- o **Rapidly Improving Technologies.** Over the past few years, both optical and Internet Protocol based networking technologies have undergone extremely rapid innovation, due, in large part, to market based development of underlying technologies. This rapid technology innovation has resulted in both a rapid improvement in price-performance for optical and Internet Protocol systems, as well as rapid improvement in the functionality and applications supported by these technologies. The Company believes that this rapid innovation will continue well into the future.

- o **High Demand Elasticity.** The Company believes rapid decreases in communication services costs and prices causes the development of new bandwidth-intensive applications, which drive even more significant increases in bandwidth demand. In addition, communications services are direct substitutes for other, existing modes of information distribution such as traditional broadcast entertainment and distribution of software, audio and video content using physical media delivered over motor transportation systems. The Company believes that as communications services improve more rapidly than these alternative content distribution systems, significant demand will be generated from these sources. The Company believes that high elasticity of demand from both these new applications and substitution for existing distribution systems will continue for the foreseeable future.

In connection with the Company's belief that communications services are direct substitutes for other, existing modes of information distribution, on March 13, 2002, the Company completed the acquisition of CorpSoft, Inc., which conducts its business under the name Corporate SoftwareSM. Corporate Software is a major distributor, marketer and reseller of business software. Based in Norwood, Massachusetts, Corporate Software is an industry leader in the field of software marketing, procurement and license management. It is a leading distributor of software products from Microsoft(R), IBM/Lotus (R), Novell(R), Sun Microsystems (R), Computer Associates (R), Symantec (R) and 200 other software publishers, and serves more than 5,000 business customers in 128 countries.

The Company believes that communications price performance will improve more rapidly than computing and data storage price performance and, as a result, companies will, over time, seek information technology operating efficiency by purchasing software functionality and data storage as commercial services procured over a broadband networks such as the Level 3 Network.

Level 3 believes that the combination of Level 3's network infrastructure, and Corporate Software's expertise in software lifecycle management and marketing, as well as strong customer relationships, will position Level 3 to benefit as companies change the manner in which they buy and use software capability.

The Company also believes that there are several significant implications that result from this Silicon Economics market dynamic:

- o Incorporating Technology Changes. Given the rapid rate of improvement in optical and Internet Protocol technologies, those communications service providers that are most effective at rapidly deploying new technologies will have an inherent cost and service advantage over companies that are less effective at deploying these new technologies.

- o Capital Intensity. The rapid improvements in these technologies and the need to move to new technologies more quickly results in shortened economic lives of underlying assets. To achieve the rapid unit cost reductions and improvements in service capabilities, service providers must deploy new generations of technology sooner, resulting in a more capital-intensive business model. Those providers with the technical, operational and financial ability to take advantage of the rapid advancements in these technologies are expected to have higher absolute capital requirements, shortened asset lives, rapidly decreasing unit costs and prices, rapidly increasing unit demand and higher cash flows and profits.

- o Industry Structure. As a result of the rapid innovation in the underlying technology, the communications industry is visibly shifting from a utility model to a technology model. Just as in the computing industry, where market-based standards and rapid price performance improvements have existed for over 20 years, it is extremely difficult for a single communications company to be best-of-class across a wide variety of disciplines in a rapidly changing environment. Rather, an opportunity exists for companies to focus on areas in which they have significant competitive advantages and develop significant market share in a disaggregated industry structure.

Level 3's Strategy. The Company is seeking to capitalize on the opportunities presented by significant advancements in optical and Internet Protocol technologies by pursuing its Business Plan. Key elements of the Company's strategy include:

- o Become the Low Cost Provider of Communications Services. Level 3's network has been designed to provide high quality communications services at a lower cost. For example, the Level 3 Network is constructed using multiple conduits to allow the Company to cost-effectively deploy future generations of optical networking components (both fiber and transmission electronics and optronics) and thereby expand capacity and reduce unit costs. In addition, the Company's strategy is to maximize the use of open, non-proprietary interfaces in the design of its network software and hardware. This approach is intended to provide Level 3 with the ability to purchase the most cost-effective network equipment from multiple vendors and allow Level 3 to deploy new technology more rapidly and effectively.

- o Combine Latest Generations of Fiber and Optical Technologies. In order to achieve unit cost reductions for transmission capacity, Level 3 has designed its network with multiple conduits to deploy successive generations of fiber to exploit improvements in optical transmission technology. Optimizing optical transmission systems to exploit specific generations of fiber optic technology currently provides transmission capacity on the new fiber more cost effectively than deploying new optical transmission systems on previous generations of fiber.

- o Offer a Comprehensive Range of Communications Services. The Company provides a comprehensive range of communications services over the Level 3 Network. The Company is offering broadband transport services under the brand name (3)LinkSM, colocation services under the brand name (3)CenterSM Colocation, MPLS based private networks under the brand name

- (3)PacketSM MPN, Internet access services under the brand name
- (3)CrossroadsSM, and Softswitch based services under the brand names
- (3)ConnectSM Modem and (3)VoiceSM. The availability of these services varies by location.

o Provide Upgradeable Metropolitan Backbone Networks. Level 3's significant investment in metropolitan optical networks enables the Company to connect directly to points of traffic aggregation. These traffic aggregation facilities are typically locations where Level 3's customers wish to interconnect with the Level 3 Network. Level 3's metropolitan backbone networks allow Level 3 to extend its network services to these aggregation points at low costs. The Company has constructed metropolitan networks totaling approximately 14,200 conduit miles and approximately 777,000 fiber miles in the United States, and approximately 3,500 conduit miles and approximately 154,000 fiber miles in Europe. The Company believes that these metropolitan networks are a significant strategic advantage versus other intercity communications companies that must connect to customers using potentially high cost, low capacity, legacy facilities provided by former local monopoly providers. This difficult situation is sometimes referred to as the "local loop bottleneck".

o Provide Colocation Facilities. Level 3 believes that providing colocation services on its network attracts communications intensive customers by allowing Level 3 to offer those customers reduced bandwidth costs, rapid provisioning of additional bandwidth, interconnection with other third-party networks and improved network performance. Therefore, Level 3 believes that controlling significant colocation facilities in its Gateways provides it with a competitive advantage.

As of December 31, 2001, Level 3 had secured approximately 5.8 million square feet of space for its Gateway and colocation facilities and had completed the buildout of approximately 3.3 million square feet of this space.

o Target Communications Intensive Customers. The Company's distribution strategy is to utilize a direct sales force focused on communications intensive businesses. These businesses include both traditional and next generation carriers, ISPs, application service providers, content providers, systems integrators, web-hosting companies, media distribution companies, web portals, eCommerce companies, streaming media companies, storage providers and wireless communications providers. Providing communications services at continually declining bandwidth costs and prices is at the core of the Company's market enabling strategy since bandwidth generally represents a substantial portion of these businesses' costs.

o Utilize Optimization Technologies. In order to effectively manage its business in a rapidly changing environment, Level 3 has assembled an operations research team that has developed and continues to refine a set of sophisticated non-linear, mixed integer optimization models. The objective for these models is to maximize the net present value of the Company's cash flows given relevant constraints. These tools are designed to assist Level 3 in determining optimal pricing for its services, in determining demand forecasts based on price elasticity, in optimizing network design based on optimal topology and optronics configuration, in optimizing network implementation based on optimal timing of capacity installation, in optimizing the timing of introducing new technologies and in determining long-term network requirements. The Company believes that its optimization proficiency and technology provides the Company a competitive advantage.

o Provide Seamless Interconnection to the Public Switched Telephone Network (the "PSTN"). The Company offers (3)VoiceSM long distance service, which allows the seamless interconnection of the Level 3 Network with the PSTN for long distance voice transmissions. Seamless interconnection allows customers to use Level 3's Internet Protocol based services without modifying existing telephone equipment or dialing procedures (that is, without the need to dial access codes or follow other similar special procedures). The Company's (3)ConnectSM

Modem



turnkey modem infrastructure service uses similar Softswitch technology to seamlessly interconnect to the PSTN and to the public Internet.

o **Develop Advanced Business Support Systems.** The Company has developed and continues to develop a substantial, scalable and web-enabled business support system infrastructure specifically designed to enable the Company to offer services efficiently to its targeted customers. The Company believes that this system will reduce its operating costs, give its customers direct control over some of the services they buy from the Company and allow the Company to grow rapidly while minimizing redesign of its business support systems.

o **Attract and Motivate High Quality Employees.** The Company has developed programs designed to attract and retain employees with the technical skills necessary to implement the Business Plan. The programs include the Company's Shareworks stock purchase plan and its Outperform Stock Option program.

**Competitive Advantages.** The Company believes that it has the following competitive advantages that, together with its strategy, will assist it in implementing the Business Plan:

o **Experienced Management Team.** Level 3 has assembled a management team that it believes is well suited to implement the Business Plan. Level 3's senior management has substantial experience in leading the development and marketing of communications and information technology products and services and in designing, constructing and managing intercity, metropolitan and international networks.

o **A More Readily Upgradeable Network Infrastructure.** Level 3's network design takes advantage of recent technological innovations, incorporating many of the features that are not present in older communication networks, and provides Level 3 flexibility to take advantage of future developments and innovations. Level 3 has designed the transmission network to optimize all aspects of fiber and optronics simultaneously as a system to deliver the lowest unit cost to its customers. As fiber and optical transmission technology changes, Level 3 expects to realize new unit cost improvements by deploying the latest fiber in available empty or spare conduits in the multiple-conduit Level 3 Network. Each new generation of fiber enables associated optical transmission equipment to be spaced further apart and carry more traffic than the same equipment deployed on older generations of fiber. The Company believes that the spare conduit design of the Level 3 Network will enable Level 3 to lower costs and prices while enjoying higher margins than its competitors.

o **Integrated End-to-End Network Platform.** Level 3's strategy is to deploy network infrastructure in major metropolitan areas and to link these networks with significant intercity networks in North America and Europe. The Company believes that the integration of its metropolitan and intercity networks with its colocation facilities will expand the scope and reach of its on-net customer coverage, facilitate the uniform deployment of technological innovations as the Company manages its future upgrade paths and allow the Company to grow or scale its service offerings rapidly. Level 3 believes that it is the only global communications service provider with the unique combination of large fiber-count, multi-conduit metropolitan networks, uniformly deployed multi-conduit intercity networks and substantial colocation facilities.

o **On-Net Transport Activation Process ("ONTAPSM").** Level 3 has developed ONTAP - an automated process to significantly shorten the time period between receipt of a customer's order and the installation of that order. Most industry participants install a customer's order over a several week and often several month process. Through the use of ONTAP, Level 3 is able to reduce that installation time interval significantly. Level 3 is able to provision or install a customer's capacity order in a matter of days rather than the industry standard of weeks or even months. In general, using ONTAP, Level 3 is able to install a customer's private line or wavelength service that is on the Level 3 network within 10 calendar days. In addition, ONTAP

provides a customer with: immediate verification that the requested capacity is available on the Level 3 network and a confirmed delivery date. As a result, a customer can more closely tie its capacity purchases to its actual demand rather than having to forecast future demand in advance to meet a competitor's much longer installation interval.

- o Online Customer Service Center. Level 3 provides its customers with access to a web-enabled, self service application - the Online Customer Service Center or Online CSC. The Online CSC provides Level 3's customers with online direct access to the same internal systems used by Level 3's staff. The Online CSC features include: ability to request new or additional services, review order status, review and modify the customer's profile and review the most up to date Level 3 product information. The Online CSC also provides various reports for Level 3's (3) CrossroadsSM, (3)Connect ModemSM and (3)PacketSM Usage reports. In addition, through the Online CSC, a customer is able to create new repair tickets, view open repair tickets and view a 90-day history of closed repair tickets.

- o Prefunded Business Plan. Level 3 believes that it has prefunded its Business Plan through free cash flow breakeven through approximately \$14 billion in cumulative debt and equity capital raised to date. As a result, Level 3 believes that it has lower financial risk relative to certain other communications service providers.

### **The Level 3 Network.**

The Level 3 Network is an advanced, international, facilities based communications network. Today, the Company provides its services over its own facilities. Through 2000, the Company primarily offered its communications services using local and intercity facilities that had been leased from third parties. This enabled the Company to develop and offer certain of its services during the construction of its own facilities. Today, the Company's network encompasses:

- o an intercity network covering nearly 16,000 miles in North America;
- o leased or owned local networks in 57 North American markets;
- o an intercity network covering approximately 3,600 miles across Europe;
- o leased or owned local networks in 9 European markets;
- o approximately 5.8 million square feet of Gateway and transmission facilities in North America and Europe; and
- o a 1.28 Tbps transatlantic cable system.

Intercity Networks. The Company's nearly 16,000 mile fiber optic intercity network in North America consists of the following:

- o Multiple conduits connecting approximately 200 North American cities. In general, Level 3 has installed groups of 10 to 12 conduits in its intercity network. The Company believes that the availability of spare conduit will allow it to deploy future technological innovations in optical networking components as well as providing Level 3 with the flexibility to offer conduit to other entities.
- o Initial installation of optical fiber strands designed to accommodate dense wave division multiplexing transmission technology. In addition, the Company believes that the installation of newer optical fibers will allow a combination of greater wavelengths of light per strand, higher transmission speeds and longer physical spacing between network electronics. The Company also

believes that each new generation of optical fiber will allow increases in the performance of these aspects network design and will therefore enable lower unit costs.

- o High speed SONET transmission equipment employing self-healing protection switching and designed for high quality and reliable transmission. The Company expects that over time, SONET equipped networks will be replaced with network designs that employ a "mesh" architecture made possible by advances in optical technologies. A mesh architecture allows carriers to establish alternative protection schemes that reduce the amount of capacity required to be reserved for protection purposes.

- o A design that maximizes the use of open, non-proprietary hardware and software interfaces to allow less costly upgrades as hardware and software technology improves.

North America. During the first quarter of 2001, the Company completed its construction activities relating to its North American intercity network. Also during 2001, the Company completed the migration of customer traffic from its original leased capacity network to the Company's completed North America intercity network. During 2000, the Company had substantially completed the construction of this intercity network. Deployment of the North American intercity network was accomplished through simultaneous construction efforts in multiple locations, with different portions being completed at different times. The Company has completed construction of 15,889 route miles of its North American intercity network. All route miles of the North American intercity network are operational.

Europe. In Europe, the Company has completed construction of, its approximately 3,600 route mile fiber optic intercity network with characteristics similar to those of the North American intercity network in a two Ring architecture. During 2000, the Company completed the construction of both Ring 1 and Ring 2 of its European network. Ring 1, which is approximately 1,800 miles, connects the major European cities of Paris, Frankfurt, Amsterdam, Brussels and London and was operational at December 31, 2000. Ring 2, which is approximately 1,600 miles, connects the major German cities of Berlin, Cologne, Dusseldorf, Frankfurt, Hamburg, Munich and Stuttgart. Ring 2 became operational during the first quarter of 2001.

During 2001, the Company announced an expansion of its European operations to 8 additional cities. The additional European cities include: Karlsruhe, Cologne and Stuttgart, Germany; Milan, Italy; Zurich and Geneva, Switzerland; Madrid, Spain; and Stockholm, Sweden. The Company anticipates that it will be operational in these additional cities by the end of the second quarter 2002. The Company intends to expand to these additional locations through the acquisition of available capacity from other carriers in the region.

Level 3's European network is linked to the Level 3 North American intercity network by the Level 3 transatlantic 1.28 Tbps cable system, which was also completed and placed into service during 2000. The transatlantic cable system - referred to by the Company as the Yellow system - has an initial capacity of 320 Gbps and is upgradeable to 1.28 Tbps. The deployment of Yellow was complete pursuant to a co-build agreement announced in February 2000, whereby Global Crossing Ltd. participated in the construction of, and obtained a 50% ownership interest in, Yellow. Under the co-build agreement, Level 3 and Global Crossing Ltd. each now separately own and operate two of the four fiber pairs on Yellow. Level 3 also acquired additional capacity on Global Crossing Ltd.'s transatlantic cable, Atlantic Crossing 1, during 2000 to serve as redundant capacity for its fiber pairs on Yellow.

Asia. The Company established an Asia Pacific headquarters in Hong Kong in 1999, and during 2000 the Company completed and opened Gateway facilities in Tokyo and Hong Kong. In January 2000, Level 3 announced its intention to develop and construct a Northern Asia undersea cable system initially connecting Hong Kong and Japan. The Hong Kong-Japan cable was intended to be the first stage of the Company's construction of an undersea network in the region. At that time, the Company indicated its intention to share construction and operating expenses of the system with one or more industry partners. In December 2000, the Company signed an agreement to collaborate with FLAG Telecom on the development of the Northern Asia undersea cable system connecting Hong Kong, Japan, Korea and Taiwan.

During the fourth quarter of 2001 the Company announced the disposition of its Asian operations in a sale transaction with Reach, Ltd. Although the Company believed that Asia represented an attractive longer-term investment opportunity, given current volatile market and economic conditions the Company determined that it was necessary to focus its resources, both capital and managerial on the immediate opportunities provided by the Company's operational assets in North America and Europe. This transaction closed on January 18, 2002. As a result of the Reach transaction, the Company expects to reduce its future cash obligations by approximately \$300 million.

As part of the agreement, the Reach and the Company agreed that Level 3 will provide capacity and services to Reach over Level 3's North American intercity network, and Level 3 will buy capacity and services from Reach in Asia. This arrangement will allow Level 3 to continue to service its customer base with capacity needs in Asia and provide Reach access to a the Level intercity networks in North America and Europe. Additionally, the Company is maintaining a sales group in Asia to serve its global customers and Asian-based carriers with capacity needs in North America and Europe.

**Local Market Infrastructure.** The Company's local facilities include fiber optic networks connecting Level 3's intercity network Gateway sites to ILEC and CLEC central offices, long distance carrier points-of-presence ("POPs"), buildings housing communication-intensive end users and Internet peering and transit facilities. Level 3's high fiber count metropolitan networks allow the Company to extend its services directly to its customers' locations at low costs, because the availability of this network infrastructure does not require extensive multiplexing equipment to reach a customer location, which is required in ordinary fiber constrained metropolitan networks.

The Company had secured approximately 5.8 million square feet of space for its Gateway and transmission facilities as of December 31, 2001 and had completed the buildout of approximately 3.3 million square feet of this space. The Company's initial Gateway facilities were designed to house local sales staff, operational staff, the Company's transmission and Internet Protocol routing and Softswitch facilities and technical space to accommodate (3)CenterSM Colocation services - that is, the colocation of equipment by high-volume Level 3 customers, in an environmentally controlled, secure site with direct access to the Level 3 Network generally through dual, fault tolerant connections. The Company's newer facilities are typically larger than the Company's initial facilities and were designed to include a smaller percentage of total square feet for the Company's transmission and Internet Protocol routing/Softswitch facilities and a larger percentage of total square feet for the provision of

(3)CenterSM Colocation services. The Company is offering its (3)LinkSM Transport services, (3)CenterSM Colocation services, (3)CrossroadsSM services, (3)ConnectSM Modem services and (3)VoiceSM services at its Gateway sites. The availability of these services varies by location.

As of December 31, 2001, the Company had operational, facilities based local metropolitan networks in 27 U.S. markets and nine European markets. Also as of December 31, 2001, the Company had entered into interconnection agreements with RBOCs covering 58 North American markets.

The Company has negotiated master leases with several CLECs and ILECs to obtain leased capacity from those providers so that the Company can provide its customers with local transmission capabilities before its own local networks are complete and in locations not directly accessed by the Company's owned facilities.

At March 8, 2002, the Company had a total of 66 markets in service: 57 in the United States and nine in Europe. In the United States, the Company markets in service include:

Albany	Hartford	New York	Salt Lake City
Atlanta	Houston	Newark	San Antonio
Austin	Jacksonville	Oakland	San Diego
Baltimore	Indianapolis	Omaha	San Francisco
Boston	Jersey City	Orlando	San Jose
Buffalo	Kansas City	Orange County	San Luis Obispo
Charlotte	Las Vegas	Philadelphia	Seattle
Chicago	Long Island	Phoenix	St. Louis
Cincinnati	Los Angeles	Pittsburgh	Stamford
Cleveland	Louisville	Portland	Tampa
Dallas	Manchester	Princeton	Washington, D.C.
Denver	Memphis	Providence	Wilmington
Detroit	Miami	Raleigh	
El Paso	Nashville	Richmond	
Fort Worth	New Orleans	Sacramento	

In Europe, the markets in service include:

Amsterdam	Hamburg
Berlin	London
Brussels	Munich
Dusseldorf	Paris
Frankfurt	

**Products and Services**

Level 3 offers a comprehensive range of communications services, including the following:

o Transport Services. The Company's transport services are branded "(3)LinkSM" and consist of (3)LinkSM Global Wavelengths, (3)LinkSM Private Line services, (3)LinkSM Dark Fiber and (3)PacketSM MPN.

□ (3)LinkSM Global Wavelength. Level 3 is offering (3)Link Global Wavelengths - a point-to-point connection of a fixed amount of bandwidth on a particular wavelength or color of light. Currently,(3)Link Global Wavelength is available at 2.5GBps and 10GBps. This product is targeted to those customers that require both significant amounts of bandwidth and desire to provide their own traffic protection schemes. The approach enables customers to build and manage a network by deploying their own SONET, ATM or IP equipment at the end points where the wavelength is delivered.  
(3)Link Global Wavelength services are typically offered through short term, annual and long-term pre-paid leases.

□ (3)LinkSM Private Line services. (3)Link Private Line services consist of a fixed amount of dedicated bandwidth between fixed locations for the exclusive use of the customer. These services are offered with committed levels of quality and with network protection schemes included. (3)Link Private Line services are currently priced at a fixed rate depending upon the distance between end points and the amount of bandwidth required. These services are typically offered through short term, annual and long-term pre-paid contracts. The Company is offering the following types of private line services:

- o (3)LinkSM Private Line - U.S. Intercity Services. Level 3 provides this transport service over its North American intercity network. Available transmission speeds include DS-3, OC-3, OC-12 and OC-48.

- o (3)LinkSM Private Line - Metro Services. Level 3 provides this service within a metropolitan area. This service is provided in three categories: Metro Access Stand-alone - a metro circuit is installed from a customer site to a colocation cabinet in a Level 3 Gateway in that city; Metro Point to Point - a circuit is installed between two of a customers' sites by passing through the Level 3 Gateway in that city; and Metro Access - a circuit is installed from the customer's location to access backbone services that are located within the Level 3 Gateway. Available transmission speeds include DS-3, OC-3, OC-12 and OC-48.

- o (3)LinkSM Private Line - International Services. Level 3 provides this private line service between two locations on a point to point basis that cross an international boundary. This service can be installed between two customer points-of-presence where each point is located within a Level 3 Gateway facility. The service is available between mainland Europe and the United Kingdom and the United States. Available transmission speeds depends upon the country locations, but range from DS-1 to OC-48.

- o (3)LinkSM Unprotected Private Line. Level 3 provides this private line service between two locations on a point to point basis on an unprotected basis - that is, without any network protection scheme. As this product is offered as an unprotected service, (3)Link Unprotected Private Line provides a customer with cost advantages when a customer desires to purchase private line capacity without a network protection scheme for purposes of creating a meshed network or for adding additional capacity or protection to the customer's existing network. Available transmission speeds for this product are either OC-3/STM-1 or OC-12/STM-4.

- (3)LinkSM Dark Fiber. Level 3 offers long-term leases of dark fiber and conduit along its local and intercity networks on a long-term basis. Customers can lease dark fiber and conduit in any combination of three ways: (1) segment by segment, (2) full ring or (3) the entire Level 3 Network. Level 3 offers colocation space in its Gateway and intercity re-transmission facilities to these customers for their transmission electronics.

- o Colocation and Gateway Services.

- (3)CenterSM Colocation. The Company offers high quality, data center grade space where customers can locate servers, content storage devices and communications network equipment in a safe and secure technical operating environment.

At its colocation sites, the Company offers high-speed, reliable connectivity to the Level 3 Network and to other networks, including both local and wide area networks, the PSTN and Internet. Level 3 also offers customers AC/DC power, emergency back-up generator power, HVAC, fire protection and security. These sites are monitored and maintained 24 hours a day, seven days a week.

As of December 31, 2001, Level 3 offered (3)Center Colocation in 74 facilities in 66 markets located in the United States and Europe. Level 3 believes that its ability to offer both metropolitan and intercity communications services to its (3)Center Colocation customers provides it with an advantage over its competitors, because (3)Center Colocation customers often spend a substantial portion of their operating expenses on communications services. This service is typically offered through annual and long-term contracts.

- o (3)PacketSM MPN. (3)Packet MPN or (3)Packet MPLS Private Networks is an MPLS-based data transport service that offers Ethernet access into Level 3's managed wide area network. The Company is currently developing (3)Packet MPN to allow for ATM and Frame Relay access as well.

Customers can purchase ports in any Level 3's markets in North America or Europe to build virtual connections between ports and create a customized network solution. (3)Packet MPN, which is a product that is billed based on a customer's usage, is designed to allow communications-intensive customers to deploy and manage traffic over a virtual private network, enabling them to access capacity as usage demand dictates. This flexibility can decrease network costs and is a highly scaleable alternative to traditional transport services. These services are typically offered through short-term or annual contracts.

o (3)CrossRoadsSM. (3)CrossRoads is a high quality, high speed Internet access product offering. The service is offered in a variety of capacities - 100BaseT, GigE, DS-1, DS-3, OC-3 and OC-12 - using a variety of interfaces including Ethernet and SONET. A unique feature of the service is Destination Sensitive Billing or DSB. Through DSB, (3)CrossRoads customers pay for bandwidth based on the destination of their traffic. DSB customers pay for either "Sent" or "Received" bandwidth, but not both.

Level 3 believes that the combination of Destination Sensitive Billing with metropolitan and intercity networks and significant colocation space is a competitive advantage and that this accounts for the rapid market acceptance of (3)CrossRoads to date. These services are typically offered through short-term and annual contracts.

o Softswitch Services. Level 3 has pioneered and developed the Softswitch - a distributed computer system that emulates the functions performed by traditional circuit switches enabling Level 3 to control and process telephone calls over an Internet Protocol network. Currently, Level 3 is offering two Softswitch based services: (3)ConnectSM Modem and (3)VoiceSM. These services are typically offered through short-term, annual and long-term contracts.

| (3)ConnectSM Modem. The Company is offering to its (3)Connect Modem customers an outsourced, turn-key infrastructure solution for the management of dial up access to either the public Internet or a corporate data network. (3)Connect Modem was the first service offered by the Company that used Softswitch technology to seamlessly interconnect to the PSTN. ISPs comprise a majority of the customer base for (3) Connect Modem and are provided a fully managed dial up network infrastructure for access to the public Internet. Corporate customers that purchase (3)Connect Modem services receive connectivity for remote users to support data applications such as telecommuting, e-mail retrieval, and client/server applications.

As part of this service, Level 3 arranges for the provision of local network coverage, dedicated local telephone numbers (which the (3)Connect Modem customer distributes to its customers in the case of an ISP or to its employees in the case of a corporate customer), racks and modems as well as dedicated connectivity from the customer's location to the Level 3 Gateway facility. Level 3 also provides monitoring of this infrastructure 24 hours a day, seven days a week. By providing a turn-key infrastructure modem solution, Level 3 believes that this product allows its customers to save both capital and operating costs associated with maintaining the infrastructure.

At end of the fourth quarter 2001, the Company's (3)Connect Modem product was processing approximately 11.3 billion minutes per month, representing an approximately 31% increase from the end of the third quarter 2001.

| (3)VoiceSM Services. The Company also offers (3)Voice, an Internet Protocol based long distance service, which uses Softswitch technology. This long distance service is currently available for originating long distance calls in 24 markets and is generally targeted at carriers. The end users of the Company's (3)Voice carrier customers place a long distance call by using existing telephone equipment and dialing procedures. The local service provider transfers the call to the Level 3 Softswitch where it is converted to Internet Protocol format. The call is then transmitted along the Level 3 Network to another Level 3 Gateway facility closest to the receiving city where it is sent to the called party in whatever format is desired, including a standard telephone call. Calls on the

Level 3 Softswitch network can be terminated or completed anywhere in North America. The (3)Voice long distance service is offered at a quality level equal to that of the traditional telephone network.

Corporate Software. On March 13, 2002, Level 3 announced that it had completed the previously disclosed acquisition of CorpSoft, Inc., which conducts its business under the name Corporate Software<sup>SM</sup>. Corporate Software is a major distributor, marketer and reseller of business software. Based in Norwood, Massachusetts, Corporate Software is an industry leader in the field of software marketing, procurement and license management. It is a leading distributor of software products from Microsoft(R), IBM/Lotus(R), Novell(R), Sun Microsystems(R), Computer Associates(R), Symantec(R) and 200 other software publishers, and serves more than 5,000 business customers in 128 countries.

Corporate Software uses a Software Asset Management ("SAM") approach to maximize a customer's return on its software investments. Corporate Software provides its customers with the following software management services:

- o License Contract Management Services. This service includes: central coordination of license agreements; contract management business practices and back-office capabilities to unify and coordinate volume purchasing and enterprise wide software agreements including Microsoft EA and Select agreements; ability to process and manage contract to meet cyclical increases in demand through the year; the ability to measure, report and monitor worldwide contacts in support of contractual obligations of clients to Microsoft; and manage commitment levels, product pools, pricing and contract dates and renewals.

- o Management Tracking & Reporting. This service includes: fundamental reporting abilities that directly support license management and sales activities; order management system allowing the tracking of procurement from most general (parent company) to most specific (ship-to-location); combined with cost-allocation data, reports can be inputted directly into customer's data warehouse for optimal software asset management.

- o Order Management. This service includes: state-of-the-art ordering system to minimize ordering errors and help ensure compliance; and systems to assist a customer to order the correct right version of a software title on the correct operating system platform.

- o E-Procurement Services - CorpSoft Central. These services include: customized, Web-commerce solution that provides Microsoft customers immediate access to Microsoft software; features that include product pricing and availability based on site-specific enrollment, online ordering capability, real-time order status and tracking, customer reports, reduced returns, tracking of existing and deployed licenses reconciled to EA agreements, online invoices and license proofs, special order research capability, and online help and documentation; and visibility of license milestone for Microsoft Select agreements and "true up" counts for Microsoft EA agreements.

Level 3 believes that, in part, the information technology industry has been shaped by data processing and data storage price-performance improvement rates that, until recently, have improved much more rapidly than communications price-performance improvement rates. As a result, enterprises have generally located computing and storage resources at the point of use. The Company believes that, over time, significant economies of scale can be obtained by commercial entities, which manage computing, operating system and software application resources, and which offer access to these resources to enterprises on a commercial basis.

The Company believes that the combination of its continuously upgradeable network, and Corporate Software's expertise in software lifecycle management and strong customer relationship position, over time, will permit the Company to offer companies software functionality as a service available over the Level 3 network.



(i)Structure, Inc. Level 3 currently offers, through its subsidiary

(i)Structure, Inc. (formerly PKS Information Services, Inc.), computer operations outsourcing and systems integration services to customers located throughout the United States as well as abroad.

The Company's systems integration services help customers define, develop and implement cost-effective information services. The computer outsourcing services offered by the Company include networking and computing services necessary for older mainframe-based systems and newer client/server-based systems. The Company provides its outsourcing services to clients that want to focus their resources on core businesses, rather than expend capital and incur overhead costs to operate their own computing environments. (i)Structure believes that it is able to utilize its expertise and experience, as well as operating efficiencies, to provide its outsourcing customers with levels of service equal to or better than those achievable by the customers themselves, while at the same time reducing the customers' cost for such services. This service is particularly useful for those customers moving from older computing platforms to more modern client/server networks.

(i)Structure offers reengineering services that allow companies to convert older legacy software systems to modern networked computing systems, with a focus on reengineering software to enable older software application and data repositories to be accessed by web browsers over the Internet or over private or limited access Internet Protocol networks. (i)Structure also provides customers with a combination of workbench tools and methodologies that provide a complete strategy for converting mainframe-based application systems to client/server architecture.

## **Distribution Strategy**

Communications Services. Level 3's sales strategy is to utilize a direct sales force focused on communications intensive businesses. These targeted businesses include both traditional and next generation carriers, ISPs, application service providers, content providers, systems integrators, web-hosting companies, streaming media companies, storage providers and wireless communications providers. Level 3 believes that these companies are the most significant drivers of bandwidth demand. The past distinctions between retail and wholesale have been blurred as these communications intensive businesses purchase Level 3 services, add value and then market to end-users. Bandwidth constitutes a significant portion of these companies' cost structure and their needs for bandwidth in many cases are growing at an exponential rate. Providing continually declining bandwidth costs to these companies is at the core of Level 3's market enabling strategy.

Beginning in 2001, Level 3 changed its customer focus to the top 300 global users of bandwidth capacity. These top 300 global users tend to be financially more viable than certain Internet start-ups. The Company has in place policies and procedures to review the financial condition of potential and existing customers and concludes that collectibility is probable prior to commencement of services. If the financial condition of an existing customer deteriorates to a point where payment for services is in doubt, the Company will not recognize revenue attributable to that customer until cash is received. Based on these policies and procedures, the Company believes its exposure to credit risk within the communications business and effect to the financial statements is limited. The Company is not immune from the affects of the downturn in the economy and specifically the telecommunications industry; however, the Company believes the concentration of credit risk with respect to receivables is mitigated due to the dispersion of the Company's customer base among geographic areas and remedies provided by terms of contracts and statutes. The Company estimates that approximately 25% of its recurring revenue base as of December 31, 2001, consists of financially weaker customers. Approximately 80% of this amount is expected to disconnect services during the first half of 2002.

For the year ended December 31, 2001, approximately 53% of the Company's sales were to carriers, 30% were to internet service providers or ISPs, 11% were to content providers and 6% were to other types of customers. For the year ended December 31, 2001, no single customer accounted for more than 10% of the Company's consolidated total revenues.

Corporate Software. In 2001, Corporate Software had more than 5,000 active customer accounts. Corporate Software's customer base includes corporations, government agencies, educational institutions, non-profit organizations and other business entities. Sales contracts with large customers for the procurement of products generally cover a one to three year period subject to the customers' rights to terminate the contract upon notice.

These contracts usually include provisions regarding price, availability, payment terms and return policies. Standard payment terms with Corporate Software's customers are generally net 30 days from the date of invoice.

(i)Structure. (i)Structure's outsourcing sales are relationship oriented and (i)Structure has a team of ten Sales Directors within the United States. Sales activities are focused on new sales in geographic territories, major accounts, sales to existing customers and channel sales. To support outsourcing sales, (i)Structure partners with companies that provide integration and application services. The marketing activities of the company include:

collateral, web marketing, industry conferences and direct marketing programs.

(i)Structure also sells application software and related services through a small sales force that is geographically focused. Sales activities are focused on new sales in geographic territories, major accounts, sales to existing customers and channel sales. To support these sales (i)Structure partners with companies that provide integration and application services. The marketing activities of the company include: collateral, web marketing, industry conferences and direct marketing programs.

### **Business Support Systems**

In order to pursue its sales and distribution strategies, the Company has developed and is continuing to develop and implement a set of integrated software applications designed to automate the Company's operational processes. Through the development of a robust, scalable business support system, the Company believes that it has the opportunity to develop a competitive advantage relative to traditional telecommunications companies. Whereas traditional telecommunications companies operate extensive legacy business support systems with compartmentalized architectures that limit their ability to scale rapidly and introduce enhanced services and features, Level 3 has developed a business support system architecture intended to maximize both reliability and scalability.

Key design aspects of the business support system development program are:

- o integrated modular applications to allow the Company to upgrade specific applications as new products are available;
- o a scalable architecture that allows certain functions that would otherwise have to be performed by Level 3 employees to be performed by the Company's alternative distribution channel participants;
- o phased completion of software releases designed to allow the Company to test functionality on an incremental basis;
- o "web-enabled" applications so that on-line access to all order entry, network operations, billing, and customer care functions is available to all authorized users, including Level 3's customers and resellers;
- o use of a tiered, client/server architecture that is designed to separate data and applications, and is expected to enable continued improvement of software functionality at minimum cost; and
- o use of pre-developed or "shrink wrapped" applications, where applicable, which will interface to Level 3's internally developed applications.

### **Interconnection and Peering**

As a result of the Telecom Act, properly certificated companies may, as a matter of law, interconnect with ILECs on terms designed to help ensure economic, technical and administrative equality between the interconnected parties. The Telecom Act provides, among other things, that ILECs must offer competitors the services and facilities necessary to offer local switched services. See "Regulation."

As of December 31, 2001, the Company had entered into interconnection agreements covering 58 markets. The Company may be required to negotiate new or renegotiate existing interconnection agreements as Level 3

expands its operations in current and additional markets in the future and as existing agreements expire or are terminated.

Peering agreements between the Company and ISPs are necessary in order for the Company to exchange traffic with those ISPs without having to pay transit costs. The Company is considered a Tier 1 Internet Service Provider and has settlement free peering arrangements with all ISPs in North America. In Europe, the Company has settlement free peering arrangements with all ISPs except one major Tier 1 ISP. The Company is currently negotiating settlement free peering arrangements with this ISP. The basis on which the large national ISPs make peering available or impose settlement charges is evolving as the provision of Internet access and related services has expanded.

### **Employee Recruiting and Retention**

As of December 31, 2001, Level 3 had 3,178 employees in the communications portion of its business and (i)Structure had approximately 549 employees, for a total of 3,727 employees. These numbers do not include the employees of Corporate Software, since this transaction closed on March 13, 2002. Corporate Software has approximately 800 employees worldwide. The Company believes that its ability to implement the Business Plan will depend in large part on its ability to attract and retain substantial numbers of additional qualified employees.

In order to attract and retain highly qualified employees, the Company believes that it is important to provide (i) a work environment that encourages each individual to perform to his or her potential, (ii) a work environment that facilitates cooperation towards shared goals and (iii) a compensation program designed to attract the kinds of individuals the Company seeks and to align employees' interests with the Company's. The Company believes that its policies and practices help provide such a work environment. With respect to compensation programs, while the Company believes financial rewards alone are not sufficient to attract and retain qualified employees, the Company believes a properly designed compensation program is a necessary component of employee recruitment and retention. In this regard the Company's philosophy is to pay annual cash compensation, which, if the Company's annual goals are met, is moderately greater than the cash compensation paid by competitors. The Company's non-cash benefit programs (including medical and health insurance, life insurance, disability insurance, etc.) are designed to be comparable to those offered by its competitors. As economic conditions dictate, the Company reviews the structure of its compensation plans and may make adjustments to these plans as these conditions warrant.

The Company believes that the qualified candidates it seeks place particular emphasis on equity-based long term incentive ("LTI") programs. The Company currently has two complementary programs: (i) the equity-based "Shareworks" program, which helps ensure that all employees have an ownership interest in the Company and are encouraged to invest risk capital in the Company's stock; and (ii) an innovative Outperform Stock Option ("OSO") program applicable to the Company's employees. The Shareworks program currently enables employees to contribute up to 7% of their compensation toward the purchase of restricted common stock, which purchases are matched one for one by the Company. If an employee remains employed by the Company for three years from the date of purchase, the shares that are contributed by the Company will vest. The shares that are purchased by the employee are vested at the time of purchase. The Shareworks program also provides that, subject to satisfactory Company performance, the Company's employees will be eligible annually for grants by the Company of its restricted common stock of up to a set percentage determined by the Compensation Committee of the Board of Directors of the employees' compensation, which shares will vest three years from the employee's initial grant date. For the year ended December 31, 2001, the Company granted to its eligible employees a 5% grant.

The Company has adopted the OSO program, which differs from LTI programs generally adopted by the Company's competitors that make employees eligible for conventional non-qualified stock options ("NQSOs"). While widely adopted, the Company believes such NQSO programs reward employees when company stock price performance is inferior to investments of similar risks, dilute public stockholders in a manner not directly proportional to performance and fail to provide a preferred return on stockholders' invested capital over the return to option holders. The Company believes that the OSO program is superior to an NQSO-based program with respect to these issues while, at the same time, providing employees a success-based reward balancing the associated risk.

The Company's OSO program is the primary component of Level 3's long term incentive, stock based compensation programs. The OSO program was designed by the Company so that its stockholders receive a market related return on their investment before OSO holders receive any return on their options. The Company believes that the OSO program better aligns employees' and stockholders' interests by basing stock option value on the Company's ability to outperform the market in general, as measured by the S&P 500 Index. The value received for options under the OSO plan is based on a formula involving a multiplier related to how much the Company's common stock outperforms the S&P 500 Index. Participants in the OSO program do not realize any value from options unless our common stock price outperforms the S&P 500 Index. To the extent that the Level 3 common stock outperforms the S&P 500, the value of OSOs to an option holder may exceed the value of NQSOs.

In July 2000, the Company adopted a convertible outperform stock option program, ("C-OSO") as an extension of the existing OSO plan. The program is a component of the Company's ongoing employee retention efforts and offers similar features to those of an OSO, but provides an employee with the greater of the value of a single share of the Company's common stock at exercise, or the calculated OSO value of a single OSO at the time of exercise.

C-OSO awards were made to eligible employees employed on the date of the grant. The awards were made in September 2000 and December 2000. Each award vests over three years as follows: 1/6 of each grant at the end of the first year, a further 2/6 at the end of the second year and the remaining 3/6 in the third year. Each award is immediately exercisable upon vesting. Awards expire four years from the date of the grant. In September 2001, the Company granted Special Convertible Outperform Stock Option ("Special COSO") to certain employees on the date of grant. Each Special COSO vests in equal quarterly installments over three years and is immediately exercisable upon vesting. Special COSOs expire four years from the date of grant.

Subsequent to March 31, 1998 (the effective date of the separation of the Company's former construction business), the Company adopted the recognition provisions of SFAS No. 123. Under SFAS No. 123, the fair value of an OSO (as computed in accordance with accepted option valuation models) on the date of grant is amortized over the vesting period of the OSO. The recognition provisions of SFAS No. 123 are applied prospectively upon adoption. As a result, they are applied to all stock awards granted in the year of adoption and are not applied to awards granted in previous years unless those awards are modified or settled in cash after adoption of the recognition provisions. The adoption of SFAS No. 123 resulted in non-cash charges to operations of \$314 million in 2001, \$236 million in 2000 and \$125 million in 1999 and will continue to result in non-cash charges to operations for future periods that the Company believes will also be material. The amount of the non-cash charge will be dependent upon a number of factors, including the number of options granted and the fair value estimated at the time of grant.

## **Competition**

**Communications.** The communications industry is highly competitive. Many of the Company's existing and potential competitors in the communications industry have financial, personnel, marketing and other resources significantly greater than those of the Company, as well as other competitive advantages including larger customer bases. Increased consolidation and strategic alliances in the industry resulting from the Telecom Act, the opening of the U.S. market to foreign carriers, technological advances and further deregulation could give rise to significant new competitors to the Company.

In recent years, competition has increased in all areas of Level 3's communications services market. The increased number of competitors and resulting investment in telecommunications networks has created a substantial oversupply of network capacity in the industry. While the Company believes that this oversupply condition is temporary, the oversupply has resulted in an intensely competitive environment forcing numerous competitors to curtail their business plans and, in a number of cases, to file for protection under bankruptcy or protection from creditor statutes. The Company's primary competitors are IXC's, ILECs, CLECs, ISPs and other companies that provide communications products and services. The following information identifies key competitors for each of the Company's product offerings.

For transport services, Level 3's key competitors in the United States are other facilities based communications companies including Williams Communications, Global Crossing, Qwest Communications, and

Broadwing. In Europe, the Company's key competitors are other carriers such as KPNQwest N.V., Telia International, Colt Telecom Group plc, WorldCom, and Global Crossing.

The Company's key competitors for its (3)Connect Modem services are other providers of dial up Internet access including WorldCom, Genuity, Sprint, Qwest, ICG and AT&T. In addition, the key competitors for the Company's (3)Voice service offering are other providers of wholesale long distance communications services including AT&T, WorldCom, Sprint and certain RBOCs. The RBOCs are seeking authorizations to provide certain long distance services which will further increase competition in the long distance services market. See "- Regulation."

Level 3's key competitors for its (3)Center Colocation services are other facilities based communications companies, and other colocation providers such as web hosting companies and third party colocation companies. These companies include Cable & Wireless, Equinix, Switch & Data, Qwest Communications and Broadwing.

For the Company's (3)Crossroads Internet access service, Level 3 competes with companies that include WorldCom, Genuity, Sprint, AT&T, Cable & Wireless, and Qwest.

The communications industry is subject to rapid and significant changes in technology. For instance, recent technological advances permit substantial increases in transmission capacity of both new and existing fiber, and the introduction of new products or emergence of new technologies may reduce the cost or increase the supply of certain services similar to those which the Company plans on providing. Accordingly, in the future the Company's most significant competitors may be new entrants to the communications and information services industry, which are not burdened by an installed base of outmoded or legacy equipment.

Corporate Software. The personal computer software market is intensely competitive. With respect to its business, Corporate Software faces competition from a wide variety of sources, including "software-only" resellers, hardware resellers and manufacturers and large systems integrators. Current competitors from the software-only reseller category would include Software Spectrum, ASAP Software and Softwarehouse International.

Competitors also include hardware resellers and manufacturers. These companies compete in the large and mid-size organization markets with marketing efforts to provide customers with software and hardware services. Such competitors include Dell Computer Corporation and Compaq Computer Corporation, hardware manufacturers that also sell software, and systems integrators such as Compucom Systems, Inc. Many of these companies do have a global presence.

The manner in which personal computer software products are distributed and sold is continually changing and new methods of distribution may emerge or expand. Software publishers may intensify their efforts to sell their products directly to end-users, including current and potential customers of Corporate Software, without utilizing services such as those provided by Corporate Software. In the past, direct sales from software publishers to end-users have not been significant, although end-users have traditionally been able to purchase upgrades directly from publishers. From time to time, some publishers have instituted programs for the direct sale of large order quantities of software to major corporate accounts, and Corporate Software anticipates that these types of transactions will continue to be used by various publishers in the future. Corporate Software could be adversely affected if major software publishers successfully implement or expand programs for the direct sale of software through volume purchase agreements or other arrangements intended to exclude the resale channel. The licensing program changes recently announced by Microsoft are not expected to reduce the role of the reseller channel in the sale of Microsoft products. Corporate Software believes that the total range of services it provides to its customers cannot be easily substituted by publishers, particularly because publishers do not offer the scope of services or product offerings required by most of Corporate Software's customers. However, there can be no assurance that publishers will not increase their efforts to sell substantial quantities of software directly to end-users without engaging Corporate Software to provide value-added services. If the resale channel's participation in volume license and maintenance agreements is reduced or eliminated, or if other methods of distribution of software become common, Corporate Software's business and financial results could be materially adversely affected. Corporate Software currently delivers a limited amount of software through electronic software distribution and intends to continue to participate in this method of software distribution as demand for this service by large organizations emerges and as

communications technology improvements permit electronic software distribution to be made securely and efficiently.

(i)Structure. The information technology infrastructure outsourcing market is highly competitive. There are few barriers to entry for new entrants with access to capital. Companies compete on reliability of their data centers, knowledge and competency of technical staff, quality of service and price. Large competitors have many resources available to them including longer operating history, name recognition, greater financial resources, large installed customer base and established industry relationships. These competitors may also be able to provide services outside of the data center, which can be used in pricing negotiations. (i)Structure prices competitively, but larger companies may be able to more effectively compete on price to obtain the potential customer's business.

At present, (i)Structure's competitors in the information technology infrastructure outsourcing market include:

- o larger established computer outsourcing companies such as IBM Global Services, EDS, and Computer Sciences Corporation (CSC);

- o midsize companies or divisions of larger companies such as ACS, Acxiom, and Lockheed; and

- o enterprises that maintain their computer processing environments in-house.

(i)Structure expects to offer application software services primarily in Europe. The market for these services is highly competitive and there are few barriers to entry. Companies are competing on the usefulness of their intellectual property, knowledge and competency of technical staff, quality of service and price. Large competitors have many resources available to them including longer operating history, name recognition, greater financial resources, large installed customer base and established industry relationships. At present, (i)Structure's competitors in the application software services market include European software development businesses and IT service companies such as S1 Inc., Bottomline Technologies, Inc. and Eontec.

## **Regulation**

The Company's communications and information services business will be subject to varying degrees of federal, state, local and international regulation.

### **Pending Legislation**

On February 27, 2002, the U.S. House of Representatives approved The Internet Freedom and Broadband Deployment Act of 2001 (H.R. 1542), also known as the Tauzin-Dingell bill, by a count of 273-157. The legislation allows the Bell Operating Companies to offer in-region long distance data services without meeting the requirements of Section 271 of the Telecommunications Act of 1996. In addition, the legislation removes requirements that the RBOCs sell certain network elements, including line-sharing and fiber-fed local loops to competitive carriers. The Telecommunications Act of 1996 (1996 Act) requires RBOCs to open their networks to competitors before the incumbent carriers may enter the long-distance voice market and provide nondiscriminatory access to unbundled network elements. It is unclear whether the legislation will be approved by the United States Senate. If Tauzin-Dingell becomes law, it could materially alter how the company provides its services, to whom it sells its services and how the company prices those services.

### **Federal Regulation**

The FCC regulates interstate and international telecommunications services. The FCC imposes extensive regulations on common carriers such as ILECs that have some degree of market power. The FCC imposes less regulation on common carriers without market power, such as the Company. The FCC permits these nondominant carriers to provide domestic interstate services (including long distance and access services) without prior authorization; but it requires carriers to receive an authorization to construct and operate telecommunications facilities, and to provide or resell telecommunications services, between the United States and international points.

The Company has recently obtained FCC approval to land its transatlantic cable in the U.S. The Company has obtained FCC authorization to provide international services on a facilities and resale basis. The Company has filed tariffs for its access and international long distance services with the FCC.

Under the Telecom Act, any entity, including cable television companies, and electric and gas utilities, may enter any telecommunications market, subject to reasonable state regulation of safety, quality and consumer protection. Because implementation of the Telecom Act is subject to numerous federal and state policy rulemaking proceedings and judicial review, there is still uncertainty as to what impact it will have on the Company. The Telecom Act is intended to increase competition. The Telecom Act opens the local services market by requiring ILECs to permit interconnection to their networks and establishing ILEC obligations with respect to:

- o Reciprocal Compensation. Requires all ILECs and CLECs to complete calls originated by competing carriers under reciprocal arrangements at prices based on a reasonable approximation of incremental cost or through mutual exchange of traffic without explicit payment.

- o Resale. Requires all ILECs and CLECs to permit resale of their telecommunications services without unreasonable restrictions or conditions. In addition, ILECs are required to offer wholesale versions of all retail services to other telecommunications carriers for resale at discounted rates, based on the costs avoided by the ILEC in the wholesale offering.

- o Interconnection. Requires all ILECs and CLECs to permit their competitors to interconnect with their facilities. Requires all ILECs to permit interconnection at any technically feasible point within their networks, on nondiscriminatory terms and at prices based on cost (which may include a reasonable profit). At the option of the carrier seeking interconnection, colocation of the requesting carrier's equipment in an ILEC's premises must be offered, except where the ILEC can demonstrate space limitations or other technical impediments to colocation.

- o Unbundled Access. Requires all ILECs to provide nondiscriminatory access to specified unbundled network elements (including certain network facilities, equipment, features, functions, and capabilities) at any technically feasible point within their networks, on nondiscriminatory terms and at prices based on cost (which may include a reasonable profit).

- o Number Portability. Requires all ILECs and CLECs to permit, to the extent technically feasible, users of telecommunications services to retain existing telephone numbers without impairment of quality, reliability or convenience when switching from one telecommunications carrier to another.

- o Dialing Parity. Requires all ILECs and CLECs to provide "1+" equal access to competing providers of telephone exchange service and toll service, and to provide nondiscriminatory access to telephone numbers, operator services, directory assistance, and directory listing, with no unreasonable dialing delays.

- o Access to Rights-of-Way. Requires all ILECs and CLECs to permit competing carriers access to poles, ducts, conduits and rights-of-way at regulated prices.

ILECs are required to negotiate in good faith with carriers requesting any or all of the above arrangements. If the negotiating carriers cannot reach agreement within a prescribed time, either carrier may request binding arbitration of the disputed issues by the state regulatory commission. Even when an agreement has not been reached, ILECs remain subject to interconnection obligations established by the FCC and state telecommunications regulatory commissions.

In August 1996, the FCC released a decision (the "Interconnection Decision") establishing rules implementing the above-listed requirements and providing guidelines for review of interconnection agreements by state public utility commissions. The United States Court of Appeals for the Eighth Circuit (the "Eighth Circuit") vacated certain portions of the Interconnection Decision. On January 25, 1999, the Supreme Court reversed the Eighth Circuit with respect to the FCC's jurisdiction to issue regulations governing local interconnection pricing

(including regulations governing reciprocal compensation). The Supreme Court also found that the FCC had authority to promulgate a "pick and choose" rule and upheld most of the FCC's rules governing access to unbundled network elements. The Supreme Court, however, remanded to the FCC the standard by which the FCC identified the network elements that must be made available on an unbundled basis.

On November 5, 1999, the FCC released an order largely retaining its list of unbundled network elements but eliminating the requirement that ILECs provide unbundled access to local switching for customers with four or more lines in the densest portion of the top 50 Metropolitan Statistical Areas, and the requirement to unbundle operator services and directory assistance. In its decision, the FCC reaffirmed that network elements should be priced using a total element long run incremental pricing ("TELRIC") methodology. A number of parties challenged the FCC's TELRIC finding. On Jan. 22, 2001, the U.S. Supreme Court agreed to hear those appeals. Oral argument took place on Oct. 10, 2001. The Supreme Court's decision could effect some pricing terms in the Company's existing interconnection agreements and may require the renegotiation of existing interconnection agreements. The Supreme Court's decision could also result in new rules being promulgated by the FCC. Given the general uncertainty surrounding the effect of these decisions and appeals, the Company may not be able to continue to obtain or enforce interconnection terms that are acceptable to it or that are consistent with its business plans.

The Telecom Act also codifies the ILECs' equal access and nondiscrimination obligations and preempts inconsistent state regulation. The Telecom Act contains special provisions that modify previous court decrees that prevented RBOCs from providing long distance services and engaging in telecommunications equipment manufacturing. These provisions permit a RBOC to enter the long distance market in its traditional service area if it satisfies several procedural and substantive requirements, including obtaining FCC approval upon a showing that the RBOC has entered into interconnection agreements (or, under some circumstances, has offered to enter into such agreements) in those states in which it seeks long distance relief, the interconnection agreements satisfy a 14-point "checklist" of competitive requirements, and the FCC is satisfied that the RBOC's entry into long distance markets is in the public interest. To date, the FCC has approved petitions to provide long distance service by Verizon in New York, Massachusetts, Connecticut, Pennsylvania, and Rhode Island. Verizon has applications pending in New Jersey, and Vermont Southwestern Bell has received approval for Texas, Oklahoma Kansas, Arkansas and Missouri.. BellSouth has applications pending for Georgia and Louisiana. The Telecom Act permitted the RBOCs to enter the out-of-region long distance market immediately upon its enactment.

In October 1996, the FCC adopted an order in which it eliminated the requirement that non-dominant carriers such as the Company maintain tariffs on file with the FCC for domestic interstate services. On February 13, 1997, the U.S. Court of Appeals for the District of Columbia stayed implementation of the FCC order. On April 28, 2000, all litigation with respect to the FCC's order was resolved in favor of the FCC. As a result, a deadline of August 1, 2001 was established for non-dominant carriers, such as Level 3, to eliminate tariffs for interstate services. In March 2001, the FCC also ordered that all nondominant interexchange carriers detariff international interexchange services by January 28, 2002. Pursuant to these orders, the Company cancelled its tariff for domestic interstate and international private line services effective July 31, 2001. The Company's state tariffs remain in place. While tariffs provided a means of providing notice of prices as well as terms and conditions for the provision of service, the Company has historically relied primarily on its sales force and marketing activities to provide information to its customers regarding these matters and expects to continue to do so. Further, in accordance with the FCC's orders the Company maintains a schedule of its rates, terms and conditions for its domestic and international private line services on its website at [www.level3.com](http://www.level3.com).

In 2001, the FCC adopted its CLEC access charge order adopting a benchmark rate for CLEC access charges. The order became effective in June 2001. The rules establish a conclusive presumption that CLEC access rates at or below the benchmark are just and reasonable. The FCC adopted a three-year transition period until the rates reach the rates charged by the ILEC in the same area. In addition, the FCC clarified that an interexchange carrier's refusal to serve customers of a CLEC that tariffs access rates at or below the benchmark rate, when the interexchange carrier serves ILEC end users in the same area, generally constitutes a violation of their duty to provide service upon reasonable request. The CLEC access charge order is subject to both petitions for reconsideration at the FCC and appeals in the U.S. Court of Appeals. In addition, CLEC access charges are among the intercarrier compensation issues addressed in the FCC's Notice of Proposed Rulemaking regarding a unified intercarrier compensation regime. The Company's long standing policy has been to mirror the access rates charged



by the ILECs. Because the rates established by the FCC in the CLEC access charge order are consistent with the ILEC rates, the Company is not required to change the manner in which access charges are assessed or collected.

Beginning in June 1997, every RBOC advised CLECs that they did not consider calls in the same local calling area from their customers to CLEC customers, who are ISPs, to be local calls under the interconnection agreements between the RBOCs and the CLECs. The RBOCs claim that these calls are exchange access calls for which exchange access charges would be owed. The RBOCs claimed, however, that the FCC exempted these calls from access charges so that no compensation is owed to the CLECs for transporting and terminating such calls. As a result, the RBOCs threatened to withhold, and in many cases did withhold, reciprocal compensation for the transport and termination of such calls. To date, thirty-six state commissions have ruled on this issue in the context of state commission arbitration proceedings or enforcement proceedings. In thirty-three states, to date, the state commission has determined that reciprocal compensation is owed for such calls. Several of these cases are presently on appeal. Reviewing courts have upheld the state commissions in eight decisions rendered to date on appeal. Decisions in the Fourth, Fifth and Seventh U.S. Circuit Courts of Appeal have upheld state determinations that reciprocal compensation is owed for ISP bound traffic. A decision is pending before the U.S. Circuit Court of Appeals for the District of Columbia. On February 25, 1999, the FCC issued a Declaratory Ruling on the issue of inter-carrier compensation for calls bound to ISPs. The FCC ruled that the calls are largely jurisdictionally interstate calls, not local calls. The FCC, however, determined that this issue was not dispositive of whether inter-carrier compensation is owed.

The FCC noted a number of factors which would allow the state commissions to leave their decisions requiring the payment of compensation undisturbed. That decision was appealed to the Court of Appeals for the District of Columbia Circuit which held on appeal that the FCC had failed to adequately support its conclusions under the requirements of the Telecommunications Act. On April 18, 2001, the FCC adopted a new order regarding intercarrier compensation for ISP-bound traffic. In that Order, the Commission set out to address the issues raised by the Court of Appeals and established a new intercarrier compensation mechanism for ISP-bound traffic. In addition to establishing a new rate structure, the Commission capped the amount of traffic that would be "compensable" and prohibited payment for ISP-traffic to carriers entering new markets. The April 2001 order was appealed and on Feb. 12, 2002, the Court of Appeals for the District of Columbia Circuit heard oral argument. A decision is expected in the summer of 2002.

Although there is a fair amount of uncertainty surrounding the regulatory and economic treatment of ISP-bound traffic, the Company has over the past two years entered into agreements with Verizon, formerly Bell Atlantic, that provides for payment for ISP bound traffic in the 14-state Verizon territory, the SBC Corporation for the 13-state operating territory that includes its affiliates Pacific Bell, Southwestern Bell, Ameritech and Southern New England Telephone and BellSouth in its nine-state operating territory. Given the general uncertainty surrounding the effect of these decisions and appeals, the Company may have to change how it treats the compensation it receives for terminating calls bound for Internet Service Providers if the agreements under which compensation is paid incorporate changes in FCC rules and regulations.

The FCC has to date treated ISPs as "enhanced service providers," exempt from federal and state regulations governing common carriers, including the obligation to pay access charges and contribute to the universal service fund. Nevertheless, regulations governing disclosure of confidential communications, copyright, excise tax, and other requirements may apply to the Company's provision of Internet access services. The Company cannot predict the likelihood that state, federal or foreign governments will impose additional regulation on the Company's Internet business, nor can it predict the impact that future regulation will have on the Company's operations.

In December 1996, the FCC initiated a Notice of Inquiry regarding whether to impose regulations or surcharges upon providers of Internet access and information services (the "Internet NOI"). The Internet NOI sought public comment upon whether to impose or continue to forebear from regulation of Internet and other packet-switched network service providers. The Internet NOI specifically identifies Internet telephony as a subject for FCC consideration. On April 10, 1998, the FCC issued a Report to Congress on its implementation of the universal service provisions of the Telecom Act. In that Report, the FCC stated, among other things, that the provision of transmission capacity to ISPs constitutes the provision of telecommunications and is, therefore, subject to common carrier regulations. The FCC indicated that it would reexamine its policy of not requiring an ISP to contribute to the

universal service mechanisms when the ISP provides its own transmission facilities and engages in data transport over those facilities in order to provide an information service. Any such contribution by a facilities based ISP would be related to the ISP's provision of the underlying telecommunications services. In the Report, the FCC also indicated that it would examine the question of whether certain forms of "phone-to-phone Internet Protocol telephony" are information services or telecommunications services. It noted that the FCC did not have an adequate record on which to make any definitive pronouncements on that issue at this time, but that the record the FCC had reviewed suggests that certain forms of phone-to-phone Internet Protocol telephony appear to have similar functionality to non-Internet Protocol telecommunications services and lack the characteristics that would render them information services. If the FCC were to determine that certain Internet Protocol telephony services are subject to FCC regulations as telecommunications services, the FCC noted it may find it reasonable that the ISPs pay access charges and make universal service contributions similar to non-Internet Protocol based telecommunications service providers. The FCC also noted that other forms of Internet Protocol telephony appear to be information services. The Company cannot predict the outcome of these proceedings or other FCC proceedings that may effect the Company's operations or impose additional requirements, regulations or charges upon the Company's provision of Internet access services.

The Communications Act requires that every telecommunications carrier contribute, on an equitable and non-discriminatory basis, to federal universal service mechanisms established by the FCC, and the FCC also requires providers of non-common carrier telecommunications to contribute to universal service, subject to some exclusions and limitations. At present, these contributions are calculated based on contributors' interstate and international revenues derived from U.S. domestic end users for telecommunications or telecommunications services, as those terms are defined under FCC regulations. Level 3, pursuant to federal regulations, pays these contributions. The amount of Level 3's contributions can vary based upon the total amount of federal universal service support being provided under the FCC's federal mechanisms and associated administrative expenses, the methodology used by the FCC to calculate each carrier's contributions, and, at present, the proportion of Level 3's assessable interstate and international revenues derived from its domestic end users for telecommunications or telecommunications services to, for all contributors, the total amount of assessable interstate and international revenues derived from domestic end users for telecommunications or telecommunications services. The extent to which Level 3's services are viewed as telecommunications/telecommunications services or as information services will also affect Level 3's contributions. The FCC has pending several proceedings that could affect the total amount of universal service support, including proceedings related to the types of service that receive subsidy support, the extent of subsidies for rural, insular and high cost areas. The FCC is also considering whether to change its methodology for assessing a carrier's contributions from a revenue based methodology to an end-user connection based methodology. Level 3 is unable to predict which of these proposed changes, if any, the FCC will adopt and the cumulative effect of any such changes on Level 3's total subsidy contribution payments.

In 1999, the FCC strengthened its existing colocation rules to encourage competitive deployment of high-speed data services. The order, among other things, restricted the ability of ILECs to prevent certain types of equipment from being colocated and required ILECs to offer alternative colocation arrangements that will be less costly. Early in 2000, the D.C. Circuit struck down several aspects of the colocation order and remanded it back to the FCC for further consideration. In response to the remand, the FCC released an order in August 2001. In that order, the FCC found that multifunctional equipment could be colocated only if the primary purpose and function of the equipment is for the CLEC to obtain "equal in quality" interconnection or nondiscriminatory access to UNEs. The FCC also eliminated its rules that gave CLECs the option of picking their physical colocation space. Following this remand order, several ILECs filed petitions for review with the D.C. Circuit. The oral argument is scheduled for May 10, 2002.

In recent months, the FCC has initiated a number of proceedings that may have an effect on how the FCC regulates local competition and broadband services as well as how it assesses universal service contribution requirements. Because these proceedings are in the early stages of the rulemaking process, the Company is unable to assess the potential effect at this time.

Performance Measurements and Standards for UNEs and Interconnection. In November 2001, the FCC released a Notice of Proposed Rulemaking seeking comment on the proposal to adopt performance measurements and standards for evaluating ILEC performance in the provision of UNEs.

Performance Measurements and Standards for Interstate Special Access Services. In November 2001, the FCC released a Notice of Proposed Rulemaking seeking comment on whether it should adopt specific performance measurements and standards for evaluating the ILECs' performance in the provision of special access services.

Triennial Review of the Commission's UNE Rules. In December 2001, the FCC released a Notice of Proposed Rulemaking to undertake a comprehensive review of the unbundling rules. This rulemaking address consolidates issues pending in various other proceedings, including access to high capacity loops and dedicated transport, local switching, and next-generation networks.

Examination of Regulatory Treatment of Incumbent Carriers' Broadband Telecommunications Services. On December 20, 2001, the FCC released a Notice of Proposed Rulemaking proposing to declare ILECs non-dominant in the provision of broadband services, and thereby reduce the regulatory requirements they must comply with, on grounds that sufficient competition from cable, satellite, and terrestrial wireless providers exists to check ILEC market power.

Appropriate Framework for Broadband Access to the Internet over Wireline Facilities. On February 15, 2002, the FCC released a Notice of Proposed Rulemaking proposing to deregulate ILEC provision of broadband services by declaring them "information services" exempt from Title II regulation under the Communications Act. The NPRM further solicits comments on whether a reclassification of ILEC broadband Internet services would eliminate the unbundling and interconnection rules that currently apply to such services. Finally, the NPRM also asks whether wireline facilities-based providers of broadband Internet access services - including cable, wireless and satellite providers - should contribute to the Universal Service subsidy funds.

### **State Regulation**

The Telecom Act is intended to increase competition in the telecommunications industry, especially in the local exchange market. With respect to local services, ILECs are required to allow interconnection to their networks and to provide unbundled access to network facilities, as well as a number of other procompetitive measures. Because the implementation of the Telecom Act is subject to numerous state rulemaking proceedings on these issues, it is currently difficult to predict how quickly full competition for local services, including local dial tone, will be introduced.

State regulatory agencies have jurisdiction when Company facilities and services are used to provide intrastate services. A portion of the Company's traffic may be classified as intrastate and therefore subject to state regulation. The Company expects that it will offer more intrastate services (including intrastate switched services) as its business and product lines expand. To provide intrastate services, the Company generally must obtain a certificate of public convenience and necessity from the state regulatory agency and comply with state requirements for telecommunications utilities, including state tariffing requirements. The Company currently is authorized to provide telecommunications services in all fifty states and the District of Columbia. The Company is seeking expanded authority in the states of Alaska, California, Georgia, Idaho, Maine, Minnesota, Missouri, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, South Dakota, Tennessee, Utah, West Virginia and Wisconsin. In addition, the Company will be required to obtain interconnection agreements with independent telephone companies in each state where it wishes to expand its network coverage. States also often require prior approvals or notifications for certain transfers of assets, customers or ownership of certificated carriers and for issuances by certified carriers of equity or debt.

### **Local Regulation**

The Company's networks will be subject to numerous local regulations such as building codes and licensing. Such regulations vary on a city-by-city, county-by-county and state-by-state basis. To install its own fiber optic transmission facilities, the Company will need to obtain rights-of-way over privately and publicly owned land. Rights-of-way that are not already secured may not be available to the Company on economically reasonable or advantageous terms.

## Canadian Regulation

The Canadian Radio-television and Telecommunications Commission (the "CRTC") generally regulates long distance telecommunications services in Canada. Regulatory developments over the past several years have terminated the historic monopolies of the regional telephone companies, bringing significant competition to this industry for both domestic and international long distance services, but also lessening regulation of domestic long distance companies. Resellers, which, as well as facilities-based carriers, now have interconnection rights, but which are not obligated to file tariffs, may not only provide transborder services to the U.S. by reselling the services provided by the regional companies and other entities but also may resell the services of the former monopoly international carrier, Teleglobe Canada ("Teleglobe"), including offering international switched services provisioned over leased lines. Although the CRTC formerly restricted the practice of "switched hubbing" over leased lines through intermediate countries to or from a third country, the CRTC recently lifted this restriction. The Teleglobe monopoly on international services and undersea cable landing rights terminated as of October 1, 1998, although the provision of Canadian international transmission facilities-based services remains restricted to "Canadian carriers" with majority ownership by Canadians. Ownership of non-international transmission facilities are limited to Canadian carriers but the Company can own international undersea cables landing in Canada. The Company cannot, under current or foreseen law, enter the Canadian market as a provider of transmission facilities-based domestic services. Recent CRTC rulings address issues such as the framework for international contribution charges payable to the local exchange carriers to offset some of the capital and operating costs of the provision of switched local access services of the incumbent regional telephone companies, in their capacity as ILECs, and the new entrant CLECs.

While competition is permitted in virtually all other Canadian telecommunications market segments, the Company believes that the regional companies continue to retain a substantial majority of the local and calling card markets. Beginning in May 1997, the CRTC released a number of decisions opening to competition the Canadian local telecommunications services market, which decisions were made applicable in the territories of all of the regional telephone companies except SaskTel (although Saskatchewan has subsequently allowed local service competition in that province). As a result, networks operated by CLECs may now be interconnected with the networks of the ILECs. Transmission facilities-based CLECs are subject to the same majority Canadian ownership "Canadian carrier" requirements as transmission facilities-based long distance carriers. CLECs have the same status as ILECs, but they do not have universal service or customer tariff-filing obligations. CLECs are subject to certain consumer protection safeguards and other CRTC regulatory oversight requirements. CLECs must file interconnection tariffs for services to interexchange service providers and wireless service providers. Certain ILEC services must be provided to CLECs on an unbundled basis and subject to mandatory pricing, including central office codes, subscriber listings, and local loops in small urban and rural areas. For a five-year period, certain other important CLEC services must be provided on an unbundled basis at mandated prices, notably unbundled local loops in large, urban areas. ILECs, which, unlike CLECs, remained fully regulated, will be subject to price cap regulation in respect of their utility services for an initial four-year period beginning May 1, 1997, and these services must not be priced below cost. Interexchange contribution payments are now pooled and distributed among ILECs and CLECs according to a formula based on their respective proportions of residential lines, with no explicit contribution payable from local business exchange or directory revenues. CLECs must pay an annual telecommunications fee based on their proportion of total CLEC operating revenues. All bundled and unbundled local services (including residential lines and other bulk services) may now be resold, but ILECs need not provide these services to resellers at wholesale prices. Transmission facilities-based local and long distance carriers (but not resellers) are entitled to colocate equipment in ILEC central offices pursuant to terms and conditions of tariffs and intercarrier agreements. Certain local competition issues are still to be resolved. The CRTC has ruled that resellers cannot be classified as CLECs, and thus are not entitled to CLEC interconnection terms and conditions.

### The Company's Other Businesses

The Company was incorporated as Peter Kiewit Sons', Inc. in Delaware in 1941 to continue a construction business founded in Omaha, Nebraska in 1884. In subsequent years, the Company invested a portion of the cash flow generated by its construction activities in a variety of other businesses. The Company entered the coal mining business in 1943, the telecommunications business (consisting of MFS and, more recently, an investment in C-TEC Corporation and its successors RCN Corporation, Commonwealth Telephone Enterprises, Inc. and Cable Michigan,

Inc.) in 1988, the information services business in 1990 and the alternative energy business, through an investment in MidAmerican, in 1991. Level 3 also has made investments in several development-stage ventures.

In 1995, the Company distributed to the holders of Class D Stock all of its shares of MFS. In the seven years from 1988 to 1995, the Company invested approximately \$500 million in MFS; at the time of the distribution to stockholders in 1995, the Company's holdings in MFS had a market value of approximately \$1.75 billion. In December 1996, MFS was purchased by WorldCom in a transaction valued at \$14.3 billion. In December 1997, the Company's stockholders ratified the decision of the Board to effect the split-off separating the Construction Group. As a result of the split-off, which was completed on March 31, 1998, the Company no longer owns any interest in the Construction Group. In conjunction with the split-off, the Company changed its name to "Level 3 Communications, Inc.," and the Construction Group changed its name to "Peter Kiewit Sons', Inc."

In January 1998, the Company completed the sale to MidAmerican of its energy investments, consisting primarily of a 24% equity interest in MidAmerican. The Company received proceeds of approximately \$1.16 billion from this sale, and as a result recognized an after-tax gain of approximately \$324 million in 1998. In November 1998, Avalon Cable of Michigan, Inc. acquired all the outstanding stock of Cable Michigan. Level 3 received approximately \$129 million in cash for its interest in Cable Michigan and recognized a pre-tax gain of approximately \$90 million.

The Company's other businesses include its investment in the C-TEC Companies (as defined), coal mining, the SR91 Tollroad (as defined) and certain other assets. In 1998, the Company completed the sale of its interests in United Infrastructure Company, MidAmerican and Kiewit Investment Management Corp.

### **C-TEC Companies**

On September 30, 1997, C-TEC completed a tax-free restructuring, which divided C-TEC Corporation into three public companies (the "C-TEC Companies"):

C-TEC, which changed its name to Commonwealth Telephone Enterprises, Inc. ("Commonwealth Telephone"), RCN Corporation ("RCN") and Cable Michigan, Inc. ("Cable Michigan"). The Company's interests in the C-TEC Companies are held through a holding company (the "C-TEC Holding Company"). The Company owns 100% of the capital stock of the C-TEC Holding Company. Prior to February 2002, a portion of the common stock of the C-TEC Holding Company, that is, 10%, was held by David C. McCourt, a director of the Company who was formerly the Chairman of C-TEC. In February 2002, Mr. McCourt sold his interest in the C-TEC Holding Company to a subsidiary of the Company for a total of \$15 million.

**Commonwealth Telephone.** Commonwealth Telephone is a Pennsylvania public utility providing local telephone service to a 19-county, 5,191 square mile service territory in Pennsylvania. Commonwealth Telephone also provides network access and long distance services to IXC's. Commonwealth Telephone's business customer base is diverse in size as well as industry, with very little concentration. A subsidiary, Commonwealth Communications Inc. provides telecommunications engineering and technical services to large corporate clients, hospitals and universities in the northeastern United States. Another subsidiary, Commonwealth Long Distance operates principally in Pennsylvania, providing switched services and resale of several types of services, using the networks of several long distance providers on a wholesale basis. As of December 31, 2001, the C-TEC Holding Company owned approximately 45% of the outstanding common stock of Commonwealth Telephone.

On October 23, 1998, Commonwealth Telephone completed a rights offering of 3.7 million shares of its common stock. In the offering, Level 3 exercised all rights it received and purchased approximately 1.8 million additional shares of Commonwealth Telephone common stock for an aggregate subscription price of \$37.7 million.

On February 7, 2002, Commonwealth Telephone filed a registration statement on Form S-3 with respect to the sale by a subsidiary of the Company in an underwritten public offering of up to 3,162,500 shares of common stock (including 412,500 shares of common stock subject to the underwriters' over-allotment option) as a result of the exercise of certain demand registration rights held by the Company. The filing of the registration statement is consistent with the Company's public statements that the Company would consider the possible sale of certain of its non-core assets, which include holdings in public companies such as Commonwealth Telephone. On March 8, 2002, the Company filed an amendment to its registration statement (SEC File No. 333-82366) to increase the number of shares to be sold by the Company's subsidiary in an underwritten public offering to up to 4,025,000

shares of common stock (including 525,000 shares of common stock subject to the underwriters' over-allotment option).

RCN. RCN is a full service provider of local, long distance, Internet and cable television services primarily to residential users in densely populated areas in the Northeast. RCN operates as a competitive telecommunications service provider in New York City and Boston. RCN also owns cable television operations in New York, New Jersey and Pennsylvania; a 49% interest in Megacable, S.A. de C.V., Mexico's second largest cable television operator; and has long distance operations (other than the operations in certain areas of Pennsylvania). RCN is developing advanced fiber optic networks to provide a wide range of telecommunications services, including local and long distance telephone, video programming and data services (including high speed Internet access), primarily to residential customers in selected markets in the Boston to Washington, D.C. and San Francisco to San Diego corridors and Chicago. As of December 31, 2001, the C-TEC Holding Company owned approximately 27% of the outstanding common stock of RCN.

Cable Michigan. Cable Michigan was a cable television operator in the State of Michigan. On June 4, 1998, Cable Michigan announced that it had agreed to be acquired by Avalon Cable. Level 3 received approximately \$129 million in cash when the transaction closed on November 6, 1998.

### **Coal Mining**

The Company is engaged in coal mining through its subsidiary, KCP, Inc. ("KCP"). KCP has a 50% interest in two mines, which are operated by a subsidiary of Peter Kiewit Sons', Inc. ("New PKS"). Decker Coal Company ("Decker") is a joint venture with Western Minerals, Inc., a subsidiary of The RTZ Corporation PLC. Black Butte Coal Company ("Black Butte") is a joint venture with Bitter Creek Coal Company, a subsidiary of Anadarko Petroleum Corporation. The Decker mine is located in southeastern Montana and the Black Butte mine is in southwestern Wyoming. The coal mines use the surface mining method.

In September 2000, the Company sold its entire 50% ownership interest in the Walnut Creek Mining Company to a subsidiary of Peter Kiewit Sons', Inc. for cash of \$37 million.

The coal produced from the KCP mines is sold primarily to electric utilities, which burn coal in order to produce steam to generate electricity. Approximately 89% of sales are made under long-term contracts, and the remainder are made on the spot market. Approximately 60%, 75% and 77% of KCP's revenues in 2001, 2000 and 1999, respectively, were derived from long-term contracts with Commonwealth Edison Company (with Decker and Black Butte) and The Detroit Edison Company (with Decker). KCP also has other sales commitments, including those with Sierra Pacific, Idaho Power, Solvay Minerals, Pacific Power & Light and Minnesota Power, that provide for the delivery of approximately 8 million tons through 2005. The level of cash flows generated in recent periods by the Company's coal operations will not continue after the year 2000 because the delivery requirements under the Company's current long-term contracts decline significantly. Under a mine management agreement, KCP pays a subsidiary of New PKS an annual fee equal to 30% of KCP's adjusted operating income. The fee for 2001 was \$5 million.

The coal industry is highly competitive. KCP competes not only with other domestic and foreign coal suppliers, some of whom are larger and have greater capital resources than KCP, but also with alternative methods of generating electricity and alternative energy sources. In 2000, the most recent year for which information is available, KCP's production represented 1.3% of total U.S. coal production. Demand for KCP's coal is affected by economic, political and regulatory factors. For example, recent "clean air" laws may stimulate demand for low sulfur coal. KCP's western coal reserves generally have a low sulfur content (less than one percent) and are currently useful principally as fuel for coal-fired, steam-electric generating units.

KCP's sales of its western coal, like sales by other western coal producers, typically provide for delivery to customers at the mine. A significant portion of the customer's delivered cost of coal is attributable to transportation costs. Most of the coal sold from KCP's western mines is currently shipped by rail to utilities outside Montana and Wyoming. The Decker and Black Butte mines are each served by a single railroad. Many of their western coal competitors are served by two railroads and such competitors' customers often benefit from lower transportation costs because of competition between railroads for coal hauling business. Other western coal producers, particularly

those in the Powder River Basin of Wyoming, have lower stripping ratios (that is, the amount of overburden that must be removed in proportion to the amount of minable coal) than the Black Butte and Decker mines, often resulting in lower comparative costs of production. As a result, KCP's production costs per ton of coal at the Black Butte and Decker mines can be as much as four and five times greater than production costs of certain competitors. KCP's production cost disadvantage has contributed to its agreement to amend its long-term contract with Commonwealth Edison Company to provide for delivery of coal from alternate source mines rather than from Black Butte. Because of these cost disadvantages, KCP does not expect that it will be able to enter into long-term coal purchase contracts for Black Butte and Decker production as the current long-term contracts expire. In addition, these cost disadvantages may adversely affect KCP's ability to compete for spot sales in the future.

The Company is required to comply with various federal, state and local laws and regulations concerning protection of the environment. KCP's share of land reclamation expenses for the year ended December 31, 2001 was approximately \$4 million. KCP's share of accrued estimated reclamation costs was \$96 million at December 31, 2001. The Company did not make significant capital expenditures for environmental compliance with respect to the coal business in 2001. The Company believes its compliance with environmental protection and land restoration laws will not affect its competitive position since its competitors in the mining industry are similarly affected by such laws. However, failure to comply with environmental protection and land restoration laws, or actual reclamation costs in excess of the Company's accruals, could have an adverse effect on the Company's business, results of operations, and financial condition.

### **SR91 Tollroad**

The Company has invested \$13.3 million for a 65% equity interest and lent \$8.8 million to California Private Transportation Company L.P. ("CPTC"), which developed, financed, and currently operates the 91 Express Lanes, a ten mile, four-lane tollroad in Orange County, California (the "SR91 Tollroad"). The fully automated highway uses an electronic toll collection system and variable pricing to adjust tolls to demand.

Capital costs at completion were \$130 million, \$110 million of which was funded with debt that was not guaranteed by Level 3. Revenue collected over the 35-year franchise period is used for operating expenses, debt repayment, and profit distributions. The SR91 Tollroad opened in December 1995 and achieved operating break-even in 1996. Approximately 96,800 customers have registered to use the tollroad as of December 31, 2001, and weekday volumes typically exceed 26,000 vehicles per day during December 2001.

### **Other**

In December 1990, Continental Holdings, Inc., an indirect, wholly owned subsidiary of the Company ("Continental"), pursuant to a Stock Purchase Agreement (the "Agreement"), sold 100% of the issued and outstanding shares of its wholly owned subsidiary Continental PET Technologies, Inc. ("PET") to BTR Nylex Limited ("BTR"). At the time of the sale, PET was a named defendant in Pechiney Plastic Packaging, Inc. (as successor in interest to American National Can Company) vs. Continental PET Technologies, Inc., a patent infringement action, filed in the United States District Court for the District of Connecticut. Pechiney asserts that certain bottles made by PET since 1990 infringe claims contained in Pechiney's United States Patent No. 4,554,190 and that all multi-layer barrier bottles made by PET since November 1993 infringe claims of its United States Patent No. 4,526,821. PET asserts a number of defenses, including non-infringement, invalidity of the patents in suit, laches and equitable estoppel. Pechiney is seeking to enjoin PET from further infringement of the '190 and '821 patents, and seeks damages, including interest, in excess of \$130 million for alleged infringement through October 31, 2001. Pechiney is further seeking, under a theory of willful infringement, to recover enhanced damages of up to three times any actual damage award. PET asserts that Pechiney is not entitled to injunctive relief and can recover no damages because of the invalidity of the patents, improper claims construction, non-infringement, and that it has not willfully infringed either patent. PET further asserts that, if damages are recoverable, they do not exceed \$3 million, exclusive of interest. Neither the Company nor PET are named defendants in the lawsuit.

Subject to the provisions of the Agreement, Continental agreed to defend PET with respect to the litigation and, under certain circumstances, agreed to be responsible for damages. No trial date has been set in the matter, and the outcome cannot be predicted with reasonable certainty at this time. Any exposure that Continental might have pursuant to the Agreement is not determinable or predictable at this time. If the outcome of the litigation is adverse

to PET, it is uncertain whether a claim of indemnity will be made. Continental believes that it has substantial defenses to an indemnity claim, and intends to contest any such claim vigorously.

## Glossary of Terms

access.....	Telecommunications services that permit long distance carriers to use local exchange facilities to originate and/or terminate long distance service.
access charges .....	The fees paid by long distance carriers to LECs for originating and terminating long distance calls on the LECs' local networks.
backbone .....	A centralized high-speed network that interconnects smaller, independent networks. It is the through-portion of a transmission network, as opposed to spurs which branch off the through-portions.
CAP .....	Competitive Access Provider. A company that provides its customers with an alternative to the local exchange company for local transport of private line and special access telecommunications services.
capacity .....	The information carrying ability of a telecommunications facility.
Carrier .....	A provider of communications transmission services by fiber, wire or radio.
Central Office .....	Telephone company facility where subscribers' lines are joined to switching equipment for connecting other subscribers to each other, locally and long distance.
CLEC .....	Competitive Local Exchange Carrier. A company that competes with LECs in the local services market.
common carrier .....	A government-defined group of private companies offering telecommunications services or facilities to the general public on a non- discriminatory basis.
conduit .....	A pipe, usually made of metal, ceramic or plastic, that protects buried cables.
DS-3 .....	A data communications circuit capable of transmitting data at 45 Mbps.
dark fiber .....	Fiber optic strands that are not connected to transmission equipment.
dedicated lines .....	Telecommunications lines reserved for use by particular customers.
dialing parity .....	The ability of a competing local or toll service provider to provide telecommunications services in such a manner that customers have the ability to route automatically, without the use of any access code, their telecommunications to the service provider of the customers' designation.
equal access .....	The basis upon which customers of interexchange carriers are able to obtain access to their Primary Interexchange Carriers' (PIC) long distance telephone network by dialing "1", thus eliminating the need to dial additional digits and an authorization code to obtain such access.
facilities based carriers .....	Carriers that own and operate their own network and equipment.



fiber optics .....A technology in which light is used to transport information from one point to another. Fiber optic cables are thin filaments of glass through which light beams are transmitted over long distances carrying enormous amounts of data. Modulating light on thin strands of glass produces major benefits including high bandwidth, relatively low cost, low power consumption, small space needs and total insensitivity to electromagnetic interference.

Gbps .....Gigabits per second. A transmission rate. One gigabit equals 1.024 billion bits of information.

ILEC .....Incumbent Local Exchange Carrier. A company historically providing local telephone service. Often refers to one of the Regional Bell Operating Companies (RBOCs). Often referred to as "LEC" (Local Exchange Carrier).

Interconnection .....Interconnection of facilities between or among local exchange carriers, including potential physical colocation of one carrier's equipment in the other carrier's premises to facilitate such interconnection.

InterLATA .....Telecommunications services originating in a LATA and terminating outside of that LATA.

Internet .....A global collection of interconnected computer networks which use a specific communications protocol.

IntraLATA .....Telecommunications services originating and terminating in the same LATA.

ISDN .....Integrated Services Digital Network. An information transfer standard for transmitting digital voice and data over telephone lines at speeds up to 128 Kbps.

ISPs .....Internet Service Providers. Companies formed to provide access to the Internet to consumers and business customers via local networks.

IXC .....Interexchange Carrier. A telecommunications company that provides telecommunications services between local exchanges on an interstate or intrastate basis.

Kbps .....Kilobits per second. A transmission rate. One kilobit equals 1,024 bits of information.

LATA .....Local Access and Transport Area. A geographic area composed of contiguous local exchanges, usually but not always within a single state. There are approximately 200 LATAs in the United States.

leased line .....Telecommunications line dedicated to a particular customer along predetermined routes.

LEC .....Local Exchange Carrier. A telecommunications company that provides telecommunications services in a geographic area in which calls generally are transmitted without toll charges. LECs include both ILECs and CLECs.

local exchange .....A geographic area determined by the appropriate state regulatory authority in which calls generally are transmitted without toll charges to the calling or called party.

local loop .....A circuit that connects an end user to the LEC central office within a LATA. long distance carriers Long distance carriers provide services between (interexchange carriers) local exchanges on an interstate or intrastate basis. A long distance carrier may offer services over its own or another carrier's facilities.

Mbps .....Megabits per second. A transmission rate. One megabit equals 1.024 million bits of information.

MPLS .....MultiProtocol Label Switching. A switching standard for the transmission of data at increased speeds. The concept is based on having routers at the edge of a communications network and switches at the core of the network for the faster transmission of data communications.

multiplexing .....An electronic or optical process that combines a large number of lower speed transmission lines into one high speed line by splitting the total available bandwidth into narrower bands (frequency division), or by allotting a common channel to several different transmitting devices, one at a time in sequence (time division).

NAP .....Network Access Point. A location at which ISPs exchange each other's traffic.

OC-3 .....A data communications circuit consisting of three DS-3s capable of transmitting data at 155 Mbps.

OC-12 .....A data communications circuit consisting of twelve DS-3s capable of transmitting data at 622 Mbps.

OC-48 .....A data communications circuit consisting of forty-eight DS-3s capable of transmitting data at approximately 2.45 Gbps.

peering .....The commercial practice under which ISPs exchange each other's traffic without the payment of settlement charges. Peering occurs at both public and private exchange points.

POP .....Point of Presence. Telecommunications facility where a communications provider locates network equipment used to connect customers to its network backbone.

private line .....A dedicated telecommunications connection between end user locations.

PSTN .....Public Switched Telephone Network. That portion of a local exchange company's network available to all users generally on a shared basis (i.e., not dedicated to a particular user). Traffic along the public switched network is generally switched at the local exchange company's central offices.

RBOCs .....Regional Bell Operating Companies. Originally, the seven local telephone companies (formerly part of AT&T) established as a result of the AT&T Divestiture. Currently consists of four local telephone companies as a result of the mergers of Bell Atlantic with NYNEX and SBC with Pacific Telesis and Ameritech.

reciprocal compensation .....The compensation of a CLEC for termination of a local call by the ILEC on the CLEC's network, which is the same as the compensation that the CLEC pays the ILEC for termination of local calls on the ILEC's network.

resale .....	Resale by a provider of telecommunications services (such as a LEC) of such services to other providers or carriers on a wholesale or a retail basis.
router .....	Equipment placed between networks that relays data to those networks based upon a destination address contained in the data packets being routed.
SONET .....	Synchronous Optical Network. An electronics and network architecture for variable bandwidth products which enables transmission of voice, data and video (multimedia) at very high speeds. SONET ring architecture provides for virtually instantaneous restoration of service in the event of a fiber cut by automatically rerouting traffic in the opposite direction around the ring.
special access services .....	The lease of private, dedicated telecommunications lines or "circuits" along the network of a local exchange company or a CAP, which lines or circuits run to or from the long distance carrier POPs. Examples of special access services are telecommunications lines running between POPs of a single long distance carrier, from one long distance carrier POP to the POP of another long distance carrier or from an end user to a long distance carrier POP.
switch .....	A device that selects the paths or circuits to be used for transmission of information and establishes a connection. Switching is the process of interconnecting circuits to form a transmission path between users and it also captures information for billing purposes.
Tbps .....	Terabits per second. A transmission rate. One terabit equals 1.024 trillion bits of information.
T-1	A data communications circuit capable of transmitting data at 1.544 Mbps.
unbundled .....	Services, programs, software and training sold separately from the hardware.
unbundled access .....	Access to unbundled elements of a telecommunications services provider's network including network facilities, equipment, features, functions and capabilities, at any technically feasible point within such network.
web site .....	A server connected to the Internet from which Internet users can obtain information.
wireless .....	A communications system that operates without wires. Cellular service is an example.
world wide web or web .....	A collection of computer systems supporting a communications protocol that permits multimedia presentation of information over the Internet.
xDSL .....	A term referring to a variety of new Digital Subscriber Line technologies. Some of these new varieties are asymmetric with different data rates in the downstream and upstream directions. Others are symmetric. Downstream speeds range from 384 Kbps (or "SDSL") to 1.5 to 8 Mbps ("ADSL").

## Directors and Executive Officers

Set forth below is information as of March 8, 2002, about each director and each executive officer of the Company. The executive officers of the Company have been determined in accordance with the rules of the SEC.

Name	Age	Position
Walter Scott, Jr. ....	70	Chairman of the Board
James Q. Crowe.....	52	Chief Executive Officer and Director
Kevin J. O'Hara.....	41	President, Chief Operating Officer and Director
R. Douglas Bradbury.....	51	Vice Chairman of the Board and Executive Vice President
Charles C. Miller, III.....	49	Vice Chairman of the Board and Executive Vice President
Sureel A. Choksi.....	29	Group Vice President and Chief Financial Officer
Thomas C. Stortz.....	50	Group Vice President, General Counsel and Secretary
John F. Waters, Jr.....	37	Group Vice President and Chief Technology Officer
Colin V.K. Williams.....	62	Director
Mogens C. Bay.....	53	Director
William L. Grewcock.....	76	Director
Richard R. Jaros.....	50	Director
Robert E. Julian.....	62	Director
David C. McCourt.....	45	Director
Kenneth E. Stinson.....	59	Director
Michael B. Yanney.....	68	Director

## Other Management

Set forth below is information as of March 8, 2002, about the following members of senior management of the Company.

Name	Age	Position
Linda J. Adams.....	45	Group Vice President
Daniel P. Caruso.....	38	Group Vice President
Donald H. Gips.....	42	Group Vice President
John Neil Hobbs.....	42	Group Vice President
Joseph M. Howell, III.....	55	Group Vice President
Michael D. Jones.....	44	Chief Executive Officer (i)Structure, Inc.
Brady Rafuse.....	38	Group Vice President
Edward Van Macatee.....	47	Group Vice President
Ronald J. Vidal.....	42	Group Vice President

Walter Scott, Jr. has been the Chairman of the Board of the Company since September 1979, and a director of the Company since April 1964. Mr. Scott has been Chairman Emeritus of Peter Kiewit Sons', Inc. ("PKS") since the split-off. Mr. Scott is also a director of PKS, Berkshire Hathaway Inc., Burlington Resources Inc., MidAmerican, ConAgra Foods, Inc., Commonwealth Telephone Enterprises, Inc. ("Commonwealth Telephone"), RCN Corporation ("RCN"), Kiewit Materials Company and Valmont Industries, Inc.

James Q. Crowe has been the Chief Executive Officer of the Company since August 1997, and a director of the Company since June 1993. Mr. Crowe was also President of the Company until February 2000. Mr. Crowe was President and Chief Executive Officer of MFS Communications Company, Inc. ("MFS") from June 1993 to June 1997. Mr. Crowe also served as Chairman of the Board of WorldCom from January 1997 until July 1997, and as Chairman of the Board of MFS from 1992 through 1996. Mr. Crowe is presently a director of PKS, Commonwealth Telephone and RCN.

Kevin J. O'Hara has been President of the Company since July 2000 and Chief Operating Officer of the Company since March 1998. Mr. O'Hara was also Executive Vice President of the Company from August 1997

until July 2000. Prior to that, Mr. O'Hara served as President and Chief Executive Officer of MFS Global Network Services, Inc. from 1995 to 1997, and as Senior Vice President of MFS and President of MFS Development, Inc. from October 1992 to August 1995. From 1990 to 1992, he was a Vice President of MFS Telecom, Inc. ("MFS Telecom").

R. Douglas Bradbury has been Vice Chairman of the Board since February 2000 and Executive Vice President since August 1997. Mr. Bradbury was also Chief Financial Officer of the Company from August 1997 until July 2000. Mr. Bradbury has been a director of the Company since March 1998. Mr. Bradbury served as Chief Financial Officer of MFS from 1992 to 1996, Senior Vice President of MFS from 1992 to 1995, and Executive Vice President of MFS from 1995 to 1996. Mr. Bradbury is also a director of LodgeNet Entertainment Corporation.

Charles C. Miller, III has been Vice Chairman of the Board and Executive Vice President of the Company since February 15, 2001. Prior to that, Mr. Miller was President of Bellsouth International, a subsidiary of Bellsouth Corporation from 1995 until December 2000. Prior to that, Mr. Miller held various senior level officer and management position at BellSouth from 1987.

Sureel A. Choksi has been Group Vice President and Chief Financial Officer of the Company since July 2000. Prior to that, Mr. Choksi was Group Vice President Corporate Development and Treasurer of the Company from February 2000 until August 2000. Prior to that, Mr. Choksi served as Vice President and Treasurer of the Company from January 1999 to February 1, 2000. Prior to that, Mr. Choksi was a Director of Finance at the Company from 1997 to 1998, an Associate at TeleSoft Management, LLC in 1997 and an Analyst at Gleacher & Company from 1995 to 1997.

Thomas C. Stortz has been Group Vice President, General Counsel and Secretary of the Company since February 2000. Prior to that, Mr. Stortz served as Senior Vice President, General Counsel and Secretary of the Company from September 1998 to February 1, 2000. Prior to that, he served as Vice President and General Counsel of Peter Kiewit Sons', Inc. and Kiewit Construction Group, Inc. from April 1991 to September 1998. He has served as a director of Peter Kiewit Sons', Inc., RCN, C-TEC, Kiewit Diversified Group Inc. and CCL Industries, Inc.

John F. Waters, Jr. has been Group Vice President and Chief Technology Officer of the Company since February 2000. Prior to that, Mr. Waters was Vice President, Engineering of the Company from November 1997 until February 1, 2000. Prior to that, Mr. Waters was an executive staff member of MCI Communications from 1994 to November 1997.

Mogens C. Bay has been a director of the Company since November 2000. Since January 1997, Mr. Bay has been the Chairman and Chief Executive Officer of Valmont Industries, Inc., a company engaged in the infrastructure and irrigation businesses. Prior to that, Mr. Bay was President and Chief Executive Officer of Valmont Industries from August 1993 to December 1996 as well as a director of Valmont since October 1993. Mr. Bay is also a director of PKS and ConAgra Foods, Inc.

William L. Grewcock has been a director of the Company since January 1968. Prior to the split-off, Mr. Grewcock was Vice Chairman of the Company for more than five years. He is presently a director of PKS.

Richard R. Jaros has been a director of the Company since June 1993 and served as President of the Company from 1996 to 1997. Mr. Jaros served as Executive Vice President of the Company from 1993 to 1996 and Chief Financial Officer of the Company from 1995 to 1996. He also served as President and Chief Operating Officer of CalEnergy from 1992 to 1993, and is presently a director of MidAmerican, Commonwealth Telephone, RCN and Homeservices.com, Inc.

Robert E. Julian has been a director of the Company since March 31, 1998. Mr. Julian was also Chairman of the Board of (i)Structure from 1995 until 2000. From 1992 to 1995 Mr. Julian served as Executive Vice President and Chief Financial Officer of the Company. Mr. Julian is the Chairman of the Audit Committee of the Board of Directors.

David C. McCourt has been a director of the Company since March 31, 1998. Mr. McCourt has also served as Chairman of Commonwealth Telephone and RCN since October 1997. In addition, Mr. McCourt has been the Chief Executive Officer of RCN since 1997 and Chief Executive Officer of Commonwealth Telephone from October 1997 until November 1998. From 1993 to 1997 Mr. McCourt served as Chairman of the Board and Chief Executive Officer of C-TEC.

Kenneth E. Stinson has been a director of the Company since January 1987. Mr. Stinson has been Chairman of the Board and Chief Executive Officer of Peter Kiewit Sons', Inc. since the Split-Off. Prior to the Split-Off, Mr. Stinson was Executive Vice President of the Company for more than the last five years. Mr. Stinson is also a director of Kiewit Materials Company, ConAgra Foods, Inc. and Valmont Industries, Inc.

Colin V.K. Williams has been a director of the Company since August 2000. From July 1998 until December 31, 2000, Mr. Williams was Executive Vice President of the Company and President of Level 3 International, Inc. Prior to joining the company, Mr. Williams was Chairman of WorldCom International, Inc., where he was responsible for the international communications business and the development and operation of WorldCom's fiber networks overseas. In 1993 Mr. Williams initiated and built the international operations of MFS. Prior to joining MFS, Mr. Williams was Corporate Director, Business Development at British Telecom from 1988 until 1992.

Michael B. Yanney has been a director of the Company since March 31, 1998. He has served as Chairman of the Board, President and Chief Executive Officer of America First Companies L.L.C. for more than the last five years. Mr. Yanney is also a director of Burlington Northern Santa Fe Corporation, RCN and Forest Oil Corporation.

Linda J. Adams has been Group Vice President Human Resources of the Company since February 2000. Prior to that, Ms. Adams was Vice President Human Resources of the Company from November 1998 to February 2000. Prior to that, Ms. Adams was initially Vice President of Human Resources Rent-A-Center, a subsidiary of Thorn Americas, Inc., and then Senior Vice President of Human Resources for Thorn Americas, Inc. from August 1995 until August 1998. Prior to that, Ms. Adams was Vice President of Worldwide Compensation & Benefits for PepsiCo, Inc. from August 1994 to August 1995.

Daniel P. Caruso has been Group Vice President since June 2001 and prior to that was Group Vice President Transport Services of the Company from January 2001 to June 2001. Prior to that Mr. Caruso was Group Vice President Global Customer Operations of the Company from February 2000. Prior to that, Mr. Caruso served as Senior Vice President, Network Services of the Company from October 1997 to February 2000. Prior to that, Mr. Caruso was Senior Vice President, Local Service Delivery of WorldCom from December 1992 to September 1997 and was a member of the senior management of Ameritech from June 1986 to November 1992.

Donald H. Gips has been Group Vice President Corporate Strategy of the Company since January 2001. Prior to that, Mr. Gips was Group Vice President Sales and Marketing of the Company from February 2000. Prior to that, Mr. Gips served as Senior Vice President, Corporate Development of the Company from November 1998 to February 2000. Prior to that, Mr. Gips served in the White House as Chief Domestic Policy Advisor to Vice President Gore from April 1997 to April 1998. Before working at the White House, Mr. Gips was at the Federal Communications Commission as the International Bureau Chief and Director of Strategic Policy from January 1994 to April 1997. Prior to his government service, Mr. Gips was a management consultant at McKinsey and Company.

John Neil Hobbs has been Group Vice President Global Sales, Distribution and Marketing Operations since September 2000. Prior to that, Mr. Hobbs was President, Global Accounts for Concert, a joint venture between AT&T and British Telecom from July 1999 until September 2000. Prior to that, Mr. Hobbs was Director Transition and Implementation for the formation of Concert representing British Telecom from June 1998 until July 1999. From April 1997 until June 1998, Mr. Hobbs was British Telecom's General Manager for Global Sales & Service and from April 1994 until April 1997, Mr. Hobbs was British Telecom's General Manager for Corporate Clients.

Joseph M. Howell, III has been Group Vice President Corporate Marketing of the Company since February 2000. Prior to that, Mr. Howell served as Senior Vice President, Corporate Marketing of the Company from October 1997 to February 1, 2000. Prior to that, Mr. Howell was a Senior Vice President of MFS/WorldCom from 1993 to 1997.

Michael D. Jones has served Chief Executive Officer of (i)Structure, Inc. since August 2000. Prior to that, Mr. Jones served as Group Vice President and Chief Information Officer of the Company from February 2000 to August 2000 and as Senior Vice President and Chief Information Officer of the Company from December 1998 to February 1, 2000. Prior to that, Mr. Jones was Vice President and Chief Information Officer of Corporate Express, Inc. from May 1994 to May 1998.

Brady Rafuse has been Group Vice President of the Company President of the Company's European operations since August 2001 and Senior Vice President of European Sales and Marketing since December 2000. Prior to that, Mr. Rafuse served as Head of Commercial Operations for Concert, a joint venture between AT&T and British Telecom, from September 1999 to December 2000, and in a variety of positions with British Telecom from 1987 until December 2000. His last position was as General Manager, Global Energy Sector which he held from August 1998 to September 1999 and prior to that he was Deputy General Manager, Banking Sector from April 1997 to August 1998.

Edward Van Macatee has served as Group Vice President of Global Operations of the Company since January 2001. Prior to that, Mr. Macatee was Group Vice President of Global Customer Operations of the Company from September 1999 until January 2001. Prior to that Mr. Macatee was Vice President, Network Operations of the Company from April 1998 until September 1999 and Vice President of Managed Network Services for TCI Communications, Inc.

Ronald J. Vidal has been Group Vice President Investor Relations of the Company since February 1, 2000. Prior to that, Mr. Vidal served as Senior Vice President, New Ventures of the Company from October 1997 to February 1, 2000. Prior to that, Mr. Vidal was a Vice President of MFS/WorldCom from September 1992 to October 1997. Mr. Vidal joined the Company in construction project management in July 1983.

The Board is divided into three classes, designated Class I, Class II and Class III, each class consisting, as nearly as may be possible, of one-third of the total number of directors constituting the Board. The Class I Directors consist of Walter Scott, Jr., James Q. Crowe, Mogens C. Bay, Charles C. Miller, III and Colin V.K. Williams; the Class II Directors consist of William L. Grewcock, Richard R. Jaros, Robert E. Julian and David C. McCourt; and the Class III Directors consist of R. Douglas Bradbury, Kevin J. O'Hara, Kenneth E. Stinson and Michael B. Yanney. The term of the Class I Directors will terminate on the date of the 2004 annual meeting of stockholders; the term of the Class II Directors will terminate on the date of the 2002 annual meeting of stockholders; and the term of the Class III Directors will terminate on the date of the 2003 annual meeting of stockholders. At each annual meeting of stockholders, successors to the class of directors whose term expires at that annual meeting will be elected for three-year terms. The Company's officers are elected annually to serve until each successor is elected and qualified or until his death, resignation or removal.

## **Employees**

As of December 31, 2001, Level 3 had 3,178 employees in the communications portion of its business and (i)Structure had approximately 549 employees, for a total of 3,727 employees. These numbers do not include the employees of Corporate Software, since this transaction closed on March 13, 2002. Corporate Software has approximately 800 employees worldwide.

## **ITEM 2. PROPERTIES**

The Company's headquarters are located on 46 acres in the Northwest corner of the Interlocken Advanced Technology Environment within the City of Broomfield, Colorado, and within Broomfield County, Colorado. The campus facility encompasses over 850,000 square feet of office space. In addition, the Company has leased approximately 40,000 square feet of temporary office space in the Broomfield, Colorado area. In Europe, the Company has approximately 211,000 square feet of office space in the United Kingdom, approximately 59,000 square feet of office space in Germany, and approximately 14,000 square feet of office space in France. In addition, the Company is in the process of selling 340,000 square feet of excess office space located in the City of Broomfield, Colorado.

Properties relating to the Company's coal mining segment are described under "ITEM 1. BUSINESS - The Company's Other Businesses" above. In connection with certain existing and historical operations, the Company is subject to environmental risks.

The Company's Gateway facilities are being designed to house local sales staff, operational staff, the Company's transmission and IP routing/switching facilities and technical space to accommodate colocation of equipment by high-volume Level 3 customers. The Company has approximately 5.8 million square feet of space for its Gateway and transmission facilities and has completed construction on approximately 3.3 million square feet of this space.

(i)Structure also maintains its corporate headquarters in approximately 25,000 square feet of office space in the Broomfield, Colorado area and leases approximately 16,000 square feet of office space in Omaha, Nebraska. The computer outsourcing business of (i)Structure is located at an 89,000 square foot office space in Omaha and at a 60,000 square foot computer center in Tempe, Arizona. (i)Structure maintains additional office space in Bangalore, India (approximately 18,000 square feet) and several locations in the United Kingdom (approximately 21,000 square feet) for its systems integration business.

The Company has announced that it is evaluating its requirements for office and technical space and may seek to dispose of excess office and technical space in the future.

### **ITEM 3. LEGAL PROCEEDINGS**

In May 2001, a subsidiary of the Company was named as a defendant in *Bauer, et. al. v. Level 3 Communications, LLC, et al.*, a purported multi-state class action, filed in the U.S. District Court for the Southern District of Illinois and in July 2001, the Company was named as a defendant in *Koyle, et. al. v. Level 3 Communications, Inc., et. al.*, a purported multi-state class action filed in the U.S. District Court for the District of Idaho. Both of these actions involve the Company's right to install its fiber optic cable network in easements and right-of-ways crossing the plaintiffs' land. In general, the Company obtained the rights to construct its network from railroads, utilities, and others, and is installing its network along the rights-of-way so granted. Plaintiffs in the purported class actions assert that they are the owners of lands over which the Company's fiber optic cable network passes, and that the railroads, utilities, and others who granted the Company the right to construct and maintain its network did not have the legal ability to do so. The action purports to be on behalf of a class of owners of land in multiple states over which the Company's network passes or will pass. The complaint seeks damages on theories of trespass, unjust enrichment and slander of title and property, as well as punitive damages. The Company has also received, and may in the future receive, claims and demands related to rights-of-way issues similar to the issues in the these cases that may be based on similar or different legal theories. Although it is too early for the Company to reach a conclusion as to the ultimate outcome of these actions, 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 them 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, future results of operations, or future cash flows.

### **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

No matters were submitted during the fourth quarter of the fiscal year covered by this report to a vote of security holders, through the solicitation of proxies or otherwise.



## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Market Information. The Company's common stock is traded on the Nasdaq National Market under the symbol "LVLT." As of March 8, 2002, there were approximately 6,220 holders of record of the Company's common stock, par value \$.01 per share. The table below sets forth, for the calendar quarters indicated, the high and low per share closing sale prices of the common stock as reported by the Nasdaq National Market.

	High	Low
Year Ended December 31, 2001		
First Quarter.....	\$49.69	\$15.50
Second Quarter.....	18.44	4.53
Third Quarter.....	5.48	3.14
Fourth Quarter.....	7.32	1.98
Year Ended December 31, 2000		
First Quarter.....	\$130.19	\$73.81
Second Quarter.....	98.50	66.50
Third Quarter.....	92.44	59.50
Fourth Quarter.....	75.23	26.88

Dividend Policy. The Company's current dividend policy, in effect since April 1, 1998, is to retain future earnings for use in the Company's business. As a result, management does not anticipate paying any cash dividends on shares of Common Stock in the foreseeable future. In addition, the Company is effectively restricted under certain debt covenants from paying cash dividends on shares of its Common Stock.

## ITEM 6. SELECTED FINANCIAL DATA

The Selected Financial Data of Level 3 Communications, Inc. and its Subsidiaries appears below.

	Fiscal Year Ended (1)				
	2001	2000	1999	1998	1997
	(dollars in millions, except per share amounts)				
Results of Operations:					
Revenue.....	\$1,533	\$ 1,184	\$ 515	\$ 392	\$ 332
Earnings (loss) from continuing operations (2).....	(5,448)	(1,407)	(482)	(128)	83
Net earnings (loss) (3).....	(4,978)	(1,455)	(487)	804	248
Per Common Share:					
Earnings (loss) from continuing operations (2).....	(14.58)	(3.88)	(1.44)	(0.43)	0.33
Net earnings (loss) (3).....	13.32)	(4.01)	(1.46)	2.66	0.37
Dividends (4).....	-	-	-	-	-
Financial Position:					
Total assets.....	9,316	14,919	8,906	5,522	2,776
Current portion of long-term debt.....	7	7	6	5	3
Long-term debt, less current portion (5).....	6,209	7,318	3,989	2,641	137
Stockholders' equity (deficit) (6).....	(65)	4,549	3,405	2,165	2,230

(1) The financial position and results of operations of the former construction and mining management businesses ("Construction Group") of Level 3 have been classified as discontinued operations due to the March 31, 1998 split-off of Level 3's Construction Group from its other businesses.

Level 3 sold its energy segment to MidAmerican Energy Holdings Company ("MidAmerican") in 1998 and classified it as discontinued operations within the financial statements.

The operating results of the Company's Asian operations for all periods are included in discontinued operations in the statement of operations due to the sale to Reach Ltd. in January 2002.

Certain prior year amounts have been reclassified to conform to current year presentation.

(2) Level 3 incurred significant expenses in conjunction with the expansion of its communications and information services business beginning in 1998.

In 2000, 1999 and 1998, RCN Corporation issued stock in public offerings and for certain transactions. These transactions reduced the Company's ownership in RCN to 31%, 35% and 41% at December 31, 2000, 1999 and 1998, respectively, and resulted in pre-tax gains to the Company of \$95 million, \$117 million and \$62 million in 2000, 1999 and 1998, respectively.

In 1998, Level 3 acquired XCOM Technologies, Inc. and its developing telephone-to-IP network bridge technology. Level 3 recorded a \$30 million nondeductible charge against earnings for the write-off of in-process research and development acquired in the transaction.

In 1998, Cable Michigan, Inc. was acquired by Avalon Cable of Michigan, Inc. Level 3 received approximately \$129 million for its shares of Cable Michigan, Inc. in the disposition and recognized a pre-tax gain of approximately \$90 million.

In 2001, Level 3 recorded a \$3.2 billion impairment charge to reflect the reduction in the carrying amount of certain of its communications assets in accordance with SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets".

(3) In 1998, Level 3 recognized a gain of \$608 million equal to the difference between the carrying value of the Construction Group and its fair value. No taxes were provided on this gain due to the tax-free nature of the

split-off. Level 3 also recognized in 1998 an after-tax gain of \$324 million on the sale of its energy segment to MidAmerican.

In 2001, the Company recorded an impairment charge of \$516 million related to its discontinued Asian operations sold in January 2002. Losses attributable to the Asian operations were \$89 million, \$48 million, \$5 million, \$- million and \$- million for fiscal 2001, 2000, 1999, 1998 and 1997, respectively.

In 2001, Level 3 also recognized an extraordinary gain of \$1.1 billion as a result of the early extinguishment of long-term debt.

(4) The Company's current dividend policy, in effect since April 1998, is to retain future earnings for use in the Company's business. As a result, management does not anticipate paying any cash dividends on shares of common stock in the foreseeable future. In addition, the Company is effectively restricted under certain covenants from paying cash dividends on shares of its common stock.

(5) In 1998, Level 3 issued \$2 billion of 9.125% Senior Notes due 2008 and received net proceeds of \$500 million from the issuance of \$834 million principal amount at maturity of 10.5% Senior Discount Notes due 2008.

In 1999, Level 3 received \$798 million of net proceeds from an offering of \$823 million aggregate principal amount of its 6% Convertible Subordinated Notes Due 2009. In addition, Level 3 and certain Level 3 subsidiaries entered into a \$1.375 billion senior secured credit facility. Level 3 borrowed \$475 million in 1999 under the senior secured credit facility.

In 2000, Level 3 received net proceeds of approximately \$3.2 billion from the offering of \$863 million in convertible subordinated notes, \$1.4 billion in three tranches of U.S. dollar denominated senior debt securities, \$780 million from two tranches of Euro denominated senior debt securities and \$233 million from mortgage financings.

In 2001, the Company negotiated an increase in the total amount available under its senior secured credit facility to \$1.775 billion and borrowed \$650 million under the facility. Also in 2001, the Company repurchased, using cash and common stock, approximately \$1.9 billion face amount of its long-term debt and recognized an extraordinary gain of approximately \$1.1 billion as a result of the early extinguishment of debt.

(6) In 1999, the Company received approximately \$1.5 billion of net proceeds from the sale of 28.75 million shares of its Common Stock.

In 2000, the Company received approximately \$2.4 billion of net proceeds from the sale of 23 million shares of its Common Stock.

In 2001, the Company issued approximately 15.9 million shares of common stock, valued at approximately \$72 million, to repurchase long-term debt.

## **ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

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 Level 3 Communications, Inc. and its subsidiaries ("Level 3" or the "Company"). When used in this document, the words "anticipate", "believe", "plans", "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. See "Cautionary Factors That May Affect Future Results."

The following discussion and analysis of financial condition and results of operations should be read in conjunction with the Consolidated Financial Statements and accompanying notes beginning on page F-1 of this annual report.

### **Critical Accounting Policies**

The Company has identified the policies below as critical to its business operations and the understanding of its results of operations. The effect and any associated risks related to these policies on the Company's business operations is discussed throughout Management's Discussion and Analysis of Financial Condition and Results of Operations where these policies affect the Company's reported and expected financial results.

#### **Revenue**

Revenue for communications services, including private line, wavelengths, colocation, Internet access, managed modem and dark fiber revenue from contracts entered into after June 30, 1999, is recognized monthly as the services are provided. Reciprocal compensation revenue is recognized only when an interconnection agreement is in place with another carrier, and the relevant regulatory authorities have approved the terms of the agreement. Revenue attributable to leases of dark fiber pursuant to indefeasible rights-of-use agreements ("IRUs") that qualify for sales-type lease accounting, and were entered into prior to June 30, 1999, is recognized at the time of delivery and acceptance of the fiber by the customer. Certain sale and long-term IRU agreements of dark fiber and capacity entered into after June 30, 1999 are required to be accounted for in the same manner as sales of real estate with property improvements or integral equipment which results in the deferral of revenue recognition over the term of the agreement (currently up to 20 years).

Accounting practice and guidance with respect to the accounting treatment of the above transactions is evolving. Any changes in the accounting treatment could affect the manner in which the Company accounts for revenue and expenses associated with these agreements in the future.

#### **Non-Cash Compensation**

The Company applies the expense recognition provisions of SFAS No. 123, "Accounting for Stock Based Compensation" ("SFAS No. 123"). Most companies do not follow the expense recognition provisions of SFAS No. 123; rather, they disclose the information only on a pro-forma basis. As a result, these pro-forma disclosures must be considered when comparing the Company's results of operations to that reported by other companies. Under SFAS No. 123, the fair value of an option or other stock-based compensation (as computed in accordance with accepted option valuation models) on the date of grant is amortized over the vesting periods of the options in accordance with FASB Interpretation No. 28 "Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans" ("FIN 28"). Although the recognition of the value of the instruments results in compensation or professional expenses in an entity's financial statements, the expense differs from other compensation and professional expenses in that these charges, though permitted to be settled in cash, are generally settled through issuance of common stock, which would have a dilutive impact upon per share net income or loss, if and when such shares are exercised.

## Long-Lived Assets

Property and equipment is stated at cost, reduced by provisions to recognize economic impairment in value when management determines that events have occurred that require an analysis of potential impairment. Costs associated directly with the uncompleted network and the development of business support systems, including employee related costs, and interest expense incurred during the construction period are capitalized. Intercity network segments, gateway facilities, local networks and operating equipment that have been placed in service are being depreciated over their estimated useful lives, primarily ranging from 3-25 years. The total cost of a business support system is amortized over a useful life of three years. When assets are sold, retired or otherwise disposed of, the cost and related accumulated depreciation are eliminated from the accounts and the gain or loss is recognized.

The Company evaluates the carrying value of long-lived assets, including property and equipment, whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss exists when estimated undiscounted cash flows attributable to the assets are less than their carrying amount. If an asset is deemed to be impaired, the amount of the impairment loss recognized represents the excess of the asset's carrying value as compared to its estimated fair value, based on management's assumptions and projections. The Company recorded an impairment charge of \$3.2 billion in 2001 to write down the carrying amount of its North American and European conduits, its colocation assets and its transoceanic cable systems to their estimated fair value as these telecommunications assets were identified as being excess, obsolete or carried at values that may not be recoverable due to an adverse change in the extent in which these assets were being utilized caused by the unfavorable business climate within the telecommunications industry.

## New Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board, ("FASB"), issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"). SFAS No. 133, as amended by SFAS Nos. 137 and 138, is effective for fiscal years beginning January 1, 2001. SFAS No. 133 requires that all derivative instruments be recorded on the balance sheet at fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and, if it is, the type of hedge designated by the transaction. The Company currently makes minimal use of derivative instruments as defined by SFAS No. 133. Derivative instruments, as defined by SFAS No. 133, held by the Company at December 31, 2001 include an interest rate cap with a market value of less than \$1 million. The Company did not designate the interest rate cap as part of a hedge transaction. The adoption of SFAS No. 133 has not had a material effect on the Company's results of operations or its financial position.

In June 2001, the FASB issued SFAS No. 141, "Business Combinations" ("SFAS No. 141"). SFAS No. 141 requires all business combinations initiated after June 30, 2001, to be accounted for using the purchase method of accounting. Prior to the issuance of SFAS No. 141, companies accounted for mergers and acquisitions using one of two methods; pooling of interests or the purchase method. Level 3 has accounted for acquisitions using the purchase method and does not believe the issuance of SFAS No. 141 will have a material effect on the Company's future results of operations or financial position.

In June 2001, the FASB also issued SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"). SFAS No. 142 is effective for fiscal years beginning January 1, 2002. SFAS No. 142 requires companies to segregate identifiable intangible assets acquired in a business combination from goodwill. The remaining goodwill is no longer subject to amortization over its estimated useful life. However, the carrying amount of the goodwill must be assessed at least annually for impairment using a fair value based test. Goodwill attributable to equity method investments will also no longer be amortized but is still subject to impairment analysis using existing guidance for equity method investments. For the goodwill and intangible assets in place as of December 31, 2001, the Company does not believe the adoption of SFAS No. 142 will have a material effect on the Company's results of operations or its financial position. The Company believes the impact of SFAS No. 142 will not have a material impact on accounting for future acquisitions as the new standard generally results in more amortized intangible assets and less non-amortized goodwill.

In June 2001, the FASB also approved SFAS No. 143, "Accounting for Asset Retirement Obligations" ("SFAS No. 143"). SFAS No. 143 establishes accounting standards for recognition and measurement of a liability

for an asset retirement obligation and the associated asset retirement cost. The fair value of a liability for an asset retirement obligation is to be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated retirement costs are capitalized and included as part of the carrying value of the long-lived asset and amortized over the useful life of the asset. SFAS No. 143 will be effective for the Company beginning on January 1, 2003. The Company expects that its coal mining business will be affected by this standard and is currently evaluating the impact of SFAS No. 143 on its future results of operations and financial position.

In August 2001, the FASB issued SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"), which the Company elected to early adopt during the fourth quarter of 2001 with retroactive application as of January 1, 2001. SFAS No. 144 supersedes SFAS No. 121, but retains its requirements to (a) recognize an impairment loss only if the carrying amount of a long-lived asset is not recoverable from its undiscounted cash flows and (b) measure an impairment loss as the difference between the carrying amount and the estimated fair value of the asset. It removes goodwill from its scope and, therefore, eliminates the requirement to allocate goodwill to long-lived assets to be tested for impairment. It also describes a probability-weighted cash flow estimation approach to deal with situations in which alternative courses of action to recover the carrying amount of a long-lived asset are under consideration or a range is estimated for possible future cash flows. It requires that a long-lived asset to be abandoned, exchanged for a similar productive asset, or distributed to owners in a spin-off be considered held and used until it is disposed of. In these situations, SFAS No. 144 requires that an impairment loss be recognized at the date a long-lived asset is exchanged for a similar productive asset or distributed to owners in a spin-off if the carrying amount of the asset exceeds its fair value. The Company monitored and reviewed long-lived assets for possible impairment in accordance with SFAS No. 121 prior to the adoption of SFAS No. 144. Since SFAS No. 144 retains similar requirements as SFAS No. 121 for recognizing and measuring any impairment loss, the adoption of SFAS No. 144 did not have a significant effect on the Company's procedures for monitoring and reviewing long-lived assets for possible impairment. SFAS No. 144 also retains the basic provisions of APB Opinion No. 30 "Reporting the Results of Operations" for the presentation of discontinued operations in the income statement but broadens the definition of a discontinued operation such that a component of an entity (rather than a segment of a business) would be considered to be a discontinued operation if the operations and cash flows of the component will be eliminated from the ongoing operations of the company and the company will not have any significant continuing involvement in the operations of the component. A component of an entity comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. The adoption of SFAS No. 144 in 2001 had a significant impact on the accounting presentation of the sale of the Asian communications business as this business would not have qualified for treatment as a discontinued operation under APB Opinion No. 30, since it would not have qualified as a business segment.

### Results of Operations 2001 vs. 2000

The operating results of the Company's Asian operations are included in discontinued operations for all periods presented due to their sale to Reach Ltd. in January 2002. Certain prior year amounts have been reclassified to conform to current year presentation.

Revenue for 2001 and 2000 is summarized as follows (in millions):

	2001	2000
Communications.....	\$ 1,298	\$ 857
Information Services.....	123	115
Coal Mining.....	87	190
Other.....	25	22
	-----	-----
	\$ 1,533	\$ 1,184
	=====	=====

Communications revenue increased in 2001 by 51% compared to 2000. Included in total communications revenue of \$1.298 billion for 2001 was \$876 million of services revenue which includes private line, wavelengths, colocation, managed modem and amortized dark fiber revenue, \$288 million of non-recurring revenue from dark fiber contracts entered into before June 30, 1999 for which sales- type lease accounting was used and \$134 million attributable to reciprocal compensation. Communications revenue for 2000 was comprised of \$593 million of

services revenue, \$209 million of non-recurring revenue from dark fiber and \$55 million of reciprocal compensation. The increase in services revenue from 2000 was primarily due to growth in both existing customers as well as new customer contracts. Services revenue in 2000 includes revenue of \$105 million related to submarine systems, primarily from the completion of the Company's transatlantic submarine cable and subsequent sale to Viatel Inc. in November of 2000. Due to the current economic conditions of the telecommunications industry, the Company has experienced a significant increase in the number of customers disconnecting or terminating service and believes that as much as 25% of its recurring revenue base as of December 31, 2001, consists of financially weaker customers. Approximately 80% of these customers are expected to disconnect services during the first six months of 2002. These terminations, if they occur, will result in slower growth of services revenue for 2002. For some of these customers, Level 3 is able to negotiate and collect termination penalties. Level 3 recognized \$57 million of revenue in 2001 for early termination of services. Level 3 recorded in services revenue in 2001, \$35 million of revenue for construction management services provided to other communications companies. The dark fiber revenue reflects the substantial completion of the intercity network. Dark fiber revenue under sales-type lease accounting is expected to be insignificant in 2002 as the last remaining segments sold prior to June 30, 1999 were delivered to and accepted by customers in the fourth quarter of 2001. The increase in reciprocal compensation in 2001 is a result of increased managed modem usage and the Company receiving regulatory approval from several states regarding its agreements with SBC Communications Inc. and BellSouth. These agreements established a rate structure for transmission and switching services provided by one carrier to complete or carry traffic originating on another carrier's network. It is the Company's policy not to recognize revenue from these agreements until the relevant regulatory authorities approve the agreements. Certain interconnection agreements with carriers expire in the second half of 2002 and in 2003. To the extent that the Company is unable to sign new interconnection agreements, reciprocal compensation revenue may decline significantly over time.

Level 3 was a party to seven non-monetary exchange transactions in 2001 whereby it sold IRUs, other capacity, or other services to a company from which Level 3 received communications assets or services. In total these exchanges accounted for \$24 million or less than 2% of total communications revenue in 2001 and in each case, provided needed network capacity or redundancy on unprotected transmission routes. The value of these non-monetary transactions was determined using similar transactions for which cash consideration was received. Level 3 recognized no revenue from non-monetary exchange transactions in 2000.

Information services revenue, which is comprised of applications and outsourcing businesses, increased from \$115 million in 2000 to \$123 million in 2001. The increase is primarily attributable to outsourcing revenue which increased to \$85 million for the year ended December 31, 2001 compared to \$65 million for the same period in 2000. The increase in outsourcing revenue is primarily due to new long-term contracts signed in the second half of 2000. Revenue attributable to the applications business declined due to the expiration of certain contracts. If the applications business is unable to generate new sales in 2002, revenue is expected to decline further as a significant customer has notified the Company that it will not be extending its contract beyond June 30, 2002. Revenue attributable to this customer represented approximately 61% of total applications revenue in 2001.

The communications business generated Cash Revenue of \$2.097 billion during 2001 compared to \$1.261 billion in 2000. The Company defines Cash Revenue as communications revenue plus changes in cash deferred revenue (deferred revenue adjusted for changes in related accounts receivable) during the respective period. Communications Cash Revenue primarily reflects cash or other communications assets received for dark fiber and other capacity sales where revenue is deferred and then recognized over the term of the contract under GAAP. This increase is a result of growth in services revenue provided to existing customers, new customer contracts and cash collections from those customers. At December 31, 2001, deferred revenue increased by approximately 103% to \$1.459 billion from \$720 million at December 31, 2000. The amount of deferred revenue billed, but not collected as of the end of the year decreased from \$205 million in 2000 to \$145 million in 2001. For fiscal 2000, deferred revenue increased by \$585 million and the amount not collected increased by \$181 million. Communications Cash Revenue is not intended to represent revenue under GAAP.

	2001	2000
Communications Revenue.....	\$ 1,298	\$ 857
Change in Deferred Revenue.....	739	585
Change in Deferred Revenue Billed but not Collected.....	60	(181)
	-----	-----
Communications Cash Revenue	\$ 2,097	\$ 1,261
	=====	=====

Coal mining revenue decreased \$103 million in 2001 compared to 2000. The decrease in revenue is primarily attributable to the expiration of long-term coal contracts with Commonwealth Edison Company ("Commonwealth Edison") and the sale of the Company's interest in Walnut Creek Mining Company in September 2000.

Other revenue for 2001 was comparable to 2000 and is primarily attributable to California Private Transportation Company, L.P. ("CPTC"), the owner-operator of the SR91 tollroad in southern California.

Cost of Revenue for 2001 was \$742 million, representing a 6% decrease over 2000 cost of revenue of \$792 million. This decrease is a result of the continued migration of customers off of leased capacity to the Company's network and a decrease in the costs associated with transoceanic sales, specifically costs attributable to the Viatel transaction in 2000. Cost of revenue includes costs attributable to dark fiber and transoceanic sales and leased capacity, right-of-way costs, access charges and other third party costs directly attributable to the network. Overall the cost of revenue for the communications business, as a percentage of revenue, decreased significantly from 73% during 2000 to 46% during 2001. The decrease can again be attributed to the migration of customer traffic from a leased network to the Company's owned network and increased margins resulting from recent sales efforts focused on "on-net" services. Cost of revenue for the communications business, as a percentage of revenue, is expected to decline from 2001 levels.

The cost of revenue for the information services businesses, as a percentage of its revenue, in 2001 was 73% and approximated the 2000 figure of 77%. The cost of revenue for the coal mining business, as a percentage of revenue, was 68% for 2001 up from 40% in 2000. The increase related to coal mining is attributable to the expiration of high margin long-term coal contracts in 2000.

Depreciation and Amortization expenses were \$1.122 billion in 2001, a 94% increase from 2000 depreciation and amortization expenses of \$579 million. The majority of the increase is a direct result of the communications assets placed in service in the latter part of 2000 and 2001, including gateways, local networks and intercity segments. In addition, included in 2001 depreciation expense is \$45 million for the impairment charge on a corporate facility the Company designated as held-for-sale in June of 2001.

Depreciation expense is expected to decrease significantly in 2002 as a result of the impairment charges taken in 2001 against the colocation assets, conduits in North America and European intercity and metropolitan networks, and certain transoceanic assets. The Company will continue to review the depreciable lives of its existing telecommunications assets in order to verify that they correspond to the period of the estimated future benefits.

Selling, General and Administrative expenses were \$1.297 billion in 2001, a 17% increase over 2000. Excluding non-cash compensation expenses of \$314 million and \$236 million for 2001 and 2000, respectively, operating expenses increased 12% from the prior year. This increase is attributable to higher payroll expenses, professional fees, facilities related costs, and systems maintenance expenses, partially offset by declines in travel, mine management services and recruiting expenses. The increase in non-cash compensation is predominantly due to the convertible outperform stock options granted in 2000 and 2001. Selling, general and administrative costs for 2002 are expected to decline from 2001 levels due to the workforce reductions and cost savings initiatives implemented in 2001.

Restructuring and Impairment Charges were \$3.35 billion in 2001. The Company announced that due to the duration and severity of the economic slowdown for the telecommunications industry, it would be necessary to reduce operating expenses as well as reduce and reprioritize capital expenditures in an effort to be in a position to benefit when the economy recovers. As a result of these actions, the Company reduced its global work force by



approximately 2,200 employees in 2001, primarily in the communications business in the United States and Europe. Restructuring charges of approximately \$10 million, \$40 million and \$58 million were recorded in the first, second and fourth quarters of 2001, respectively, of which \$66 million related to staff reduction and related costs and \$42 million to real estate lease termination costs. In total, the Company has paid \$49 million in severance and related fringe benefit costs and \$1 million in lease termination costs as of December 31, 2001 for these actions. The remaining \$17 million of expenditures for workforce reductions primarily relate to approximately 200 European employees terminated in the first quarter of 2002. Lease termination obligations of \$41 million are expected to be substantially paid by June 30, 2002. The Company believes that after these restructuring charges, its cost structure will be better aligned with estimated future revenue streams.

The economic slowdown and the related capital reprioritization discussed above resulted in certain telecommunications assets being identified as excess, obsolete or carried at values that may not be recoverable due to an adverse change in the extent in which the telecommunication assets were being utilized caused by the unfavorable business climate within the telecommunications industry. As a result, in the second quarter of 2001 the Company recorded a non-cash impairment charge of \$61 million, representing the excess of the carrying value over the fair value of these assets. The fair value of the spare equipment was based on recent cash sales of similar equipment. The impaired assets were written-off, as the Company does not expect to utilize them to generate future cash flows.

In the fourth quarter of 2001, in light of the continued economic uncertainty, continued customer disconnections at higher rates than expected, increased difficulty in obtaining new revenue, and the overall slow down in the communications industry, the Company again reviewed the carrying value of its long-lived assets for possible impairment in accordance with SFAS No. 144. The Company determined based upon its projections, giving effect to the continuing economic slowdown and continued over-capacity in certain areas of the telecommunications industry, the estimated future undiscounted cash flows attributable to certain assets or assets groups would not exceed the current carrying value of the assets. The Company, therefore, recorded an impairment charge of \$3.2 billion to reflect the difference between the estimated fair value of the assets on a discounted cash flow basis and their current carrying value as further described below.

The impairments primarily relate to colocation assets, excess conduits in North America and European intercity and metropolitan networks, and certain transoceanic assets. Geographically, approximately 74% of the charges are attributable to North America, 17% are attributable to Europe and 9% attributable to transatlantic assets.

The financial problems of many of the "dot-coms", emerging carriers and competitors, a weakening economy, and changing customer focus, have led to an over-capacity of colocation space in several U.S. and European markets. Level 3 is attempting to sell or sublease its excess colocation space; however, current market rates for much of the space are below its carrying values. As a result, the Company recorded an impairment charge of approximately \$1.6 billion related to its colocation assets, which includes owned facilities, leasehold improvements and related equipment.

Level 3 constructed its networks in North America and Europe in such a way that they could be continuously upgraded to the most current technology without affecting its existing customers. Level 3 also installed additional conduits with the intention of selling them to other carriers. To date, the Company has sold one conduit in its North American network and, due to the current economic environment and decreasing capital expenditure budgets of potential buyers, does not expect additional sales in the foreseeable future. For this reason the Company has recorded an impairment charge of approximately \$1.2 billion for the conduits that were previously determined to be available for sale to third parties based on estimated cash flows from the disposition of the conduits.

The completion of several systems in the second half of 2001 and the expected completion of additional systems in 2002, have resulted in an over abundance of transoceanic capacity. This excess capacity, combined with limited demand, have adversely affected the transoceanic capacity markets. At current pricing levels, the Company does not believe it will recover its investment in transoceanic capacity from the future cash flows of these assets. As a result, the Company has recorded an impairment charge of approximately \$320 million for its transatlantic submarine assets.

The Company also recorded an impairment charge of approximately \$65 million for spare equipment write-downs and abandoned lateral builds in the fourth quarter of 2001.

EBITDA, as defined by the Company, consists of earnings (losses) before interest, income taxes, depreciation, amortization, non-cash operating expenses (including stock-based compensation and impairment charges) and other non-operating income or expenses. The Company excludes non-cash stock compensation due to its adoption of the expense recognition provisions of SFAS No. 123. EBITDA improved to a loss of \$300 million in 2001 from a loss of \$482 million in 2000. Excluding the \$108 million of restructuring charges recorded in 2001, EBITDA would have been a loss of \$192 million for 2001. The improvement in EBITDA is predominantly due to revenue growth and higher margins earned by the communications business.

Adjusted EBITDA, as defined by the Company, is EBITDA as defined above plus the change in cash deferred revenue and excluding the non-cash cost of goods sold associated with certain capacity sales and dark fiber contracts. For 2001, Adjusted EBITDA was \$659 million compared to \$118 million for 2000. The increase, in addition to the higher margins noted above, can be attributed to up-front cash payments received from customers for contracts that require revenue to be recognized over the term of the contract.

	2001	2000
EBITDA .....	\$ (300)	\$ (482)
Change in Deferred Revenue.....	739	585
Change in Deferred Revenue Billed but not Collected.....	60	(181)
Non-cash Cost of Goods Sold.....	160	196
	-----	-----
Adjusted EBITDA	\$ 659	\$ 118
	=====	=====

EBITDA and Adjusted EBITDA are not intended to represent operating cash flow or profitability for the periods indicated and are not calculated in accordance with GAAP. See Consolidated Statement of Cash Flows.

Interest Income declined from \$328 million in 2000 to \$161 million in 2001. The decrease is primarily attributable to the average cash and marketable securities balance declining from \$5.7 billion during 2000 to \$3.1 billion for 2001. In February 2000, the Company raised approximately \$5.5 billion in cash through debt and equity offerings. The Company has subsequently utilized these proceeds to fund its business plan and repurchase outstanding debt. In addition, the weighted average interest rate earned on the portfolio decreased by approximately 120 basis points for 2001 versus 2000. The Company expects interest income to continue to decline in 2002 due to utilization of funds to repurchase debt, pay operating and interest expenses, and fund capital expenditures, as well as lower interest rates. Pending utilization of the cash, cash equivalents and marketable securities, the Company invests the funds primarily in government and government agency securities. The investment strategy will provide lower yields on the funds, but is expected to reduce the risk to principal in the short term prior to using the funds in implementing the Company's business plan.

Interest Expense, net increased to \$646 million from \$282 million in 2001 compared to 2000. The interest expense and amortization of debt issuance costs associated with the debt raised in late February 2000, the commercial mortgages entered into during the latter half of 2000, and the increase in the size of the Senior Secured Credit Facility in the first quarter of 2001 all contributed to the increase in interest expense. Additionally, the increase can be attributed to a decrease in the amount of interest capitalized in 2001 as compared to 2000. The Company completed a significant portion of the network and other communications related facilities during 2001, therefore reducing the amount of interest capitalized. Capitalized interest was \$58 million in 2001 versus \$353 million in 2000. Partially offsetting these increases was the retirement of approximately \$1.9 billion face amount of debt in the third and fourth quarters of 2001 and lower variable interest rates attributable to the senior secured credit facility and GMAC mortgage.

Interest expense is expected to decline in future periods as a result of the convertible subordinated debt repurchased during the third quarter of 2001 and the senior debt and convertible subordinated debt securities repurchased in the "Modified Dutch Auction" completed in October of 2001. These transactions are expected to reduce annualized interest expense and annualized cash interest expense by approximately \$175 million and \$160 million, respectively.

Equity in Earnings (Losses) of Unconsolidated Subsidiaries was earnings of \$16 million in 2001, compared to loss of \$284 million in 2000. The equity losses in 2000 are predominantly attributable to RCN Corporation ("RCN"). RCN is a facilities-based provider of communications services to the residential markets primarily on the East and West coasts as well as in Chicago. RCN is also the largest regional Internet service provider in the Northeast. RCN is incurring significant costs in developing its business plan. The Company's proportionate share of RCN's losses exceeded the remaining carrying value of Level 3's investment in RCN during the fourth quarter of 2000. Level 3 does not have additional financial commitments to RCN; therefore it only recognized equity losses equal to its investment in RCN. The Company will not record any equity in RCN's future profits, until unrecorded equity losses have been offset. The Company did not recognize \$249 million and \$20 million of equity losses attributable to RCN in 2001 and 2000, respectively. Level 3 recorded equity losses attributable to RCN of \$260 million for the twelve months ended December 31, 2000.

Equity in earnings/losses of Commonwealth Telephone Enterprises, Inc. ("Commonwealth Telephone") were earnings of \$16 million in 2001 and losses of \$24 million in 2000. In 2000, Commonwealth Telephone recognized losses primarily due to a charge for the restructuring of its CTCI subsidiary. As a result, Level 3 recorded a \$27 million charge, in equity in earnings (losses) of unconsolidated subsidiaries, for its proportionate share of this charge. In 2001, Commonwealth Telephone, in addition to improved operating results, was also able to recognize a one-time benefit related to the settlement of certain restructuring liabilities recorded in 2000.

Gain on Equity Investee Stock Transactions was \$100 million for the twelve months ended December 31, 2000. Specifically, RCN issued stock for certain transactions, which diluted the Company's ownership interest. The pre-tax gains resulted from the increase in the Company's proportionate share of RCN's net assets related to these transactions. The Company did not record any gains on equity investee stock transactions during 2001 due to the suspended equity losses attributable to RCN.

Other, net increased from a loss of \$21 million for 2000 to a gain of \$2 million for 2001. In 2001, Other, net includes a charge for an other-than temporary decline in the value of investments of \$37 million and \$27 million of gains when divine, inc. agreed to release Level 3 from a deferred revenue obligation. Additionally, the Company recorded losses of \$19 million in 2001 related to losses on certain fixed asset disposals and \$31 million of other items, primarily \$17 million of realized gains from the sale of Euro denominated marketable securities. In 2000, Other, net is primarily comprised of a \$22 million gain from the sale of the Company's 50% ownership interest in the Walnut Creek Mining Company and a loss of \$37 million from the other-than temporary decline in the value of investments.

Level 3 announced in March 2002, that it intends to sell 4,025,000 shares of Commonwealth Telephone that it currently holds. If this sale occurs, Level 3 will recognize a significant gain on the disposition of these shares.

Income Tax Benefit for 2001 was zero as a result of the Company exhausting the taxable income in the carryback period in 2000. As of December 31, 2001, Level 3 had approximately \$1.8 billion of net operating loss carryforwards available to offset future taxable income. At this time, the Company is unable to determine when it will have taxable income to offset the loss carryforwards. The tax benefit for 2000 differs from the statutory rate due to the limited availability of taxable income in the carryback period for which current year losses can be offset.

On March 9, 2002, legislation was enacted that will enable the Company to carry its taxable net operating losses back five years. As a result, the Company expects to receive a Federal income tax refund of approximately \$120 million after it files its 2001 Federal income tax return carrying back the taxable loss to 1996. This benefit will be reflected in the first quarter 2002 financial statements in accordance with SFAS No. 109 "Accounting for Income Taxes".

Discontinued Operations includes the results of operations and the estimated loss on the disposal of Level 3's Asian assets. On December 19, 2001, Level 3 announced that it had agreed to sell its Asian telecommunications business to Reach Ltd. for no cash consideration. The agreement covers subsidiaries that include the Asian network operations, assets, liabilities and future financial obligations. This includes Level 3's share of the Northern Asian cable system, capacity on the Japan-US cable system, capital and operational expenses related to these two systems, gateways in Hong Kong and Tokyo, and existing customers on Level 3's Asian

network. Level 3 estimates that this transaction will reduce its future funding requirements by approximately \$300 million through a combination of reductions in capital expenditures, network and operating expenses, taxes and working capital.

The transaction closed on January 18, 2002. As of December 31, 2001, the net carrying value of Level 3's Asian assets was approximately \$465 million. In accordance with SFAS No. 144, Level 3 recorded an impairment loss, within discontinued operations, equal to the difference between the carrying value of the assets and their fair value. Based upon the terms of the sale agreement, the Company also accrued \$51 million in certain remaining capital obligations it assumed for the two submarine systems to be sold to Reach, and estimated transaction costs. The losses from the discontinued Asian operating activities in 2001 and 2000 were \$89 million and \$48 million, respectively. The higher losses are primarily attributable to increases in depreciation expense and selling, general and administrative expenses.

Extraordinary Gain on Debt Extinguishment was \$1.1 billion for the twelve months ended December 31, 2001. The Company recognized gains of approximately \$117 million, after transaction and debt issuance costs, when it exchanged approximately 15.9 million shares of common stock, valued at approximately \$72 million, for \$194 million of its convertible subordinated notes in several private transactions. The Company also recognized gains of approximately \$967 million when it repurchased approximately \$1.7 billion of debt for approximately \$731 million in cash, including accrued interest, through the Modified Dutch Auction completed in October of 2001. Offsetting these gains were losses of \$9 million from the write-off of debt issuance costs and prepayment expenses CPTC incurred to refinance its long-term debt.

Level 3 continued to repurchase debt in January and February of 2002 using cash and equity. The Company expects to recognize an extraordinary gain of approximately \$130 million in the first quarter of 2002 as a result of the transactions completed through March 13, 2002.

### Results of Operations 2000 vs. 1999

Revenue for the years ended December 31, 2000 and December 31, 1999 is summarized as follows (in millions):

	2000	1999
Communications.....	\$ 857	\$ 159
Information Services.....	115	130
Coal Mining.....	190	207
Other.....	22	19
	-----	-----
	\$ 1,184	\$ 515
	=====	=====

Communications revenue increased by 439% to \$857 million in 2000. In 2000, the Company generated services revenue, including private line, wavelengths, colocation, managed modem, and dark fiber revenue associated with contracts entered into after June 30, 1999, of \$593 million compared to \$100 million in 1999. The completion of several metropolitan networks and Gateways in the United States and Europe are primarily responsible for the increase. At December 31, 2000, Level 3 had local networks in 32 domestic and international cities and Gateway facilities in 60 markets. This compares to 25 local networks and 31 Gateways at the end of 1999. Level 3 also recognized revenue of \$105 million related to submarine systems, primarily from the completion of its transatlantic submarine cable and subsequent sale to Viatel Inc. in November of 2000. Dark fiber sales for contracts entered into before June 30, 1999 increased from \$35 million in 1999 to \$209 million in 2000. This is a result of a significant portion of Level 3's North American intercity network being completed in 2000. Also included in 2000 communications revenue was \$55 million of reciprocal compensation revenue from executed and approved interconnection agreements compared to \$24 million in 1999. Level 3 reached an agreement with SBC Communications, Inc. in January 2001 which establishes a rate structure for transmission and switching services provided by one carrier to complete or carry traffic originating on another carrier's network. The implementation of the rate structure and reciprocal compensation billing settlement is contingent upon certain conditions including approval by relevant regulatory authorities. Level 3 did not recognize any revenue related to

this agreement in 2000. Information services revenue declined by \$15 million in 2000 to \$115 million. This decline is primarily attributable to Year 2000 computer processing and consulting work completed in 1999.

The communications business generated Cash Revenue of \$1.26 billion in 2000. In addition to revenue, the Company includes the change in the cash portion of deferred revenue in its definition of Cash Revenue. The increase in cash deferred revenue for the communications business for the year was \$404 million and is in part due to the implementation of FIN 43 which requires the Company to defer the recognition of certain dark fiber contracts and IRU sales over the term of the agreement, typically 10-20 years. For these types of agreements, the Company normally receives a deposit at the time the contract is signed and the remainder when the fiber is delivered and accepted by the customer. In 1999, Cash Revenue for the communications business was \$243 million.

	2000	1999
Communications Revenue.....	\$ 857	\$ 159
Change in Deferred Revenue.....	585	108
Change in Deferred Revenue Billed but not Collected.....	(181)	(24)
	-----	-----
Communications Cash Revenue	\$ 1,261	\$ 243
	=====	=====

Coal Mining revenue declined approximately 8% in 2000 from \$207 million in 1999 to \$190 million in 2000. Coal revenue was expected to decline in 2000 as a result of the reduced shipments under long-term coal contracts and the sale of the Company's entire interest in Walnut Creek Mining Company.

Other revenue in 2000 approximated 1999 revenue and is primarily attributable to California Private Transportation Company, L.P.

Cost of Revenue for 2000 was \$792 million, representing a 120% increase over 1999 cost of revenue of \$360 million as a result of the expanding communications business. Overall the cost of revenue for the communications business, as a percentage of revenue, decreased significantly from 115% during 1999 to 73% for 2000. This decrease is attributed to the expanding communications business. The Company recognized \$196 million of costs associated with dark fiber and transoceanic cable sales in 2000. The cost of revenue for the information services businesses, as a percentage of its revenue, was 77% for 2000 compared to 65% for 1999. Lower margins on new contracts and the omission of Year 2000 related work resulted in the decline in margins. The cost of revenue for the coal mining business, as a percentage of revenue, was 40% for 2000 and 45% in 1999. In December 1999, Commonwealth Edison and the Company renegotiated certain coal contracts whereby Commonwealth Edison was no longer required to take delivery of its coal commitments but still must pay Level 3 the margins Level 3 would have earned had the coal been delivered.

Depreciation and Amortization expenses for 2000 were \$579 million, a 154% increase over 1999 deprecation and amortization expenses of \$228 million. This increase is a direct result of the communications assets placed in service in the later half of 1999 and throughout 2000, including Gateways, local metropolitan networks and domestic international and submarine networks.

Selling, General and Administrative expenses were \$1.1 billion in 2000, representing a 67% increase over 1999. This increase primarily results from the Company's addition of over 2,350 employees during 2000. There was a substantial increase in compensation, travel and facilities costs due to the additional employees. The Company also recorded \$236 million in non-cash compensation expense for the year ended December 31, 2000, for expenses recognized under SFAS No. 123 related to grants of stock options and warrants; \$125 million of non-cash compensation was recorded for the same period in 1999. The increase in non-cash compensation is due predominantly to an increase in the number of employees. Communications, insurance, bad debt, data processing and marketing costs also contributed to the higher selling, general and administrative expenses. In addition to the expenses noted above, the Company capitalized \$162 million and \$116 million of selling, general and administrative expenses in 2000 and 1999, respectively, which consisted primarily of compensation expense for employees and consultants working on capital projects.

EBITDA, as defined by the Company, decreased to a loss of \$482 million for the year ended December 31, 2000 from a \$383 million loss for 1999. This decrease was predominantly due to the increase in selling, general and

administrative expenses resulting from the rapid expansion of the communications business. EBITDA is commonly used in the communications industry to analyze companies on the basis of operating performance.

Adjusted EBITDA, as defined by the Company, was a \$118 million gain compared to a loss of \$282 million in 1999. An increase in cash deferred revenue of \$404 million and non-cash cost of goods sold related to transoceanic and dark fiber sales of \$196 million are primarily responsible for the improved Adjusted EBITDA figures.

	2000	1999
EBITDA.....	\$ (482)	\$ (383)
Change in Deferred Revenue.....	585	108
Change in Deferred Revenue Billed but not Collected.....	(181)	(24)
Non-cash Cost of Goods Sold.....	196	17
	-----	-----
Adjusted EBITDA	\$ 118	\$ (282)
	=====	=====

EBITDA and Adjusted EBITDA are not intended to represent operating cash flow for the periods indicated and are not GAAP. See Consolidated Statements of Cash Flows.

Interest Income was \$328 million for 2000 compared to \$212 million in 1999. This 55% increase was predominantly due to the Company's increased average cash, cash equivalents and marketable securities balances. Average cash balances increased largely due to the approximately \$5.4 billion in proceeds received from the February 29, 2000 debt and equity offerings. The Company's average cash balance also increased as a result of the September 1999 6% Convertible Subordinated Notes offering and the Senior Secured Credit Facility agreement. The increase in interest income is also due to increasing yields on the Company's investments due to increased market rates.

Interest Expense, net for 2000 of \$282 million represents a 62% increase from 1999. The substantial increase was due to the 6% Convertible Subordinated Notes issued in September 1999, the Senior Secured Credit Facility entered into in September 1999, as well as the approximately \$3 billion in debt securities issued on February 29, 2000. The amortization of the related debt issuance costs also contributed to the increased interest expense in 2000. Partially offsetting this increase was an increase in capitalized interest to \$353 million in 2000 from \$116 million in 1999.

Equity in Losses of Unconsolidated Subsidiaries was \$284 million in 2000 compared to \$127 million in 1999. The equity losses are predominantly attributable to the Company's investment in RCN. RCN is incurring significant costs in developing its business plan. The Company's share of RCN's losses, increased to \$260 million in 2000 from \$135 million in 1999. During the fourth quarter of 2000, Level 3's proportionate share of the RCN's fourth quarter losses exceeded the remaining carrying value of Level 3's investment in RCN. Level 3 does not have additional financial commitments to RCN; therefore it can only recognize equity losses equal to its investment in RCN. As of December 31, 2000, Level 3 had not recorded approximately \$20 million of equity losses attributable to RCN's fourth quarter losses. Equity losses for 2000 also include \$24 million of losses attributable to Commonwealth Telephone. In December 2000, Commonwealth Telephone announced that it was going to record a charge to earnings for the restructuring of its CTCI subsidiary. Therefore, Level 3 recorded \$27 million of equity losses, representing its proportionate share of the restructuring charge.

Gains on Equity Investee Stock Transactions was \$100 million for 2000 compared to \$118 million for 1999. RCN issued stock for the acquisition of 21st Century Telecom Group, Inc. and for certain transactions in early 2000, which diluted the Company's ownership of RCN from 35% at December 31, 1999 to 31% at December 31, 2000. These transactions diluted Level 3's ownership in RCN but increased its proportionate share of RCN's common equity. As a result, Level 3 recognized \$95 million of pre-tax gains related to RCN stock activity in 2000. In 1999, RCN issued stock in a public offering and for certain transactions, which resulted in a pre-tax gain of \$117 million to the Company. The Company does not expect to recognize future gains on RCN stock activity unless the gains exceed the accumulated net equity losses not recognized by the Company. Level 3 also recognized pre-tax gains of \$5 million and \$1 million in 2000 and 1999, respectively, for Commonwealth Telephone stock activity that diluted the Company's ownership to 46% at December 31, 2000.

Gain (Loss) on Sale of Assets decreased to a \$19 million loss in 2000. In the second half of 2000, market conditions and the valuations assigned to companies in certain Internet related sectors and the Company's view of the business prospects of such entities declined dramatically. Therefore, the Company recorded a \$37 million pre-tax charge for an other-than-temporary decline in the value of a publicly traded investment. Partially offsetting this charge was a \$21 million pre-tax gain on the sale of the Company's entire interest in the Walnut Creek Mining to Peter Kiewit Sons' Inc. Also included are gains and losses on the sale of construction and other operating equipment.

Other, net decreased to a loss of \$2 million in 2000 from a \$7 million gain in 1999. The decrease is predominately due to foreign exchange losses recorded in 2000.

Income Tax Benefit for 2000 differs from the prior year and the statutory rate primarily due to limited availability of taxable income in the carryback period to offset current year losses. The income tax benefit for 1999 differs from the statutory rate of 35% primarily due to losses incurred by the Company's international subsidiaries which cannot be included in the consolidated U.S. federal return, nondeductible goodwill amortization expense and state income taxes. For fiscal 2000, Level 3 recognized a benefit equal to the amount of refund available due to utilization of net operating loss carrybacks. As of December 31, 2000, Level 3 had approximately \$638 million of net operating loss carryforwards available to offset future taxable income.

Discontinued Operations increased from a loss of \$5 million in 1999 to a loss of \$48 million in 2000. Level 3 began operations in Asia in the latter half of 1999 and continued to expand them throughout 2000. Employee compensation and facility related costs primarily account for the increased losses.

### **Financial Condition-December 31, 2001**

The Company's working capital decreased from \$3.1 billion at December 31, 2000 to \$0.6 billion at December 31, 2001 due primarily to the use of available funds in payment of selling, general and administrative expenses, interest expense, construction of the Level 3 network and debt repurchases by Level 3 Finance, LLC. Proceeds from the Senior Secured Credit Facility borrowings in the first quarter of 2001 increased working capital.

Cash provided by operations decreased from \$1.0 billion in the twelve months ended December 31, 2000 to \$141 million in 2001. Fluctuations in the components of working capital are primarily responsible for the decline. Reductions in accounts payable and lower income tax refunds were partially offset by an increase in deferred revenue and lower receivable balances.

Investing activities include using the proceeds from the first quarter Senior Secured Credit Facility term loan borrowing and cash on hand to purchase \$1.2 billion of marketable securities and complete approximately \$2.4 billion of capital expenditures, primarily for the communications network. The Company also realized \$3.7 billion of proceeds from the sales and maturities of marketable securities and \$67 million of proceeds from the sale of certain operating assets and construction equipment, and spent \$110 million on assets held for sale.

Financing activities in 2001 consisted primarily of the net proceeds of \$636 million from the first quarter 2001 Senior Secured Credit Facility term loan borrowing for the telecommunications business. CPTC received \$125 million of net cash from its refinancing and repaid long-term debt of \$114 million. Level 3 Finance, LLC repurchased approximately \$1.7 billion face amount of debt and accrued interest for approximately \$695 million and \$36 million, respectively. In addition, Level 3, in non-cash transactions, exchanged approximately \$194 million of its convertible subordinated notes for approximately \$72 million of its common stock.

The Company invested approximately \$226 million in its discontinued Asian operations in 2001 including approximately \$178 million for capital expenditures.

### **Liquidity and Capital Resources**

The Company is a facilities-based provider (that is, a provider that owns or leases a substantial portion of the property, plant and equipment necessary to provide its services) of a broad range of integrated communications

services. The Company has created, through a combination of construction, purchase and, to a lesser extent, leasing of facilities and other assets, an advanced, international, end-to-end, facilities-based communications network. The Company has designed its network based on optical and Internet Protocol technologies in order to leverage the efficiencies of these technologies to provide lower cost communications services.

The further development of the communications business will continue to require significant expenditures. These expenditures may result in substantial negative operating cash flow and substantial net operating losses for the Company for the foreseeable future. The Company's capital expenditures in connection with its business plan were approximately \$2.3 billion during 2001. The majority of the spending was for construction of the U.S. and European intercity networks, certain local networks in the U.S. and Europe, and the transoceanic cable network. Through December 31, 2001, the total cost of the Level 3 network by region, including intercity and metropolitan networks, optronic and other transmission equipment, transmission facilities including gateway facilities and the regions allocated portion of undersea cables was \$9.2 billion for North America and \$1.7 billion for Europe. The Company's capital expenditures are expected to decline significantly since construction of its North American and European networks are now substantially complete. The substantial majority of the Company's ongoing capital expenditures are expected to be success-based, or tied to incremental revenue. The Company estimates that its base capital expenditures, excluding success-based capital expenditures, will total approximately \$200 million in 2002.

The cash and marketable securities already on hand and the undrawn commitments of approximately \$650 million at December 31, 2001 under the expanded Senior Secured Credit Facility (see below), provided Level 3 with approximately \$2.1 billion of available funds at the end of 2001. Based on information available at this time, management of the Company believes that the Company's current liquidity and anticipated future cash flows from operations will be sufficient to fund its business plan through free cash flow breakeven.

The Company currently estimates that the implementation of the business plan from its inception through free cash flow breakeven will require approximately \$13 billion to \$14 billion on a cumulative basis. The Company also currently estimates that its operations will reach free cash flow breakeven without a requirement for additional financing. The timing of free cash flow breakeven will be a function of revenue and cash revenue growth as well as the Company's management of network, selling, general and administrative, and capital expenditures. The Company's successful debt and equity offerings have given the Company the ability to implement the business plan. However, if additional opportunities should present themselves, the Company may be required to secure additional financing in the future. In order to pursue these possible opportunities and provide additional flexibility to fund its business plan, in January 2001 the Company filed a "universal" shelf registration statement for an additional \$3 billion of common stock, preferred stock, debt securities, warrants, stock purchase agreements and depository shares. This shelf filing, in combination with the remaining availability under a previously existing universal shelf registration statement, will allow Level 3 to offer an aggregate of up to \$3.2 billion of additional securities to fund its business plan.

In addition to raising capital through the debt and equity markets, the Company may sell or dispose of existing businesses or investments to fund portions of the business plan. In February 2002, Level 3 announced that Commonwealth Telephone had filed a registration statement allowing the Company to sell 3,165,500 shares of Commonwealth Telephone in a public offering. On March 8, the registration statement was amended to increase the number of shares to be sold by the Company up to 4,025,000. In addition, the Company has announced that it will seek to sell or sublease excess real estate. The Company may also sell or lease fiber optic capacity, or access to its conduits.

The Company may not be successful in producing sufficient cash flow, raising sufficient debt or equity capital on terms that it will consider acceptable, or selling or leasing fiber optic capacity or access to its conduits. In addition, proceeds from dispositions of the Company's assets may not reflect the assets' intrinsic values. Further, expenses may exceed the Company's estimates and the financing needed may be higher than estimated. Failure to generate sufficient funds may require the Company to delay or abandon some of its future expansion or expenditures, which could have a material adverse effect on the implementation of the business plan.

In connection with the implementation of the Company's business plan, management continues to review the existing businesses, including portions of its communications and information services businesses, to determine how those businesses will assist with the Company's focus on delivery of communications and information services



and reaching cash flow breakeven. To the extent that certain businesses are not considered to be compatible with the delivery of communication and information services or with obtaining cash flow objectives, the Company may exit those businesses. It is possible that the decision to exit these businesses could result in the Company not recovering its investment in the businesses, and in those cases, a significant charge to earnings could result. For example, the Company sold its Asian operations to Reach Ltd. and incurred a loss of \$516 million.

On July 26, 2001, Level 3 announced that it had amended its Senior Secured Credit Facility to permit the Company to acquire certain of its outstanding indebtedness in exchange for shares of common stock. During 2001, various issuances of Level 3's outstanding senior notes, senior discount notes and convertible subordinated notes traded at discounts to their respective face or accreted amounts. As of December 31, 2001, the Company had exchanged, in private transactions, approximately \$194 million of its convertible subordinated notes for shares of its common stock valued at approximately \$72 million.

On October 23, 2001, the Company announced that its first tier, wholly owned subsidiary, Level 3 Finance, LLC had completed a "Modified Dutch Auction" tender offer for a portion of the Company's senior notes and convertible subordinate notes. Level 3 Finance repurchased debt with a face value of approximately \$1.7 billion, plus accrued interest, if applicable, for a total purchase price of approximately \$731 million. The net gain on the extinguishment of the debt, including transaction costs and unamortized debt issuance costs, was approximately \$967 million and was recorded as an extraordinary item in the consolidated statement of operations.

Through March 13, 2002, Level 3 had retired an additional \$195 million face amount of debt securities, by issuing 7.4 million shares of common stock, valued at \$32 million, and using approximately \$34 million of cash. Level 3 expects to recognize a gain of approximately \$130 million, after transaction and debt issuance costs, from these transactions in the first quarter of 2002.

Level 3 is aware that the various issuances of its outstanding senior notes, senior discount notes and convertible subordinated notes continue to trade at discounts to their respective face or accreted amounts. In order to continue to reduce future cash interest payments, as well as future amounts due at maturity, Level 3 or its affiliates may, from time to time, purchase these outstanding debt securities for cash or exchange shares of Level 3 common stock for these outstanding debt securities pursuant to the exemption provided by Section 3(a)(9) of the Securities Act of 1933, as amended, in open market or privately negotiated transactions. Level 3 will evaluate any such transactions in light of then existing market conditions. The amounts involved in any such transactions, individually or in the aggregate, may be material.

The Company has a \$1.775 billion Senior Secured Credit Facility. As of March 13, 2001, \$1.125 billion of the \$1.775 billion senior secured credit facility was drawn. The balance represents the approximately \$650 million revolving credit facility.

The Senior Secured Credit Facility has customary covenants, or requirements that the company and certain of its subsidiaries must meet to remain in compliance with the contract, including a financial covenant that measures minimum revenues (Minimum Telecom Revenue). The subsidiaries of the Company that must comply with the terms and conditions of the credit facility are referred to as Restricted Subsidiaries.

The Minimum Telecom Revenue covenant generally requires that the Company meet or exceed specified levels of cash revenue from communications and information services businesses generated by the Restricted Subsidiaries. The Minimum Telecom Revenue covenant is calculated quarterly on a trailing four-quarter basis and must exceed \$1.5 billion for the first quarter of 2002, increasing to \$2.3 billion in the fourth quarter of 2002, \$3.375 billion in the fourth quarter of 2003, and \$4.75 billion in the fourth quarter of 2004. The Restricted Subsidiaries currently include those engaged in the Company's communications businesses and certain subsidiaries of (i) Structure engaged in the Company's information services businesses.

Those subsidiaries of the Company that are not subject to the limitations of the Credit Agreement are referred to as Unrestricted Subsidiaries. The Unrestricted Subsidiaries include Level 3's coal mining and toll road properties and its holdings in RCN and Commonwealth Telephone.

If the Company does not remain in compliance with this financial covenant, as well as certain other covenants, it could be in default of the terms of the Senior Secured Credit Facility. Under this scenario, the lenders

could take actions to require repayment. The Company believes it is in full compliance with all covenants as of December 31, 2001.

On January 29, 2002, the Company stated that it was in compliance with all of the terms, conditions, and covenants under the Senior Secured Credit Facility and expected to remain in compliance through the end of the first quarter 2002 based on its publicly disclosed financial projections. However, the Company stated that if sales, disconnects and cancellations were to continue at the levels experienced during the second half of 2001, the Company may violate the Minimum Telecom Revenue covenant as early as the end of the second quarter 2002. The Company also stated that to the extent the Company's operational performance improves or it completes acquisitions that generate sufficient incremental revenue, a potential violation of the covenant could be delayed beyond the second quarter of 2002 or eliminated entirely.

Level 3 announced on February 25, 2002 that it had signed a definitive agreement to acquire CorpSoft, Inc., a Norwood, Massachusetts based marketer, distributor and reseller of business software, which conducts its business under the name Corporate Software. Corporate Software had 2001 revenues of approximately \$1.1 billion. Corporate Software had 2001 EBITDA of approximately \$18 million, excluding stock-based compensation expense, one-time restructuring charges and other non-recurring employee costs. Level 3 expects the acquisition will enable its information services business to leverage CorpSoft's customer base, worldwide presence and relationships to expand its portfolio of services. In addition, Level 3 expects to utilize its network infrastructure to facilitate the deployment of software to CorpSoft's customers. The transaction closed on March 13, 2002. Since closing, revenues as measured by the Minimum Telecom Revenue covenant include Corporate Software revenues.

As a result of this transaction, the Company believes it will remain in compliance with the terms and conditions of the Senior Secured Credit Facility until the second half of 2003. The Company's expectation assumes that it takes no other actions, its sales levels do not improve beyond those experienced during the second half of 2001, and disconnects and cancellations continue to decrease during the second half of 2002 in accordance with the Company's customer credit analysis.

Given other actions the Company may take, and based on its longer term expectations for improvements in its rate of sales, disconnects and cancellations, new product and service introductions and the potential for additional acquisitions, the Company believes it will continue to remain in compliance with the terms and conditions of the Senior Secured Credit Facility over the term of that agreement.

Current economic conditions of the telecommunications and information services industry, combined with Level 3's strong financial position, have created potential opportunities for Level 3 to acquire telecommunications assets at attractive prices. Level 3 continues to evaluate these opportunities and could make acquisitions in addition to the Corporate Software transaction, and the McLeodUSA acquisition described below, in 2002.

On January 24, 2002 Level 3 completed the acquisition of the wholesale dial-up access business assets of McLeodUSA Incorporated (formerly Splitrock Services) for approximately \$50 million in cash consideration and the assumption of certain operating liabilities related to that business. The acquisition includes customer contracts, approximately 350 POPs (Points of Presence) across the U.S. and the related facilities, equipment and underlying circuits. In addition, the parties entered into certain operating agreements enabling McLeodUSA to continue to support its in-region customers. The acquisition enables Level 3 to provide managed modem service in all 50 states with a coverage area that includes 80 percent of the U.S. population, up from 37 states, and 57 percent of the U.S. population.

In December 2000, the Company entered into a sales-leaseback transaction involving two corporate aircraft. The Company is amortizing the \$8 million gain recognized on the transaction over the ten year term of the lease. Annual lease payments of approximately \$1.9 million are included in the operating lease disclosures below. The Company has not entered into any bandwidth commodity contracts through the date of this report.

The following tables summarize the contractual obligations and commercial commitments of the Company at December 31, 2001, as further described in the notes to the financial statements.

	Total	Payments Due by Period			
		Less than 1 Year	1-3 Years	4 - 5 Years	After 5 Years
Contractual Obligations					
Long-Term Debt, including current portion..	\$6,216	\$ 7	\$ 279	\$ 265	\$5,665
Reclamation.....	96	4	9	9	74
Operating Leases.....	566	54	104	102	306
Other Commercial Commitments					
Letters of Credit.....	48	38	7	5	1

On March 9, 2002, legislation was enacted that will enable the Company to carry its taxable net operating losses back five years. As a result, the Company expects to receive a Federal income tax refund of approximately \$120 million after it files its 2001 Federal income tax return carrying back the taxable loss to 1996.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Level 3 is subject to market risks arising from changes in interest rates, equity prices and foreign exchange rates. The Company's exposure to interest rate risk increased due to the \$1.375 billion Senior Secured Credit Facility entered into by the Company in September 1999, the additional \$400 million added to the Senior Secured Credit Facility during the first quarter of 2001 and the commercial mortgages entered into in 2000. As of December 31, 2001, the Company had borrowed \$1.125 billion under the Senior Secured Credit Facility and \$233 million under the commercial mortgages. Amounts drawn on the debt instruments bear interest at the alternate base rate or LIBOR rate plus applicable margins. As the alternate base rate and LIBOR rate fluctuate, so too will the interest expense on amounts borrowed under the credit facility and mortgages. The weighted average interest rate based on outstanding amounts under these variable rate instruments of \$1.4 billion at December 31, 2001, was approximately 5.4%. A hypothetical increase in the variable portion of the weighted average rate by 1% (i.e. a weighted average rate of 6.4%), would increase annual interest expense of the Company by approximately \$14 million. In an effort to reduce the risk of increased interest rates related to the Lehman commercial mortgage, the Company entered into an interest rate cap agreement in January 2001. The terms of the agreement provide that the net interest expense related to the Lehman commercial mortgage will not exceed 8% plus the original spread. The agreement therefore caps the LIBOR portion of the interest rate at 8%. At December 31, 2001, the Company had \$4.85 billion of fixed rate debt bearing a weighted average interest rate of 9.05%. A decline in interest rates in the future will not benefit the Company due to the terms and conditions of the loan agreements which require the Company to repurchase the debt at specified premiums. The Company was able to reduce its exposure to interest rate risk by acquiring certain outstanding indebtedness in exchange for shares of common stock and cash. As a result of the additional debt repurchases in 2002, the Company was able to reduce its fixed rate debt outstanding to \$4.65 billion. The Company continues to evaluate other alternatives to limit interest rate risk.

Level 3 continues to hold positions in certain publicly traded entities, primarily Commonwealth Telephone and RCN. The Company accounts for these two investments using the equity method. The market value of these investments was approximately \$563 million at December 31, 2001, which is significantly higher than their carrying value of \$121 million. The Company has registered with the Securities and Exchange Commission to sell a portion of its holdings in Commonwealth Telephone. Level 3 has also stated that it may dispose of all or part of the remaining investments in the next 12-18 months. The value received for the investments would be affected by the market value of the underlying stock at the time of any such transaction. A 20% decrease in the price of Commonwealth Telephone and RCN stock would result in approximately a \$113 million decrease in fair value of these investments. The Company does not currently utilize financial instruments to minimize its exposure to price fluctuations in equity securities.

The Company's business plan included developing and operating a telecommunications network in Europe. As of December 31, 2001, the Company had invested significant amounts of capital in that region and will continue to expand its presence in Europe in 2002. The Company issued EURO 800 million (EURO 453 million outstanding at December 31, 2001) in Senior Euro Notes in February 2000 as an economic hedge against its net investment in its

European subsidiaries. Due to the historically low exchange rates involving the U.S. Dollar and the Euro, during the fourth quarter of 2000, Level 3 elected to set aside the remaining Euros received from the debt offerings. During the third quarter of 2001, Level 3 elected to start funding its current European investing and operating activities with the Euros that had previously been set aside. Other than the issuance of the Euro denominated debt and the holding of the Euros, the Company has not made significant use of financial instruments to minimize its exposure to foreign currency fluctuations. The Company continues to analyze risk management strategies to reduce foreign currency exchange risk.

The change in interest rates and equity security prices is 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, equity prices and foreign currency rates.

## **ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

Financial statements and supplementary financial information for Level 3 Communications, Inc. and Subsidiaries begin on page F-1.

The financial statements of an equity method investee (RCN Corporation) are required by Rule 3.09 and will be filed as a part of this Report by an amendment to this Report upon the filing by RCN of their Form 10-K for the year ended December 31, 2001. RCN's filing of their Form 10-K is not yet due.

## **ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

Not Applicable.

## **ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.**

The information required by this Item 10 is incorporated by reference to the Company's definitive proxy statement for the 2002 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission, however certain information is included in Item 1. Business above under the caption "Directors and Executive Officers."

## **ITEM 11. EXECUTIVE COMPENSATION**

The information required by this Item 11 is incorporated by reference to the Company's definitive proxy statement for the 2002 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission.

## **ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

The information required by this Item 12 is incorporated by reference to the Company's definitive proxy statement for the 2002 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission.

## **ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

The information required by this Item 13 is incorporated by reference to the Company's definitive proxy statement for the 2002 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission.

## **ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K**

(a) Financial statements and financial statement schedules required to be filed for the registrant under Items 8 or 14 are set forth following the index page at page F-1. Exhibits filed as a part of this report are listed below. Exhibits incorporated by reference are indicated in parentheses.

3.1 Restated Certificate of Incorporation dated March 31, 1998 (Exhibit 1 to Registrant's Form 8-A filed on April 1, 1998).

3.2 Certificate of Amendment of Restated Certificate of Incorporation of Level 3 Communications, Inc. (Exhibit 3.1 to the Registrant's Current Report on Form 8-K dated June 3, 1999).

3.3 Specimen Stock Certificate of Common Stock, par value \$.01 per share (Exhibit 3 to the Registrant's Form 8-A filed on March 31, 1998).

3.4 Amended and Restated By-laws as of May 23, 2001 (Exhibit 3 to Registrant's Quarterly Report on Form 10-Q for the three months ended June 30, 2001).

3.5 Rights Agreement, dated as of May 29, 1998, between the Registrant and Norwest Bank Minnesota, N.A., as Rights Agent, which includes the Form of Certificate of Designation, Preferences, and Rights of Series A. Junior Participating Preferred Stock of the Registrant, as Exhibit A, the Form of Rights Certificate as Exhibit B and the Summary of Rights to Purchase Preferred Stock, as Exhibit C (Exhibit 1 to the Registrant's Form 8-A Amendment No. 1 filed on June 10, 1998).

4.1 Indenture, dated as of April 28, 1998, between the Registrant and IBJ Schroder Bank & Trust Company as Trustee relating to the Registrant's 9% Senior Notes due 2008 (Exhibit 4.1 to the Registrant's Registration Statement on Form S-4 File No. 333-56399).

4.2 Indenture, dated as of December 2, 1998, between the Registrant and IBJ Schroder Bank & Trust Company as Trustee relating to the Registrant's 10 1/2% Senior Discount Notes due 2008 (Exhibit 4.1 to the Registrant's Registration Statement on Form S-4 File No. 333-71687).

4.3.1 Form of Senior Indenture (incorporated by reference to Exhibit 4.1 to Amendment 1 to the Registrant's Registration Statement on Form S-3 (File No. 333-68887) filed with the Securities and Exchange Commission on February 3, 1999).

4.3.2 First Supplemental Indenture, dated as of September 20, 1999, between the Registrant and IBJ Whitehall Bank & Trust Company as Trustee relating to the Registrant's 6% Convertible Subordinated Notes due 2009 (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated September 20, 1999).

4.3.3 Second Supplemental Indenture, dated as of February 29, 2000, between the Registrant and The Bank of New York as Trustee relating to the Registrant's 6% Convertible Subordinated Notes due 2010 (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated February 29, 2000).

4.4 Indenture, dated as of February 29, 2000, between the Registrant and The Bank of New York as Trustee relating to the Registrant's 11% Senior Notes due 2008 (Exhibit 4.1 to the Registrant's Registration Statement on Form S-4 File No. 333-37362).

4.5 Indenture, dated as of February 29, 2000, between the Registrant and The Bank of New York as Trustee relating to the Registrant's 11 1/4% Senior Notes due 2010 (Exhibit 4.2 to the Registrant's Registration Statement on Form S-4 File No. 333-37362).

4.6 Indenture, dated as of February 29, 2000, between the Registrant and The Bank of New York as Trustee relating to the Registrant's 12% Senior Discount Notes due 2010 (Exhibit 4.3 to the Registrant's Registration Statement on Form S-4 File No. 333-37362).

4.7 Indenture, dated as of February 29, 2000, between the Registrant and The Bank of New York as Trustee relating to the Registrant's 10 3/4% Senior Euro Notes due 2008 (Exhibit 4.1 to the Registrant's Registration Statement on Form S-4 File No. 333-37364).

4.8 Indenture, dated as of February 29, 2000, between the Registrant and The Bank of New York as Trustee relating to the Registrant's 11 1/4% Senior Euro Notes due 2010 (Exhibit 4.2 to the Registrant's Registration Statement on Form S-4 File No. 333-37364).

10.1 Separation Agreement, dated December 8, 1997, by and among Peter Kiewit Sons', Inc., Kiewit Diversified Group Inc., PKS Holdings, Inc. and Kiewit Construction Group Inc. (Exhibit 10.1 to the Registrant's Form 10-K for 1997).

10.2 Amendment No. 1 to Separation Agreement, dated March 18, 1997, by and among Peter Kiewit Sons', Inc., Kiewit Diversified Group Inc., PKS Holdings, Inc. and Kiewit Construction Group Inc. (Exhibit 10.1 to the Registrant's Form 10-K for 1997).

10.3 Credit Agreement dated as of September 30, 1999 among Level 3 Communications, LLC, the Borrowers named therein, the Lenders Party thereto and The Chase Manhattan Bank, as Agent (Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for the three months ended September 30, 1999).

10.4 Stock Purchase Agreement dated as of February 21, 2002 between Level 3 Holdings, Inc. and David C. McCourt.

10.5 Warrant Agreement, dated as of March 11, 2002 between the Registrant and William L. Grewcock.

10.6 Form of Promissory Note with certain officers of the Registrant.

10.7 Form of Aircraft Time-Share Agreement

21 List of subsidiaries of the Company

23.1 Consent of Arthur Andersen LLP

23.2 Consent of PriceWaterhouseCoopers LLP

(b) Reports on Form 8-K filed by the Registrant during the fourth quarter of 2002.

On October 10, 2001, the Registrant filed a Current Report on Form 8-K relating to the amendment by its wholly owned subsidiary Level 3 Finance, LLC of "Modified Dutch Tender" offers for a portion of the Registrant's outstanding debt and convertible debt securities. In addition, such Current Report on Form 8-K reported the issuance of a press release by the Registrant relating to the actions taken by Level 3 Finance, LLC.

On October 23, 2001, the Registrant filed a Current Report on Form 8-K relating to the completion by its wholly owned subsidiary Level 3 Finance, LLC of "Modified Dutch Tender" offers for a portion of the Registrant's outstanding debt and convertible debt securities.

On October 25, 2001, the Registrant filed a Current Report on Form 8-K relating to third quarter 2001 financial results and proposed cost management initiatives.

On December 19, 2001, the Registrant filed a Current Report on Form 8-K relating to execution of a definitive agreement with Reach Ltd. concerning the disposition of the Registrant's operations in Asia.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, this 18th day of March, 2002.

### LEVEL 3 COMMUNICATIONS, INC.

*/s/ James Q. Crowe*  
By: Name: James Q. Crowe  
Title: Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<i>/s/ Walter Scott, Jr.</i> Walter Scott, Jr.	Chairman of the Board	March 18, 2002
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<i>/s/ James Q. Crowe</i> James Q. Crowe	Chief Executive Officer and Director	March 18, 2002
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<i>/s/ Kevin J. O'Hara</i> Kevin J. O'Hara	President, Chief Operating Officer and Director	March 18, 2002
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<i>/s/ R. Douglas Bradbury</i> R. Douglas Bradbury	Vice Chairman and Executive Vice President	March 18, 2002
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<i>/s/ Charles C. Miller, III</i> Charles C. Miller, III	Vice Chairman and Executive Vice President	March 18, 2002
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<i>/s/ Sureel A. Choksi</i> Sureel A. Choksi	Group Vice President and Chief Financial Officer (Principal Financial Officer)	March 18, 2002
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<i>/s/ Eric J. Mortensen</i> Eric J. Mortensen	Vice President and Controller (Principal Accounting Officer)	March 18, 2002
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<i>/s/ Mogens C. Bay</i> Mogens C. Bay	Director	March 18, 2002
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<i>/s/ William L. Grewcock</i> William L. Grewcock	Director	March 18, 2002
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*/s/ Richard R. Jaros* Director March 18, 2002 Richard R. Jaros

<i>/s/ Robert E. Julian Robert E. Julian</i>	<i>Director</i>	<i>March 18, 2002</i>
<i>/s/ David C. McCourt David C. McCourt</i>	<i>Director</i>	<i>March 18, 2002</i>
<i>/s/ Kenneth E. Stinson Kenneth E. Stinson</i>	<i>Director</i>	<i>March 18, 2002</i>
<i>/s/ Colin V.K. Williams Colin V.K. Williams</i>	<i>Director</i>	<i>March 18, 2002</i>
<i>/s/ Michael Yanney Michael Yanney</i>	<i>Director</i>	<i>March 18, 2002</i>



# **LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES**

## **INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

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Schedules not indicated above have been omitted because of the absence of the conditions under which they are required or because the information called for is shown in the consolidated financial statements or in the notes thereto.

## REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Stockholders and Board of  
Directors of Level 3 Communications, Inc.:

We have audited the consolidated balance sheets of Level 3 Communications, Inc. (a Delaware corporation) and subsidiaries as of December 31, 2001 and 2000, and the related consolidated statements of operations, cash flows, changes in stockholders' equity (deficit) and comprehensive income (loss) for each of the three years in the period ended December 31, 2001. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Level 3 Communications, Inc. and subsidiaries as of December 31, 2001 and 2000, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2001 in conformity with accounting principles generally accepted in the United States.

/s/     Arthur Andersen LLP

*Denver, Colorado  
January 29, 2002, except with respect to the matters  
discussed in Note 17, as to which the date is March 13, 2002.*

# LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

For each of the three years ended December 31, 2001

	2001	2000	1999
	(dollars in millions, except per share data)		
Revenue.....	\$1,533	\$ 1,184	\$ 515
Costs and Expenses:			
Cost of revenue.....	(742)	(792)	(360)
Depreciation and amortization.....	(1,122)	(579)	(228)
Selling, general and administrative.....	(1,297)	(1,110)	(663)
Restructuring and impairment charges.....	(3,353)	-	-
	-----	-----	-----
Total costs and expenses.....	(6,514)	(2,481)	(1,251)
	-----	-----	-----
Loss from Operations.....	(4,981)	(1,297)	(736)
Other Income (Expense):			
Interest income.....	161	328	212
Interest expense, net.....	(646)	(282)	(174)
Equity in earnings (losses) of unconsolidated subsidiaries, net.....	16	(284)	(127)
Gain on equity investee stock transactions.....	-	100	118
Other, net.....	2	(21)	5
	-----	-----	-----
Total other income (expense).....	(467)	(159)	34
	-----	-----	-----
Loss from Continuing Operations Before Income Tax.....	(5,448)	(1,456)	(702)
Income Tax Benefit.....	-	49	220
	-----	-----	-----
Net Loss from Continuing Operations.....	(5,448)	(1,407)	(482)
Loss from Discontinued Operations.....	(605)	(48)	(5)
Extraordinary Gain on Debt Extinguishment, net.....	1,075	-	-
	-----	-----	-----
Net Loss.....	\$ (4,978)	\$ (1,455)	\$ (487)
	=====	=====	=====
Earnings (Loss) Per Share of Level 3 Common Stock (Basic and Diluted):			
Continuing operations.....	\$ (14.58)	\$ (3.88)	\$ (1.44)
	=====	=====	=====
Discontinued operations.....	\$ (1.62)	\$ (.13)	\$ (.02)
	=====	=====	=====
Extraordinary gain on debt extinguishment, net.....	\$ 2.88	\$ -	\$ -
	=====	=====	=====
Net loss.....	\$ (13.32)	\$ (4.01)	\$ (1.46)
	=====	=====	=====

See accompanying notes to consolidated financial statements.

# LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

December 31, 2001 and 2000

	2001	2000
	(dollars in millions, except per share data)	
<b>Assets</b>		
Current Assets:		
Cash and cash equivalents.....	\$ 1,297	\$ 1,255
Marketable securities.....	206	2,742
Restricted securities.....	155	215
Receivables, less allowances for doubtful accounts of \$46 and \$33, respectively.....	239	526
Current assets of discontinued Asian operations.....	74	107
Other.....	63	200
	-----	-----
Total Current Assets.....	2,034	5,045
Net Property, Plant and Equipment.....	6,890	9,014
Noncurrent Assets of Discontinued Asian Operations.....	-	382
Other Assets, net.....	392	478
	-----	-----
	\$ 9,316	\$ 14,919
	=====	=====
<b>Liabilities and Stockholders' Equity (Deficit)</b>		
Current Liabilities:		
Accounts payable.....	\$ 714	\$ 1,370
Current portion of long-term debt.....	7	7
Accrued payroll and employee benefits.....	162	90
Accrued interest.....	86	124
Deferred revenue.....	124	68
Current liabilities of discontinued Asian operations.....	74	117
Other.....	225	146
	-----	-----
Total Current Liabilities.....	1,392	1,922
Long-Term Debt, less current portion.....	6,209	7,318
Deferred Revenue.....	1,335	652
Accrued Reclamation Costs.....	92	94
Other Liabilities.....	353	384
Commitments and Contingencies		
Stockholders' Equity (Deficit):		
Preferred stock, \$.01 par value, authorized 10,000,000 shares: no shares outstanding.....	-	-
Common stock:		
Common stock, \$.01 par value, authorized 1,500,000,000 shares: 384,703,922		
outstanding in 2001 and 367,599,870 outstanding in 2000.....	4	4
Class R, \$.01 par value, authorized 8,500,000 shares: no shares outstanding.....	-	-
Additional paid-in capital.....	5,602	5,167
Accumulated other comprehensive loss.....	(144)	(73)
Accumulated deficit.....	(5,527)	(549)
	-----	-----
Total Stockholders' Equity (Deficit).....	(65)	4,549
	-----	-----
	\$9,316	\$14,919
	=====	=====

See accompanying notes to consolidated financial statements.

# LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

For the three years ended December 31, 2001

	2001	2000	1999
	(dollars in millions)		
Cash Flows from Operating Activities:			
Net Loss.....	\$ (4,978)	\$ (1,455)	\$ (487)
Loss from discontinued operations.....	605	48	5
Extraordinary gain on debt extinguishment, net.....	(1,075)	-	-
	-----	-----	-----
Loss from continuing operations.....	(5,448)	(1,407)	(482)
Adjustments to reconcile loss from continuing operations to net cash provided by operating activities:			
Equity (earnings) losses, net.....	(16)	284	127
Depreciation and amortization.....	1,122	579	228
Loss on impairments.....	3,245	-	-
Dark fiber and submarine cable non-cash cost of revenue.....	160	196	17
Amortization of premiums (discounts) on marketable securities.....	5	(41)	10
Amortization of debt issuance costs.....	27	21	9
(Gain) loss on sale of property, plant and equipment and other assets.....	3	(19)	2
Gain on equity investee stock transactions.....	-	(100)	(118)
Non-cash compensation expense attributable to stock awards.....	314	236	126
Federal income tax refunds.....	73	246	81
Deferred income taxes.....	8	-	(56)
Deferred revenue.....	706	586	121
Deposits.....	100	24	(64)
Accrued interest on marketable securities.....	36	(5)	(7)
Accrued interest on long-term debt.....	79	176	69
Change in working capital items:			
Receivables.....	275	(384)	(83)
Other current assets.....	(4)	(175)	(170)
Payables.....	(666)	644	521
Other liabilities.....	115	157	86
Other.....	7	18	16
	-----	-----	-----
Net Cash Provided by Continuing Operations.....	141	1,036	433
Cash Flows from Investing Activities:			
Proceeds from sales and maturities of marketable securities.....	3,670	7,822	5,169
Purchases of marketable securities.....	(1,162)	(8,284)	(4,555)
Decrease (increase) in restricted securities.....	56	(150)	(16)
Capital expenditures.....	(2,325)	(5,576)	(3,385)
Purchase of assets held for sale, net.....	(110)	(52)	-
Investments and acquisitions, net of cash acquired.....	-	(34)	(3)
Proceeds from sale of property, plant and equipment, and other investments.....	67	99	12
	-----	-----	-----
Net Cash Provided by (Used in) Investing Activities.....	\$ 196	\$ (6,175)	\$ (2,778)

(continued)

See accompanying notes to consolidated financial statements.

# LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS-(Continued)

For the three years ended December 31, 2001

	2001	2000	1999
	(dollars in millions)		
Cash Flows from Financing Activities:			
Long-term debt borrowings, net of issuance costs.....	\$ 761	\$ 3,195	\$ 1,249
Payments and repurchases of long-term debt, including current portion.....	(812)	(21)	(6)
Issuances of common stock, net of issuance costs.....	-	2,406	1,498
Stock options exercised.....	2	16	22
	-----	-----	-----
Net Cash (Used in) Provided by Financing Activities.....	(49)	5,596	2,763
Net Cash Used in Discontinued Operations.....	(226)	(358)	(49)
Effect of Exchange Rates on Cash and Cash Equivalents.....	(20)	(56)	1
	-----	-----	-----
Net Change in Cash and Cash Equivalents.....	42	43	370
Cash and Cash Equivalents at Beginning of Year.....	1,255	1,212	842
	-----	-----	-----
Cash and Cash Equivalents at End of Year.....	\$ 1,297	\$ 1,255	\$ 1,212
	=====	=====	=====
Supplemental Disclosure of Cash Flow Information:			
Income taxes paid.....	\$ -	\$ 2	\$ 2
Interest paid.....	471	461	104
Noncash Investing and Financing Activities:			
Common stock issued in exchange for long term debt.....	\$ 72	\$ -	\$ -
Warrants issued in exchange for construction services.....	32	-	-
Equity securities received in exchange for services.....	-	43	5
Issuances of stock for Businessnet acquisition.....	-	3	8

See accompanying notes to consolidated financial statements.

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (DEFICIT)**

For the three years ended December 31, 2001

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Accumulated Deficit)	Total
(dollars in millions)					
Balances at December 31, 1998.....	\$ 3	\$ 765	\$ 4	\$ 1,393	\$ 2,165
Common Stock:					
Issuances, net of offering costs.....	-	1,506	-	-	1,506
Stock options exercised.....	-	22	-	-	22
Stock plan grants.....	-	129	-	-	129
Shareworks plan.....	-	1	-	-	1
Income tax benefit from exercise of options.....	-	78	-	-	78
Net Loss.....	-	-	-	(487)	(487)
Other Comprehensive Loss.....	-	-	(9)	-	(9)
	-----	-----	-----	-----	-----
Balances at December 31, 1999.....	3	2,501	(5)	906	3,405
Common Stock:					
Issuances, net of offering costs.....	1	2,409	-	-	2,410
Stock options exercised.....	-	15	-	-	15
Stock plan grants.....	-	237	-	-	237
Shareworks plan.....	-	5	-	-	5
Net Loss.....	-	-	-	(1,455)	(1,455)
Other Comprehensive Loss.....	-	-	(68)	-	(68)
	-----	-----	-----	-----	-----
Balances at December 31, 2000.....	4	5,167	(73)	(549)	4,549
Common Stock:					
Issued to extinguish long-term debt.....	-	72	-	-	72
Warrants issued for capital assets.....	-	32	-	-	32
Stock options exercised.....	-	2	-	-	2
Stock plan grants.....	-	312	-	-	312
Shareworks plan.....	-	17	-	-	17
Net Loss.....	-	-	-	(4,978)	(4,978)
Other Comprehensive Loss.....	-	-	(71)	-	(71)
	-----	-----	-----	-----	-----
Balances at December 31, 2001.....	\$ 4	\$ 5,602	\$ (144)	\$ (5,527)	\$ (65)
	=====	=====	=====	=====	=====

See accompanying notes to consolidated financial statements.

# LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

For the three years ended December 31, 2001

	2001	2000	1999
	(dollars in millions)		
Net Loss.....	\$ (4,978)	\$ (1,455)	\$ (487)
Other Comprehensive Income (Loss) Before Tax:			
Foreign currency translation adjustments.....	(84)	(73)	(10)
Unrealized holding gains (losses) arising during period.....	(4)	5	(3)
Reclassification adjustment for gains included in net earnings (loss)...	17	-	(1)
	-----	-----	-----
Other Comprehensive Loss, Before Tax.....	(71)	(68)	(14)
Income Tax Benefit Related to Items of Other Comprehensive Loss.....	-	-	5
	-----	-----	-----
Other Comprehensive Loss Net of Taxes.....	(71)	(68)	(9)
	-----	-----	-----
Comprehensive Loss.....	\$ (5,049)	\$ (1,523)	\$ (496)
	=====	=====	=====

See accompanying notes to consolidated financial statements.



## LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

##### **Principles of Consolidation**

The consolidated financial statements include the accounts of Level 3 Communications, Inc. and subsidiaries (the "Company" or "Level 3") in which it has control, which are engaged in enterprises primarily related to communications, information services, and coal mining. Fifty-percent-owned mining joint ventures are consolidated on a pro rata basis. Investments in other companies in which the Company exercises significant influence over operating and financial policies or has significant equity ownership are accounted for by the equity method. All significant intercompany accounts and transactions have been eliminated.

In 2001, the Company agreed to sell its Asian telecommunications business to Reach Ltd. ("Reach"). Therefore, the assets, liabilities, results of operations and cash flows for this business have been classified as discontinued operations in the consolidated financial statements (See note 3).

##### **Communications and Information Services Revenue and Cost of Revenue**

Revenue for communications services, including private line, wavelengths, colocation, Internet access, managed modem and dark fiber revenue from contracts entered into after June 30, 1999, is recognized monthly as the services are provided. Reciprocal compensation revenue is recognized only when an interconnection agreement is in place with another carrier, and the relevant regulatory authorities have approved the terms of the agreement. Revenue attributable to leases of dark fiber pursuant to indefeasible rights-of-use agreements ("IRUs") that qualify for sales-type lease accounting, and were entered into prior to June 30, 1999, are recognized at the time of delivery and acceptance of the fiber by the customer.

Effective July 1, 1999, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 43, "Real Estate Sales, an interpretation of FASB Statement No. 66" ("FIN 43"). Under FIN 43, certain sale and long-term right-of-use agreements of dark fiber and capacity entered into after June 30, 1999, are required to be accounted for in the same manner as sales of real estate with property improvements or integral equipment. Dark fiber is considered integral equipment and accordingly, a lease must include a provision allowing title to transfer to the lessee in order for that lease to be accounted for as a sales-type lease. Failure to satisfy the requirements of FIN 43 results in revenue being recognized ratably over the term of the agreement (currently up to 20 years).

The adoption of FIN 43 did impact revenue recognition, but did not have an effect on the Company's cash flows. Dark fiber IRUs generally require the customer to make a down payment due upon execution of the agreement with the balance due upon delivery and acceptance of the fiber. These long-term dark fiber contracts and the issuance of FIN 43 have, however, resulted in a substantial amount of deferred revenue being recorded on the Company's balance sheet.

On July 19, 2001, the Emerging Issues Task Force ("EITF") of the FASB reached a consensus on Issue No. 00-11 "Meeting the Ownership Transfer Requirements of FASB Statement No. 13 for Leases of Real Estate", ("EITF 00-11"). EITF 00-11 specifically addresses the transfer of ownership requirements for leases involving integral equipment or property improvements for which no formal title registration system exists and was effective for all transactions occurring after July 19, 2001. The EITF stated in order to meet the criteria for sales-type lease accounting, the lease agreement must obligate the lessor to deliver to the lessee documents that convey ownership to the lessee by the end of the lease term.

Telecommunications companies have historically applied sales-type lease accounting to certain contracts that, among other required criteria, contained a provision that permitted the lessee the option to obtain ownership to the rights of way and/or the integral equipment at the end of the lease term in exchange for a nominal fee. Under EITF 00-11, the lessee must obtain title or its equivalent to the asset if sales-type lease accounting is to be used. Level 3 treated certain transoceanic capacity agreements that met the accounting requirements as sales-type leases. The

Company does not believe the issuance of EITF 00-11 will have a significant effect on its future operating results or financial condition.

It is the Company's policy to recognize termination revenue when certain conditions have been met. These conditions include: 1) Customer has accepted all or partial delivery of asset or service, 2) Level 3 has received consideration for the service provided, and 3) Level 3 is not legally obligated to provide additional product or services to the customer or their successor. Termination revenue is typically recognized in situations where a customer and Level 3 mutually agree to terminate service or the customer and its assets fail to emerge from bankruptcy protection. If the conditions above are met, the Company will recognize termination revenue equal to the fair value of consideration received, less any amounts previously recognized. Termination revenue is reported in the same manner as the original product or service provided.

Level 3 entered in to joint build arrangements during the construction of its North American and European networks in which it was the sponsoring partner. These arrangements are generally characterized as fixed fee or cost sharing arrangements. For fixed fee joint build arrangements in which Level 3 is the sponsor, the Company assumes the cost risk of completing the work for a fixed price agreed upon at the inception of the arrangement between the parties. Level 3 recognizes revenue equal to the value of the contract when construction is complete and payment is received from the joint build partner. For cost sharing arrangements each of the joint build parties shares the cost risk of completing the work. These contracts typically include provisions in which the sponsoring partner receives a management fee for construction services provided. Level 3 recognizes this management fee as revenue in the period when the contract is completed and payment is received from the joint build partner.

Level 3 was a party to seven non-monetary exchange transactions in 2001 whereby it sold IRUs, other capacity, or other services to a company from which Level 3 received communications assets or services. In each case, the transaction provided Level 3 needed network capacity or redundancy on unprotected transmission routes. The value of these non-monetary transactions was determined using similar transactions for which cash consideration was received.

The Company is obligated under dark fiber IRUs and other capacity agreements to maintain its network in efficient working order and in accordance with industry standards. Customers are obligated for the term of the agreement to pay for their allocable share of the costs for operating and maintaining the network. The Company recognizes this revenue monthly as services are provided.

Cost of revenue for the communications business includes leased capacity, right-of-way costs, access charges and other third party circuit costs directly attributable to the network as well as actual costs of assets sold pursuant to sales-type leases. The cost of revenue associated with sales-type leases of dark fiber agreements entered into prior to June 30, 1999, was determined based on an allocation of the total estimated costs of the network to the dark fiber provided to the customers. The allocation takes into account the service capacity of the specific dark fiber provided to customers relative to the total expected capacity of the network. Changes to total estimated costs and network capacity are included prospectively in the allocation in the period in which they become known. Cost of revenue associated with the sale of transoceanic capacity that meet the accounting requirements as sales-type leases, is also determined based on taking into account service capacity and actual costs incurred by Level 3 and its contractors to construct such assets.

Accounting practice and guidance with respect to the treatment of submarine dark fiber sales and terrestrial IRU agreements continue to evolve. Any changes in the accounting treatment could affect the way the Company accounts for revenue and expenses associated with these transactions in the future.

Information services revenue is primarily derived from the computer outsourcing business and the systems integration business. Level 3 provides outsourcing services, typically through contracts ranging from 3-5 years, to firms that desire to focus their resources on their core businesses. Under these contracts, Level 3 recognizes revenue in the month the service is provided. The systems integration business helps customers define, develop and implement cost-effective information systems. Revenue from these services is recognized on a time and materials basis or percentage of completion basis depending on the extent of the services provided. Cost of revenue includes costs of consultants' salaries and other direct costs for the information services businesses.

## **Liquidity and Capital Resources**

The communications and information services industry is highly competitive. Additionally, the communications industry is currently operating in a difficult economic environment. Many of the Company's existing and potential competitors in the communications industry have financial, personnel, marketing and other resources significantly greater than those of the Company, as well as other competitive advantages including larger customer bases. Increased consolidation and strategic alliances in the industry resulting from the Telecommunications Act of 1996, the opening of the U.S. market to foreign carriers, technological advances and further deregulation could give rise to significant new competitors to the Company. Furthermore, as discussed in Note 9, the Company has certain covenants under its debt and senior secured credit facility agreements, including one related to minimum telecom revenues, as defined, that could affect the future liquidity of the Company if such covenants are not met. Management believes it will be able to take appropriate actions to ensure that the Company will continue as a going concern for the foreseeable future, beyond one year.

## **Concentration of Credit Risk**

The Company provides telecommunications services to a wide range of customers, ranging from well capitalized national carriers to local Internet start-ups. Beginning in 2001, Level 3 changed its customer focus to the top 300 global users of bandwidth capacity. These top 300 global users tend to be financially more viable than certain Internet start-ups. The Company has in place policies and procedures to review the financial condition of potential and existing customers and concludes that collectibility is probable prior to commencement of services. If the financial condition of an existing customer deteriorates to a point where payment for services is in doubt, the Company will not recognize revenue attributable to that customer until cash is received. Based on these policies and procedures, the Company believes its exposure to credit risk within the communications business and the related effect on the financial statements is limited. The Company is not immune from the affects of the downturn in the economy and specifically the telecommunications industry; however, management believes the concentration of credit risk with respect to receivables is mitigated due to the dispersion of the Company's customer base among geographic areas and remedies provided by terms of contracts and statutes.

## **Coal Sales Contracts**

Historically, Level 3's coal is sold primarily under long-term contracts with electric utilities, which burn coal in order to generate steam to produce electricity. A substantial portion of Level 3's coal revenue was earned from long-term contracts during 2001, 2000, and 1999. The remainder of Level 3's sales are made on the spot market where prices are substantially lower than those in the long-term contracts. Beginning in 2001, a higher proportion of Level 3's sales occurred on the spot market as long-term contracts began to expire. Costs of revenue related to coal sales include costs of mining and processing, estimated reclamation costs, royalties and production taxes.

The coal industry is highly competitive. Level 3 competes not only with other domestic and foreign coal suppliers, some of whom are larger and have greater capital resources than Level 3, but also with alternative methods of generating electricity and alternative energy sources. Many of Level 3's competitors are served by two railroads and, due to the competition, often benefit from lower transportation costs than Level 3 which is served by a single railroad. Additionally, many competitors have more favorable geological conditions than Level 3, often resulting in lower comparative costs of production.

Level 3 is also required to comply with various federal, state and local laws concerning protection of the environment. Level 3 believes its compliance with environmental protection and land restoration laws will not affect its competitive position since its competitors are similarly affected by these laws.

Level 3's coal sales contracts are concentrated with several electric utility and industrial companies. In the event that these customers do not fulfill contractual responsibilities, Level 3 could pursue the available legal remedies.

**Depreciation and Amortization**

Property, plant and equipment are recorded at cost. Depreciation and amortization for the Company's property, plant and equipment are computed on accelerated and straight-line methods based on the following useful lives:

Facility and Leasehold Improvements.....	20-40 years
Network Infrastructure (including fiber).....	7-25 years
Operating Equipment.....	3-7 years
Network Construction Equipment.....	5-7 years
Furniture, Fixtures and Office Equipment.....	3-7 years

Depletion of mineral properties is provided using the units-of-extraction method based on the remaining tons of coal committed under sales contracts.

**Investee Stock Activity**

The Company recognizes gains and losses from the sale, issuance and repurchase of stock by its equity method investees in the statements of operations unless the Company has unrecorded equity losses attributable to the investee due to the lack of future financial commitments to the investee.

**Earnings Per Share**

Basic earnings per share have been computed using the weighted average number of shares during each period. Diluted earnings per share is computed by including the dilutive effect of common stock that would be issued assuming conversion or exercise of outstanding convertible subordinated notes, stock options, stock based compensation awards and other dilutive securities.

**Intangible Assets**

Intangible assets primarily include amounts allocated upon acquisitions of businesses, franchises and subscriber lists. These assets are amortized on a straight-line basis over the expected period of benefit.

For intangibles originating from communications or other information services related acquisitions, the Company is amortizing these assets over a five year period. Intangibles attributable to other acquisitions and investments are amortized over periods which do not exceed 40 years.

**Long-Lived Assets**

The Company reviews the carrying amount of long-lived assets or groups of assets for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The determination of any impairment includes a comparison of estimated undiscounted future operating cash flows anticipated to be generated during the remaining life of the asset to the net carrying value of the asset.

**Reserves for Reclamation**

The Company follows the policy of providing an accrual for reclamation of mined properties, based on the estimated total cost of restoration of such properties to meet compliance with laws governing strip mining, by applying per-ton reclamation rates to coal mined. These reclamation rates are determined using the remaining estimated reclamation costs and tons of coal committed under sales contracts. The Company reviews its reclamation cost estimates annually and revises the reclamation rates on a prospective basis, as necessary.

**Income Taxes**

Deferred income taxes are provided for the temporary differences between the financial reporting and tax basis of the Company's assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. In 2000, Level 3 utilized a portion of its accumulated net operating tax losses to offset prior

years' taxable income. The remaining net operating losses not utilized can be carried forward for 20 years to offset future taxable income. A valuation allowance has been recorded against deferred tax assets, as the Company is unable to conclude under relevant accounting standards that it is more likely than not that deferred tax assets will be realizable. See Note 17.

### **Comprehensive Income (Loss)**

Comprehensive income (loss) includes net earnings (loss) and other non-owner related changes in equity not included in net earnings (loss), such as unrealized gains and losses on marketable securities classified as available for sale and foreign currency translation adjustments related to foreign subsidiaries.

### **Foreign Currencies**

Generally, local currencies of foreign subsidiaries are the functional currencies for financial reporting purposes. Assets and liabilities are translated into U.S. dollars at year-end exchange rates. Revenue, expenses and cash flows are translated using average exchange rates prevailing during the year. Gains or losses resulting from currency translation are recorded as a component of accumulated other comprehensive income (loss) in stockholders' equity (deficit) and in the statements of comprehensive income (loss).

### **Use of Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### **Derivatives**

In June 1998, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities". SFAS No. 133 as amended by SFAS Nos. 137 and 138, is effective for fiscal years beginning January 1, 2001. SFAS No. 133 requires that all derivative instruments be recorded on the balance sheet at fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction, the type of hedge, and the extent of hedge ineffectiveness. The Company currently makes minimal use of derivative instruments as defined by SFAS No. 133, so the adoption of SFAS No. 133 in 2001 did not have a material effect on the Company's results of operations or its financial position.

### **Recently Issued Accounting Pronouncements**

In June 2001, the FASB issued SFAS No. 141, "Business Combinations" ("SFAS No. 141"). SFAS No. 141 requires all business combinations initiated after June 30, 2001, to be accounted for using the purchase method of accounting. Prior to the issuance of SFAS No. 141, companies accounted for mergers and acquisitions using one of two methods; pooling of interests or the purchase accounting method. Level 3 has accounted for acquisitions using the purchase method and does not believe the issuance of SFAS No. 141 will have a material effect on the Company's future results of operations or financial position.

In June 2001, the FASB also issued SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"). SFAS No. 142 is effective for fiscal years beginning January 1, 2002. SFAS No. 142 requires companies to segregate identifiable intangible assets acquired in a business combination from goodwill. The remaining goodwill is no longer subject to amortization over its estimated useful life. However, the carrying amount of the goodwill must be assessed at least annually for impairment using a fair value based test. Goodwill attributable to equity method investments will also no longer be amortized but is still subject to impairment analysis using existing guidance for equity method investments. For the goodwill and intangible assets in place as of December 31, 2001, the Company does not believe the adoption of SFAS No. 142 will have a material impact on the Company's results of operations or its financial position. The Company believes the impact of SFAS No. 142 will not have a material effect on accounting for future acquisitions as the new standard generally results in more amortized intangible assets and less non-amortized goodwill.

In June 2001, the FASB also approved SFAS No. 143, "Accounting for Asset Retirement Obligations" ("SFAS No. 143"). SFAS No. 143 establishes accounting standards for recognition and measurement of a liability for an asset retirement obligation and the associated asset retirement cost. The fair value of a liability for an asset retirement obligation is to be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated retirement costs are capitalized and included as part of the carrying value of the long-lived asset and amortized over the useful life of the asset. SFAS No. 143 will be effective for the Company beginning on January 1, 2003. The Company expects that its coal mining business will be affected by this standard and is currently evaluating the potential effect of SFAS No. 143 on its future results of operations and financial position.

In August 2001, the FASB issued SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"), which the Company elected to early adopt during the fourth quarter of 2002 retroactive to January 1, 2001. SFAS No. 144 supersedes SFAS No. 121, but retains its requirements to (a) recognize an impairment loss only if the carrying amount of a long-lived asset is not recoverable from its undiscounted cash flows and (b) measure an impairment loss as the difference between the carrying amount and the estimated fair value of the asset. It removes goodwill from its scope and, therefore, eliminates the requirement to allocate goodwill to long-lived assets to be tested for impairment. It also describes a probability-weighted cash flow estimation approach to deal with situations in which alternative courses of action to recover the carrying amount of a long-lived asset are under consideration or a range is estimated for possible future cash flows. It requires that a long-lived asset to be abandoned, exchanged for a similar productive asset, or distributed to owners in a spin-off be considered held and used until it is disposed of. In these situations, SFAS No. 144 requires that an impairment loss be recognized at the date a long-lived asset is exchanged for a similar productive asset or distributed to owners in a spin-off if the carrying amount of the asset exceeds its fair value. The Company continued to monitor and review long-lived assets for possible impairment in accordance with SFAS No. 121 prior to the adoption of SFAS No. 144. Since SFAS No. 144 retains similar requirements as SFAS No. 121 for recognizing and measuring any impairment loss, the adoption of SFAS No. 144 did not have a significant effect on the Company's procedures for monitoring and reviewing long-lived assets for possible impairment. SFAS No. 144 also retains the basic provisions of APB Opinion No. 30 "Reporting the Results of Operations" for the presentation of discontinued operations in the income statement but broadens the definition of a discontinued operation such that a component of an entity (rather than a segment of a business) would be considered to be a discontinued operation if the operations and cash flows of the component will be eliminated from the ongoing operations of the company and the company will not have any significant continuing involvement in the operations of the component. A component of an entity comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. The adoption of SFAS No. 144 in 2001 had a significant impact on the accounting presentation of the sale of the Asian communications business as this business would not have qualified for treatment as a discontinued operation under APB Opinion No. 30, since it did not meet the definition of a business segment.

## **Reclassifications**

Certain prior year amounts have been reclassified to conform to the current year presentation.

### **(2) Restructuring and Impairment Charges**

In 2001, the Company announced that due to the duration and severity of the slowdown in the economy and the telecommunications industry, that it would be necessary to reduce operating expenses as well as reduce and reprioritize capital expenditures in an effort to be in a position to benefit when the economy recovers. As a result of these actions, the Company has reduced its global work force, primarily in the communications business in the United States and Europe by approximately 2,200 employees in 2001. Restructuring charges of approximately \$10 million, \$40 million and \$58 million were recorded in the first, second and fourth quarters of 2001, respectively, of which \$66 million related to staff reduction and related costs and \$42 million to real estate lease termination costs. In total, the Company has paid \$49 million in severance and related fringe benefit costs and \$1 million in lease termination costs as of December 31, 2001 for these actions. The remaining estimated cash expenditures of \$17 million relating to the workforce reductions primarily relate to approximately 200 European employees terminated in the first quarter of 2002. Lease termination obligations of \$41 million are expected to be substantially paid by June 30, 2002.

The economic downturn and related capital reprioritization discussed above resulted in certain telecommunications assets being identified as excess, obsolete or carried at values that may not be recoverable due to an adverse change in the extent in which the telecommunication assets were being utilized caused by the unfavorable business climate within the telecommunications industry. As a result, in the second quarter of 2001 the Company recorded a non-cash impairment charge of \$61 million, representing the excess of the carrying value over the estimated fair value of these assets. The estimated fair value of these assets was based on recent cash sales of similar assets. The impaired assets were written-off, as the Company does not expect to utilize them to generate future cash flows.

In the fourth quarter of 2001, in light of the continued economic uncertainty, continued customer disconnections at higher rates than expected, increased difficulty in obtaining new revenue and the overall slow down in the communications industry, the Company again reviewed the carrying value of its long-lived assets for possible impairment in accordance with SFAS No. 144. The Company determined based upon its projections, giving effect to the continuing economic slowdown and continued over-capacity in certain areas of the telecommunications industry, the estimated future undiscounted cash flows attributable to certain assets would not exceed the current carrying value of the assets. The Company, therefore, recorded an impairment charge of \$3.2 billion to reflect the difference between the estimated fair value of the assets on a discounted cash flow basis and their current carrying value as further described below.

The impairments primarily relate to colocation assets, excess conduits in North America and European intercity and metropolitan networks, and certain transoceanic assets. Geographically, approximately 74% of the charges are attributable to North America, 17% are attributable to Europe and 9% attributable to transatlantic assets.

The financial problems of many of the "dot-coms", emerging carriers and competitors, a weakening economy, and changing customer focus, have led to an over-capacity of colocation space in several U.S. and European markets. Level 3 is attempting to sell or sublease its excess colocation space; however, current market rates for much of the space are below its carrying values. As a result, the Company recorded an impairment charge of approximately \$1.6 billion related to its colocation assets, primarily owned facilities, leasehold improvements and related equipment.

Level 3 constructed its networks in North America and Europe in such a way that they could be continuously upgraded to the most current technology without affecting its existing customers. Level 3 also installed additional conduits with the intention of selling them to other carriers. To date, the Company has only sold one conduit in its North American network and, due to the current economic environment and decreasing capital expenditure budgets of potential buyers, does not expect additional sales in the foreseeable future. For this reason the Company has recorded an impairment charge of approximately \$1.2 billion for the five conduits that were previously determined to be available for sale to third parties, based on estimated cash flows from the disposition of the conduits.

The completion of several transoceanic cable systems in the second half of 2001 and the expected completion of additional systems in 2002, have resulted in an over abundance of transoceanic capacity. This excess capacity, combined with limited demand, have adversely affected the transoceanic capacity markets. At current pricing levels, the Company does not believe it will recover its investment from future cash flows. As a result, the Company has recorded an impairment charge of approximately \$320 million for its transatlantic submarine assets.

The Company also recorded an impairment charge of approximately \$65 million for spare equipment write-downs and abandoned lateral fiber builds in the fourth quarter of 2001.

### (3) Discontinued Asian Operations

On December 19, 2001, Level 3 announced that it had agreed to sell its Asian telecommunications business to Reach Ltd. for no cash consideration. The agreement covers subsidiaries that included the Asian network operations, assets, liabilities and future financial obligations. This includes Level 3's share of the Northern Asian cable system, capacity on the Japan-US cable system, capital and operational expenses related to these two systems, gateways in Hong Kong and Tokyo, and existing customers on Level 3's Asian network.

The transaction closed on January 18, 2002. As of December 31, 2001, the net carrying value of Level 3's Asian assets was approximately \$465 million. In accordance with SFAS No. 144, Level 3 recorded an impairment loss on these assets held for sale within discontinued operations, equal to the difference between the carrying value of the

assets and their fair value. Based upon the terms of the agreement, the Company also accrued \$51 million in certain capital obligations it retained for the two submarine systems to be sold to Reach, and estimated transaction costs.

The following is summarized financial information for the discontinued Asian operations for the three years ending December 31, 2001:

Operations	2001	2000	1999
	(dollars in millions)		
Revenue.....	\$ 13	\$ 1	\$ -
Costs and Expenses:			
Cost of revenue.....	(17)	(2)	-
Depreciation and amortization.....	(27)	(5)	-
Selling, general and administrative.....	(58)	(42)	(5)
	-----	-----	-----
Total costs and expenses.....	(102)	(49)	(5)
	-----	-----	-----
Loss from Operations.....	(89)	(48)	(5)
Loss on Impairment of Asian Assets.....	(516)	-	-
	-----	-----	-----
Loss from Discontinued Operations.....	\$(605)	\$ (48)	\$ (5)
	=====	=====	=====

SFAS No. 144 requires that long-lived assets that have met the relevant criteria should be classified as "held for sale" and shall be identified separately in the asset and liability sections of the balance sheet. The assets and liabilities of the Asian operations met these criteria as of December 31, 2001 and are classified as current due to their sale to Reach in January of 2002.

The following is summarized financial information for the discontinued Asian operations as of December 31, 2001 and 2000:

Financial Position	2001	2000
	(dollars in millions)	
Current Assets:		
Cash and cash equivalents.....	\$ 34	\$ 13
Restricted securities.....	17	-
Receivables.....	21	91
Other.....	-----	-----
Total Current Assets.....	74	107
Net Property, Plant and Equipment.....	-	369
Other Assets, net.....	-	13
	-----	-----
	\$ 74	\$489
	=====	=====
Current Liabilities:		
Accounts payable.....	\$ 58	\$ 116
Current portion of long-term debt.....	8	-
Deferred revenue.....	6	-
Other.....	2	1
Total Current Liabilities.....	74	117
	-----	-----
Net Assets.....	\$ -	\$372
	=====	=====



#### (4) Loss Per Share

The Company had a loss from continuing operations for the three years ended December 31, 2001. Therefore, the dilutive effect of the approximately 15 million, 19 million and 13 million shares at December 31, 2001, 2000 and 1999, respectively, attributable to the convertible subordinated notes and the approximately 53 million, 21 million and 23 million options and warrants outstanding at December 31, 2001, 2000 and 1999 respectively, have not been included in the computation of diluted loss per share because their inclusion would have been anti-dilutive to the computation.

The following details the earnings (loss) per share calculations for the Level 3 Common Stock.

	2001	Year Ended	
		2000	1999
Loss from Continuing Operations (in millions).....	\$ (5,448)	\$ (1,407)	\$ (482)
Discontinued Operations.....	(605)	(48)	(5)
Extraordinary Gain on Debt Extinguishment, net.....	1,075	-	-
	-----	-----	-----
Net Loss.....	\$ (4,978)	\$ (1,455)	\$ (487)
	=====	=====	=====
Total Number of Weighted Average Shares Outstanding used to Compute			
Basic and Dilutive Earnings Per Share (in thousands).....	373,792	362,539	334,348
Earnings (Loss) per Share (Basic and Diluted):			
Continuing operations.....	\$ (14.58)	\$ (3.88)	\$ (1.44)
	=====	=====	=====
Discontinued operations.....	\$ (1.62)	\$ (.13)	\$ (.02)
	=====	=====	=====
Extraordinary gain on debt extinguishment, net.....	\$ 2.88	\$ -	\$ -
	=====	=====	=====
Net loss.....	\$ (13.32)	\$ (4.01)	\$ (1.46)
	=====	=====	=====

#### (5) Disclosures about Fair Value of Financial Instruments

The following methods and assumptions were used to determine classification and fair values of financial instruments:

##### Cash and Cash Equivalents

Cash equivalents generally consist of funds invested in highly liquid instruments purchased with an original maturity of three months or less. The securities are stated at cost, which approximates fair value.

##### Marketable and Restricted Securities

Level 3 has classified all marketable and restricted securities as available-for-sale. Restricted securities primarily include investments in mutual funds that are restricted to fund certain reclamation liabilities of its coal mining ventures, cash deposits related to construction renovations for the New York Gateway facility, and cash to collateralize letters of credit. The cost of the securities used in computing unrealized and realized gains and losses is determined by specific identification. Fair values are estimated based on quoted market prices for the securities on hand or for similar investments. Net unrealized holding gains and losses are included in accumulated other comprehensive income (loss) within stockholders' equity.

At December 31, 2001 and 2000, the cost, unrealized holding gains and losses, and estimated fair values of marketable and restricted securities were as follows:

	Cost	Unrealized Holding Gains (dollars in millions)	Unrealized Holding Losses (dollars in millions)	Fair Value
2001				
Marketable Securities:				
U.S. Treasury securities.....	\$ 206	\$ -	\$ -	\$ 206
	=====	=====	=====	=====
Restricted Securities:				
Cash and cash equivalents.....	\$ 128	\$ -	\$ -	\$ 128
Wilmington Trust:				
Intermediate term bond fund.....	15	-	-	15
Equity fund.....	11	1	-	12
	-----	-----	-----	-----
	\$ 154	\$ 1	\$ -	\$ 155
	=====	=====	=====	=====
	Cost	Unrealized Holding Gains (dollars in millions)	Unrealized Holding Losses (dollars in millions)	Fair Value
2000				
Marketable Securities:				
Commercial Paper.....	\$ 204	\$ -	\$ -	\$ 204
U.S. Treasury securities.....	2,534	4	-	2,538
	-----	-----	-----	-----
	\$2,738	\$ 4	\$ -	\$ 2,742
	=====	=====	=====	=====
Restricted Securities:				
Cash and cash equivalents.....	\$ 173	\$ -	\$ -	\$ 173
Wilmington Trust:				
Intermediate term bond fund.....	14	-	-	14
Equity fund.....	11	4	-	15
	-----	-----	-----	-----
	\$ 198	\$ 4	\$ -	\$ 202
	=====	=====	=====	=====

For debt securities, costs do not vary significantly from principal amounts. The Company recognized \$17 million of gains in 2001 from the sale of marketable securities; all of which were attributable to foreign currency gains on securities denominated in Euros. The Company did not recognize any realized gains and losses on sales of marketable and equity securities in 2000. Realized gains and losses on sales of marketable and equity securities were \$17 million and \$16 million in 1999.

At December 31, 2001, the contractual maturities of the debt securities are as follows:

	Cost (dollars in millions)	Fair Value (dollars in millions)
U.S. Treasury Securities:		
Less than 1 year.....	\$ 206	\$ 206
	=====	=====

Maturities for the restricted securities have not been presented, as the types of securities are either cash or mutual funds which do not have a single date.

## Long-Term Debt

The fair value of long-term debt was estimated using the December 31, 2001 and 2000 average of the bid and ask price for the publicly traded debt instruments. Amounts under the Tranche A and Tranche C of the Senior Secured Credit Facility and the commercial mortgages are not publicly traded. The fair value for these instruments is assumed to approximate their carrying value at December 31, 2001 as they are secured by underlying assets and are at variable interest rates thus minimizing credit and interest rate risks.

The carrying amount and estimated fair values of Level 3's financial instruments are as follows:

	2001 Carrying Amount	Fair Value (dollars in millions)	2000 Carrying Amount	Fair Value
Cash and Cash Equivalents.....	\$ 1,297	\$ 1,297	\$ 1,256	\$ 1,256
Marketable Securities.....	206	206	2,742	2,742
Restricted Securities.....	155	155	215	215
Investments (Note 8).....	127	569	146	569
Long-term Debt, including current portion (Note 9).....	6,216	3,354	7,325	5,766

## (6) Receivables

Receivables at December 31, 2001 and 2000 were as follows:

	Communications	Information Services	Coal (dollars in millions)	Other	Total
2001					
Accounts Receivable - Trade:					
Services.....	\$ 151	\$ 21	\$ 11	\$ 1	\$ 184
Dark Fiber.....	40	-	-	-	40
Joint Build Costs.....	20	-	-	-	20
Other Receivables.....	41	-	-	-	41
Allowance for Doubtful Accounts.....	(43)	(3)	-	-	(46)
	-----	-----	-----	-----	-----
Total	\$ 209	\$ 18	\$ 11	\$ 1	\$ 239
	=====	=====	=====	=====	=====
2000					
Accounts Receivable - Trade:					
Services.....	\$ 141	\$ 25	\$ 19	\$ 1	\$ 186
Dark Fiber.....	161	-	-	-	161
Joint Build Costs.....	162	-	-	-	162
Other Receivables.....	49	1	-	-	50
Allowance for Doubtful Accounts.....	(29)	(4)	-	-	(33)
	-----	-----	-----	-----	-----
Total	\$ 484	\$ 22	\$ 19	\$ 1	\$ 526
	=====	=====	=====	=====	=====

Joint build receivables primarily relate to costs incurred by the Company for construction of network assets in which Level 3 is partnering with other companies. Generally, under these types of agreements, the sponsoring partner will incur 100% of the construction costs and bill the other party as certain construction milestones are accomplished.

The Company recognized bad debt expense in selling, general and administrative expenses of \$42 million, \$31 million and \$11 million in 2001, 2000 and 1999, respectively. The Company decreased accounts receivable and allowance for doubtful accounts by approximately \$29 million and \$7 million in 2001 and 2000, respectively, for amounts the Company deemed as uncollectible.

## (7) Property, Plant and Equipment

The Company has substantially completed the construction of its communications network. Costs associated directly with the uncompleted network, including employee related costs, are capitalized, and interest expense incurred during construction is capitalized based on the weighted average accumulated construction expenditures and the interest rates related to borrowings associated with the construction (Note 9). Intercity segments, gateway facilities, local networks and operating equipment that have been placed in service are being depreciated over their estimated useful lives, primarily ranging from 3-25 years.

The Company continues to develop business support systems required for its business plan. The external direct costs of software, materials and services, payroll and payroll related expenses for employees directly associated with the project, and interest costs incurred when developing the business support systems are capitalized. Upon completion of a project, the total cost of the business support system is amortized over a useful life of three years.

As noted previously, in 2001, the Company recorded a charge on the statement of operations for impairment of certain assets. The impairments primarily relate to colocation assets (\$1.6 billion), conduits in North America and European intercity and metropolitan networks (\$1.2 billion), and certain transoceanic assets (\$320 million). For those assets that are determined to be impaired, the fair value of the asset becomes the new basis or "cost" of the asset and the accumulated depreciation that had previously been recorded, is eliminated.

Capitalized business support systems and network construction costs that have not been placed in service have been classified as construction-in-progress within Property, Plant & Equipment below.

	Cost	Accumulated Depreciation (dollars in millions)	Book Value
2001			
Land and Mineral Properties.....	\$ 218	\$ (22)	\$ 192
Facility and Leasehold Improvements			
Communications.....	1,423	(22)	1,401
Information Services.....	26	(5)	21
Coal Mining.....	65	(62)	3
CPTC.....	92	(14)	78
Network Infrastructure.....	4,111	(107)	4,004
Operating Equipment			
Communications.....	1,152	(367)	785
Information Services.....	69	(41)	28
Coal Mining.....	82	(72)	10
CPTC.....	18	(11)	7
Network Construction Equipment.....	67	(17)	50
Furniture, Fixtures and Office Equipment.....	180	(94)	86
Construction-in-Progress.....	225	-	225
	-----	-----	-----
	\$7,728	\$ (838)	\$ 6,890
	=====	=====	=====

	Cost	Accumulated Depreciation (dollars in millions)	Book Value
2000			
Land and Mineral Properties.....	\$ 191	\$ (11)	\$ 180
Facility and Leasehold Improvements			
Communications.....	1,280	(51)	1,229
Information Services.....	25	(4)	21
Coal Mining.....	68	(64)	4
CPTC.....	92	(12)	80
Network Infrastructure.....	3,400	(43)	3,357
Operating Equipment			
Communications.....	1,577	(554)	1,023
Information Services.....	50	(26)	24
Coal Mining.....	93	(85)	8
CPTC.....	17	(9)	8
Network Construction Equipment.....	139	(27)	112
Furniture, Fixtures and Office Equipment.....	146	(44)	102
Construction-in-Progress.....	2,866	-	2,866
	-----	-----	-----
	\$ 9,944	\$ (930)	\$ 9,014
	=====	=====	=====

Depreciation expense was \$1,082 million in 2001, \$529 million in 2000 and \$192 million in 1999. Depreciation expense attributable to the network construction equipment is capitalized and included in Construction-in-Progress until such time the constructed asset is placed in service.

#### (8) Other Assets

At December 31, 2001 and 2000 other non-current assets consisted of the following:

	2001 (in millions)	2000 (in millions)
Investments.....	\$127	\$146
Debt Issuance Costs, net.....	113	161
Goodwill, net of accumulated amortization of \$142 and \$102.....	28	68
Prepaid Network Assets.....	21	35
CPTC Deferred Development and Financing Costs.....	20	14
Assets Held for Sale.....	62	-
Employee and Officer Notes Receivable.....	10	-
Deposits.....	-	40
Other.....	11	14
	-----	-----
Total other assets.....	\$392	\$478
	=====	=====

The Company holds significant equity positions in two publicly traded companies:

RCN Corporation ("RCN") and Commonwealth Telephone Enterprises, Inc. ("Commonwealth Telephone"). RCN is a facilities-based provider of bundled local and long distance phone, cable television and Internet services to residential markets primarily on the East and West coasts as well as Chicago. Commonwealth Telephone holds Commonwealth Telephone Company, an incumbent local exchange carrier operating in various rural Pennsylvania markets, and CTSI, Inc., a competitive local exchange carrier which commenced operations in 1997.

On December 31, 2001, Level 3 owned approximately 27% and 45% of the outstanding shares of RCN and Commonwealth Telephone, respectively, and accounts for each entity using the equity method. The market value of the Company's investment in RCN and Commonwealth Telephone was \$78 million and \$485 million, respectively, on December 31, 2001.

During the fourth quarter of 2000, Level 3's proportionate share of RCN's losses exceeded the remaining carrying value of Level 3's investment in RCN. Level 3 does not have additional financial commitments to RCN; therefore it recognized equity losses only to the extent of its investment in RCN. If RCN becomes profitable, Level 3 will not record its equity in RCN's profits until unrecorded equity losses have been offset. The Company's investment in RCN, including goodwill, was zero at December 31, 2001 and December 2000, respectively. The Company did not recognize approximately \$249 million of suspended equity losses attributable to RCN in 2001, bringing the total amount of suspended equity losses to approximately \$269 million. Level 3 recorded equity losses attributable to RCN of \$260 million and \$134 million for the twelve months ended December 31, 2000 and 1999, respectively.

The Company recognizes gains from the sale, issuance and repurchase of stock by its equity method investees in its statements of operations. During 2000, RCN issued stock for the acquisition of 21st Century Telecom Group, Inc., completed in April, 2000, and for certain transactions which diluted the Company's ownership of RCN from 35% at December 31, 1999 to 31% at December 31, 2000. The increase in the Company's proportionate share of RCN's net assets as a result of these transactions resulted in a pre-tax gain of \$95 million for the Company for the year ended December 31, 2000. The Company recognized a similar pre-tax gain of \$117 million in 1999. The Company did not recognize any gains in 2001 and does not expect to recognize future gains on RCN stock activity until the suspended equity losses are recognized by the Company.

The following is summarized financial information of RCN for the year ended December 31, 2001(unaudited) and the years ended December 31, 2000 and 1999, and as of December 31, 2001 (unaudited) and December 31, 2000.

	Year Ended December 31,		
	2001	2000	1999
<b>Operations:</b>			
RCN Corporation:			
Revenue .	\$ 456	\$ 333	\$ 276
Net loss available to common shareholders.....	(836)	(891)	(369)
Level 3's Share:			
Net loss.....	-	(260)	(134)
Goodwill amortization.....	-	(1)	(1)
	-----	-----	-----
	\$ -	\$ (261)	\$ (135)
	=====	=====	=====
<b>Financial Position:</b>			
	December 31,		
	2001	2000	
Current Assets.....	\$ 956	\$ 1,854	
Other Assets .....	2,647	2,922	
	-----	-----	
Total assets.....	3,603	4,776	
Current Liabilities.....	313	531	
Other Liabilities.....	1,929	2,284	
Minority Interest.....	51	75	
Preferred Stock.....	2,142	1,991	
	-----	-----	
Total liabilities and preferred stock.....	4,435	4,881	
	-----	-----	
Common shareholders' deficit.....	\$ (832)	\$ (105)	
	=====	=====	
Level 3's Investment:			
Equity in net assets.....	\$ -	\$ -	
Goodwill.....	-	-	
	-----	-----	
	\$ -	\$ -	
	=====	=====	

The Company's investment in Commonwealth Telephone, including goodwill, was \$121 million and \$105 million at December 31, 2001 and 2000, respectively.

The Company previously made investments in certain public and private companies in connection with those entities agreeing to purchase various services from the Company. The Company originally recorded these transactions as investments and deferred revenue on the balance sheet. The value of the investment and deferred revenue is equal to the estimated fair value of the securities at the time of the transaction or the value of the services to be provided, whichever was more readily determinable. Level 3 closely monitors the success of these investees in executing their business plans. For those companies that are publicly traded, Level 3 also monitors current and historical market values of the investee as it compares to the carrying value of the investment. The Company recorded a charge of \$37 million during 2001 for an other-than temporary decline in the value of such investments, which is included in Other, net on the consolidated condensed statements of operations. Future appreciation will be recognized only upon sale or other disposition of these securities. The carrying amount of the investments was zero at December 31, 2001 and \$37 million at December 31, 2000. The Company recognized revenue of approximately \$13 million and less than \$1 million for actual services provided to other entities involved in the program for the twelve months ended December 31, 2001 and 2000, respectively. As of December 31 2001, the Company had deferred revenue obligations of \$9 million with respect to these transactions.

In August, 2001, the Company and divine, inc., a company included in those described above, entered into an agreement whereby divine would repurchase shares of common stock issued to Level 3 and absolve Level 3 of any further obligations with respect to the deferred revenue recorded at the time of the original transaction. As a result, Level 3 recorded a \$27 million gain in Other, net on the consolidated statement of operations in 2001.

As of December 31, 2001, the goodwill identified in Other Assets is attributable to technology purchased in the XCOM Technologies, Inc. acquisition in 1998. This technology was used by Level 3 to develop an interface between its Internet protocol-network and the existing public switched telephone network. In accordance with SFAS No. 142, the Company will continue to amortize this intangible asset over its remaining useful economic life. Goodwill amortization expense, excluding amortization expense attributable to equity method investees, was \$40 million in 2001, \$50 million in 2000, and \$36 million in 1999.

Assets held for sale includes certain corporate facilities that management of the Company has elected to dispose as soon as practicable. The Company recorded an impairment charge in depreciation expense of \$45 million in 2001, representing the difference between the carrying value and adjusted market value of these facilities, as determined through consultations with a commercial real estate broker. Also included in assets held for sale are certain telecommunications equipment identified as excess and which management expects to sell within the next year due to the Company's decision in June 2001 to reprioritize its capital expenditures.

Loans were made to certain employees and officers of the Company. The loans are generally secured by Level 3 common stock or other personal assets of the borrower and bear interest at rates ranging from 6% to 9.5%.

## (9) Long-Term Debt

At December 31, 2001 and 2000, long-term debt was as follows:

	2001	2000
	(dollars in millions)	
Senior Secured Credit Facility:		
Term Loan Facility		
Tranche A (4.69% due 2007).....	\$ 450	\$ 200
Tranche B (5.69% due 2008).....	275	275
Tranche C (6.08% due 2008).....	400	-
Senior Notes (9.125% due 2008).....	1,430	2,000
Senior Notes (11% due 2008).....	442	800
Senior Discount Notes (10.5% due 2008).....	583	619
Senior Euro Notes (10.75% due 2008).....	307	465
Senior Discount Notes (12.875% due 2010).....	386	399
Senior Euro Notes (11.25% due 2010).....	93	279
Senior Notes (11.25% due 2010).....	129	250
Commercial Mortgage:		
GMAC (4.52% due 2003).....	120	120
Lehman (5.64% due 2004).....	112	113
Convertible Subordinated Notes (6.0% due 2010).....	728	863
Convertible Subordinated Notes (6.0% due 2009).....	612	823
CPTC Long-term Debt (with recourse only to CPTC)		
(7.63% due 2004-2028).....	140	115
Other.....	9	4
	-----	-----
	6,216	7,325
Less current portion.....	(7)	(7)
	-----	-----
	\$ 6,209	\$ 7,318
	=====	=====

In July 2001, Level 3 announced that it had amended its Senior Secured Credit Facility to permit the Company to acquire certain of its outstanding indebtedness in exchange for shares of common stock. Various issuances of Level 3's outstanding senior notes, senior discount notes and convertible subordinated notes have traded at discounts to their respective face or accreted amounts.

The Company purchased \$130 million of its 6% Convertible Subordinated Notes due in 2009 and \$64 million of its 6% Convertible Subordinated Notes due in 2010 during the second half of 2001. The Company issued approximately 15.9 million shares of its common stock worth approximately \$72 million in exchange for the debt. The net gain on the early extinguishment of the debt, including transaction costs and unamortized debt issuance costs, was \$117 million and is classified as an extraordinary item in the consolidated statement of operations. Level 3 will continue to evaluate these transactions in the future. The amounts involved in any such transactions, individually or in the aggregate, may be material.

In September 2001, the Company announced that its first tier, wholly owned subsidiary, Level 3 Finance, LLC was commencing a "Modified Dutch Auction" tender offer for a portion of the Company's senior debt and convertible debt securities. Under the "Modified Dutch Auction" procedures, Level 3 Finance accepted tendered notes in each offer in the order of the lowest to the highest tender prices specified by the tendering holders within the applicable price range for the applicable series of notes (see table below.)

In October 2001, Level 3 Finance completed the purchase of Company debt with a face value of approximately \$1.7 billion, plus accrued interest, for a total purchase price of approximately \$731 million. The net gain on the extinguishment of the debt, including transaction costs, foreign currency gains and unamortized debt issuance costs, was approximately \$967 million and was recorded as an extraordinary item in the consolidated statement of operations.



	Maximum Principal Amount at Maturity Sought (\$ millions)	Purchase Price Range per \$1,000 Principal	Actual Principal Amount at Maturity Repurchased (\$ millions)	Actual Weighted Average Purchase Price/\$1,000
Senior Notes (9.125%) .....	\$ 725	\$350 - \$450	\$ 570	\$ 450
Senior Notes (11%) .....	450	380 - 480	359	480
Senior Discount Notes (10.5%) .....	125	210 - 250	125	210
Senior Euro Notes (10.75%) .....	267	370 - 440	136	440
Senior Discount Notes (12.875%) .....	100	150 - 180	100	150
Senior Euro Notes (11.25%) .....	178	370 - 440	173	440
Senior Notes (11.25%) .....	150	370 - 460	121	460
Convertible Subordinated Notes (due 2010) .....	325	190 - 220	71	220
Convertible Subordinated Notes (due 2009) .....	525	190 - 220	80	220
	-----		-----	
	\$ 2,845		\$ 1,735	
	=====		=====	

Assumes 1EURO = .89 USD

## Senior Secured Credit Facility

On September 30, 1999, Level 3 and certain Level 3 subsidiaries entered into a \$1.375 billion secured credit facility ("Senior Secured Credit Facility"). The facility was originally comprised of a senior secured revolving credit facility in the amount of \$650 million and a two-tranche senior secured term loan facility aggregating \$725 million. The secured term loan facility consists of a \$450 million tranche A and a \$275 million tranche B term loan facility, respectively. At December 31, 2000, Level 3 had borrowed \$200 million and \$275 million under the tranche A and tranche B secured term loan facility, respectively. On January 8, 2001, the Company borrowed the remaining \$250 million available under the existing tranche A of the Senior Secured Credit Facility.

On March 22, 2001, Level 3 entered into an amendment to increase the borrowing capacity under the Senior Secured Credit Facility by \$400 million, to \$1.775 billion. As part of the agreement, Level 3 borrowed \$400 million under a new tranche C of the term loan facility. The net proceeds will be used for implementing the business plan, including the purchase of telecommunications assets.

The obligations under the revolving credit facility are secured by substantially all the assets of Level 3 and, subject to certain exceptions, its wholly owned domestic subsidiaries (other than the borrower under the term loan facility). Such assets will also secure a portion of the term loan facility. Additionally, all obligations under the term loan facility will be secured by the equipment that is purchased with the proceeds of the term loan facility.

Amounts drawn under the secured credit facility will bear interest, at the option of the Company, at an alternate base rate or reserve-adjusted LIBOR plus applicable margins. The applicable margins for the revolving credit facility and tranche A term loan facility range from 50 to 175 basis points over the alternate base rate and from 150 to 275 basis points over LIBOR and are fixed for the tranche B term loan facility at 250 basis points over the alternate base rate and 375 basis points over LIBOR. The tranche C applicable margins are fixed at 300 basis points over the alternate base rate and 400 basis points over LIBOR. Interest and commitment fees on the revolving credit facility and the term loan facilities are payable quarterly with specific rates determined by actual borrowings under each facility. Debt issuance costs of \$38 million were capitalized and will be amortized as interest expense over the terms of Senior Secured Credit Facility.

The revolving credit facility provides for automatic and permanent quarterly reductions of the amount available for borrowing under that facility, commencing at \$17.25 million on March 31, 2004, and increasing to approximately \$61 million per quarter. The tranche A term loan facility amortizes in consecutive quarterly payments beginning on March 31, 2004, commencing at \$9 million per quarter and increasing to \$58.5 million per quarter. The revolving credit facility and tranche A term loan facility mature on September 30, 2007. The tranche B term loan facility amortizes in consecutive quarterly payments beginning on March 31, 2004, commencing at less than \$1 million and increasing to \$67 million in 2007. Tranche C of the term loan facility amortizes in consecutive quarterly payments

beginning on June 30, 2004, commencing at \$1 million per quarter and increasing to \$97 million per quarter in 2007, with the final installment due January 30, 2008.

As of December 31, 2001, Level 3 had not borrowed any funds under the \$650 million revolving credit facility. The availability of funds and any requirement to repay previously borrowed funds is contingent upon the continued compliance with the relevant debt covenants.

The Senior Secured Credit Facility has customary covenants, or requirements that the company and certain of its subsidiaries must meet to remain in compliance with the contract, including a financial covenant that measures minimum revenues (Minimum Telecom Revenue). The subsidiaries of the Company that must comply with the terms and conditions of the credit facility are referred to as Restricted Subsidiaries.

The Minimum Telecom Revenue covenant generally requires that the Company meet or exceed specified levels of cash revenue from communications and information services businesses generated by the Restricted Subsidiaries. The Minimum Telecom Revenue covenant is calculated quarterly on a trailing four-quarter basis and must exceed \$1.5 billion for the first quarter of 2002, increasing to \$2.3 billion in the fourth quarter of 2002, \$3.375 billion in the fourth quarter of 2003, and \$4.75 billion in the fourth quarter of 2004. The Restricted Subsidiaries currently include those engaged in the Company's communications businesses and certain subsidiaries of (i)Structure engaged in the company's information services businesses.

Those subsidiaries of the Company that are not subject to the limitations of the Senior Secured Credit Facility are referred to as Unrestricted Subsidiaries. The Unrestricted Subsidiaries include Level 3's coal mining and toll road properties and its holdings in RCN and Commonwealth Telephone.

If the Company does not remain in compliance with this financial covenant, as well as certain other covenants, it could be in default under the terms of the Senior Secured Credit Facility. Under this scenario, the lenders could take actions to require repayment. The Company believes it is in full compliance with all covenants as of December 31, 2001.

On January 29, 2002, the Company stated that it was in compliance with all of the terms, conditions, and covenants under its credit facility and expected to remain in compliance through the end of the first quarter based on its publicly disclosed financial projections. However, the Company stated that if sales, disconnects and cancellations were to continue at the levels experienced during the second half of 2001, it may violate the Minimum Telecom Revenue covenant as early as the end of the second quarter 2002. The Company also stated that to the extent the Company's operational performance improves or it completes acquisitions that generate sufficient incremental revenue, a potential violation of the covenant could be delayed beyond the second quarter of 2002 or eliminated entirely. See Note 17 for additional information on actions taken to address covenant issues.

**9.125% Senior Notes**

In April 1998, Level 3 Communications, Inc. received \$1.94 billion of net proceeds from an offering of \$2 billion aggregate principal amount 9.125% Senior Notes Due 2008 ("9.125% Senior Notes"). Interest on the notes accrues at 9.125% per year and is payable on May 1 and November 1 each year in cash.

The 9.125% Senior Notes are subject to redemption at the option of Level 3 Communications, Inc., in whole or in part, at any time or from time to time on or after May 1, 2003, plus accrued and unpaid interest thereon to the redemption date, if redeemed during the twelve months beginning May 1, of the years indicated below:

Year	Redemption Price
2003 .....	104.563%
2004 .....	103.042%
2005 .....	101.521%
2006 and thereafter.....	100.000%

The 9.125% Senior Notes are senior, unsecured obligations of Level 3 Communications, Inc., ranking pari passu with all existing and future senior unsecured indebtedness of the Company. The notes contain certain covenants, which among other things, limit consolidated debt, dividend payments, and transactions with affiliates. Level 3 Communications, Inc. used the net proceeds of the note offering in connection with the implementation of its business plan.

Debt issuance costs of \$65 million were originally capitalized and are being amortized as interest expense over the term of the Senior Notes. As a result of amortization and debt repurchases, the capitalized debt issuance costs have been reduced to \$30 million at December 31, 2001.

**11% Senior Notes due 2008**

In February 2000, Level 3 Communications, Inc. received \$779 million of net proceeds, after transaction costs, from a private offering of \$800 million aggregate principal amount of its 11% Senior Notes due 2008 ("11% Senior Notes"). Interest on the notes accrues at 11% per year and is payable semi-annually in arrears in cash on March 15 and September 15, beginning September 15, 2000. The 11% Senior Notes are senior, unsecured obligations of Level 3 Communications, Inc., ranking pari passu with all existing and future senior debt. The 11% Senior Notes cannot be prepaid by Level 3 Communications, Inc., and mature on March 15, 2008. The 11% Senior Notes contain certain covenants, which among other things, limit additional indebtedness, dividend payments, certain investments and transactions with affiliates.

Debt issuance costs of \$21 million were originally capitalized and are being amortized as interest expense over the term of the 11% Senior Notes. As a result of amortization and debt repurchases, the capitalized debt issuance costs have been reduced to \$9 million at December 31, 2001.

**10.5% Senior Discount Notes due 2008**

In December 1998, Level 3 Communications, Inc. sold \$834 million aggregate principal amount at maturity of 10.5% Senior Discount Notes Due 2008 ("10.5% Senior Discount Notes"). The sales proceeds of \$500 million, excluding debt issuance costs, were recorded as long term debt. Interest on the 10.5% Senior Discount Notes accretes at a rate of 10.5% per annum, compounded semiannually, to an aggregate principal amount of \$834 million (\$709 million after the Dutch auction conducted in October of 2001) by December 1, 2003. Cash interest will not accrue on the 10.5% Senior Discount Notes prior to December 1, 2003; however, Level 3 Communications, Inc. may elect to commence the accrual of cash interest on all outstanding 10.5% Senior Discount Notes on or after December 1, 2001, in which case the outstanding principal amount at maturity of each 10.5% Senior Discount Note will on the elected commencement date be reduced to the accreted value of the 10.5% Senior Discount Note as of that date and cash interest shall be payable on that Note on June 1 and December 1 thereafter. Commencing June 1, 2004, interest on the 10.5% Senior Discount Notes will accrue at the rate of 10.5% per annum and will be payable in cash semiannually in arrears. Accrued interest expense for the year ended December 31, 2001 on the 10.5% Senior Discount Notes of \$65 million was added to long-term debt.

The 10.5% Senior Discount Notes will be subject to redemption at the option of Level 3 Communications, Inc., in whole or in part, at any time or from time to time on or after December 1, 2003 at the following redemption prices (expressed as percentages of accreted value) plus accrued and unpaid interest thereon to the redemption date, if redeemed during the twelve months beginning December 1, of the years indicated below:

Year	Redemption Price
2003 .....	105.25%
2004 .....	103.50%
2005 .....	101.75%

These notes are senior unsecured obligations of Level 3 Communications, Inc., ranking pari passu with all existing and future senior unsecured indebtedness of Level 3 Communications, Inc. The 10.5% Senior Discount Notes contain certain covenants which, among other things, restrict the Company's ability to incur additional debt, make

certain restricted payments, pay dividends, enter into sale and leaseback transactions, enter into transactions with affiliates, and sell assets or merge with another company.

The net proceeds of \$486 million were used to accelerate the implementation of its business plan, primarily the funding for the increase in committed number of route miles of the Company's U.S. intercity network.

Debt issuance costs of \$14 million were originally capitalized and are being amortized over the term of the 10.5% Senior Discount Notes. As a result of amortization and debt repurchases, the capitalized debt issuance costs have been reduced to \$8 million at December 31, 2001.

### **10.75% Senior Euro Notes due 2008**

On February 29, 2000, Level 3 Communications, Inc. received EURO 488 million (\$478 million when issued) of net proceeds, after debt issuance costs, from an offering of EURO 500 million aggregate principal amount 10.75% Senior Euro Notes due 2008 ("10.75% Senior Euro Notes"). Interest on the notes accrues at 10.75% per year and is payable in Euros semi-annually in arrears on March 15 and September 15 each year beginning on September 15, 2000. The 10.75% Senior Euro Notes are not redeemable by Level 3 Communications, Inc. prior to maturity. Debt issuance costs of EURO 12 million (\$12 million) were originally capitalized and are being amortized over the term of the 10.75% Senior Euro Notes. As a result of the amortization and debt repurchases, the net capitalized debt issuance costs had been reduced to \$6 million at December 31, 2001.

The 10.75% Senior Euro Notes are senior, unsecured obligations of the Company, ranking *pari passu* with all existing and future senior debt. The 10.75% Senior Euro Notes contain certain covenants, which among other things, limit additional indebtedness, dividend payments, certain investments and transactions with affiliates.

The issuance of the EURO 500 million 10.75% Senior Euro Notes has been designated as, and is effective as, an economic hedge against the investment in certain of the Company's foreign subsidiaries. Therefore, foreign currency gains and losses resulting from the translation of the debt have been recorded in other comprehensive income (loss) to the extent of translation gains or losses on such investment. The 10.75% Senior Euro Notes were valued, based on current exchange rates, at \$307 million in the Company's financial statements at December 31, 2001. The difference between the carrying value at December 31, 2000 and the value at issuance, after repurchases, was recorded in other comprehensive income.

### **12.875% Senior Discount Notes due 2010**

On February 29, 2000, Level 3 Communications, Inc. sold in a private offering \$675 million aggregate principal amount at maturity (\$575 million after the Dutch auction conducted in October of 2001) of its 12.875% Senior Discount Notes due 2010 ("12.875% Senior Discount Notes"). The sale proceeds of \$360 million, excluding debt issuance costs, were recorded as long-term debt. Interest on the 12.875% Senior Discount Notes accretes at a rate of 12.875% per year, compounded semi-annually, to an aggregate principal amount of \$675 million by March 15, 2005. Cash interest will not accrue on the 12.875% Senior Discount Notes prior to March 15, 2005. However, Level 3 Communications, Inc. may elect to commence the accrual of cash interest on all outstanding 12.875% Senior Discount Notes on or after March 15, 2003. In that case, the outstanding principal amount at maturity of each 12.875% Senior Discount Note will, on the elected commencement date, be reduced to the accreted value of the 12.875% Senior Discount Note as of that date and cash interest shall be payable on the 12.875% Senior Discount Notes on March 15 and September 15 thereafter. Commencing September 15, 2005, interest on the 12.875% Senior Discount Notes will accrue at the rate of 12.875% per year and will be payable in cash semi-annually in arrears. Accrued interest expense from the date of issuance through December 31, 2001 on the 12.875% Senior Discount Notes of \$52 million was added to long-term debt.

The 12.875% Senior Discount Notes are subject to redemption at the option of Level 3 Communications, Inc., in whole or in part, at any time or from time to time on or after March 15, 2005. Level 3 Communications, Inc. may redeem the 12.875% Senior Discount Notes at the redemption prices set for the below, plus interest, if any, to the redemption date. The following prices are for 12.875% Senior Discount Notes redeemed during the 12-month period commencing on March 15 of the years set forth below and are expressed as percentages of principal amount.

Year	Redemption Price
2005 .....	106.438%
2006 .....	104.292%
2007 .....	102.146%
2008 and thereafter.....	100.000%

In addition, at any time and from time to time, prior to March 15, 2003, Level 3 Communications, Inc. may redeem up to a maximum of 35% of the aggregate principal amount at maturity of the 12.875% Senior Discount Notes with the proceeds of one or more private placements to persons other than affiliates of the Company or underwritten public offerings of common stock of Level 3 Communications, Inc. resulting in gross proceeds of at least \$100 million in the aggregate. Level 3 Communications, Inc. may redeem the 12.875% Senior Discount Notes at a redemption price equal to 112.875% of the accreted value of the notes plus accrued interest, if any, to the redemption date.

The 12.875% Senior Discount Notes are senior, unsecured obligations of the Company, ranking pari passu with all existing and future senior debt. The 12.875% Senior Discount Notes contain certain covenants, which among other things, limit additional indebtedness, dividend payments, certain investments and transactions with affiliates.

Debt issuance costs of \$9 million were originally capitalized and are being amortized as interest expense over the term of the 12.875% Senior Discount Notes. As a result of amortization and debt repurchases, the capitalized debt issuance costs have been reduced to \$6 million at December 31, 2001.

### **11.25% Senior Euro Notes due 2010**

On February 29, 2000, Level 3 Communications, Inc. received EURO 293 million (\$285 million when issued) of net proceeds, after debt issuance costs, from an offering of EURO 300 million aggregate principal amount 11.25% Senior Euro Notes due 2010 ("11.25% Senior Euro Notes"). Interest on the notes accrues at 11.25% per year and is payable semi-annually in arrears in Euros on March 15 and September 15 each year beginning September 15, 2000.

The 11.25% Senior Euro Notes are subject to redemption at the option of Level 3 Communications, Inc., in whole or in part, at any time or from time to time on or after March 15, 2005. The 11.25% Senior Euro Notes may be redeemed at the redemption prices set forth below, plus accrued and unpaid interest, if any, to the redemption date. The following prices are for 11.25% Senior Euro Notes redeemed during the 12-month period commencing on March 15 of the years set forth below, and are expressed as percentages of principal amount.

Year	Redemption Price
2005 .....	105.625%
2006 .....	103.750%
2007 .....	101.875%
2008 and thereafter.....	100.000%

In addition, at any time and from time to time, prior to March 15, 2003, Level 3 Communications, Inc. may redeem up to a maximum of 35% of the original aggregate principal amount of the 11.25% Senior Euro Notes. The Notes may be redeemed at a redemption price equal to 111.25% of the principal amount thereof, plus accrued and unpaid interest thereon, if any, to the redemption date. The redemption must be made with the proceeds of one or more private placements to persons other than affiliates of the Company or underwritten public offerings of common stock of Level 3 Communications, Inc. resulting in gross proceeds of at least \$100 million in the aggregate.

Debt issuance costs of EURO 7 million (\$7 million) were originally capitalized and are being amortized over the term of the 11.25% Senior Euro Notes. As a result of amortization and debt repurchases, the capitalized debt issuance costs have been reduced to \$3 million at December 31, 2001. The 11.25% Senior Euro Notes are senior, unsecured obligations of the Company, ranking pari passu with all existing and future senior debt. The 11.25% Senior Euro

Notes contain certain covenants, which among other things, limit additional indebtedness, dividend payments, certain investments and transactions with affiliates.

The issuance of the EURO 300 million 11.25% Senior Euro Notes has been designated as, and is effective as, an economic hedge against the investment in certain of the Company's foreign subsidiaries. Therefore, foreign currency gains and losses resulting from the translation of the debt have been recorded in other comprehensive income (loss) to the extent of translation gains or losses on such net investment. The 11.25% Senior Euro Notes were valued, based on current exchange rates, at \$93 million in the Company's financial statements at December 31, 2001.

**11.25% Senior Notes due 2010**

In February 2000, Level 3 Communications, Inc. received \$243 million of net proceeds, after transaction costs, from a private offering of \$250 million aggregate principal amount of its 11.25% Senior Notes due 2010 ("11.25% Senior Notes"). Interest on the notes accrues at 11.25% per year and is payable semi-annually in arrears on March 15 and September 15 in cash beginning September 15, 2000.

The 11.25% Senior Notes are subject to redemption at the option of Level 3 Communications, Inc., in whole or in part, at any time or from time to time on or after March 15, 2005. Level 3 Communications, Inc. may redeem the 11.25% Senior Notes at the redemption prices set forth below, plus accrued and unpaid interest, if any, to the redemption date. The following prices are for 11.25% Senior Notes redeemed during the 12-month period commencing on March 15 of the years set forth below:

Year	Redemption Price
2005 .....	105.625%
2006 .....	103.750%
2007 .....	101.875%
2008 and thereafter.....	100.000%

In addition, at any time and from time to time, prior to March 15, 2003, Level 3 Communications, Inc. may redeem up to a maximum of 35% of the original aggregate principal amount of the 11.25% Senior Notes. The redemption must be made with the proceeds of one or more private placements to persons other than affiliates of the Company or underwritten public offerings of common stock of Level 3 Communications, Inc. resulting in gross proceeds of at least \$100 million in the aggregate. Level 3 Communications, Inc. may redeem the 11.25% Senior Notes at a redemption price equal to 111.25% of the principal amount of the notes plus accrued interest, if any, to the redemption date.

The 11.25% Senior Notes are senior, unsecured obligations of the Company, ranking pari passu with all existing and future senior debt. The 11.25% Senior Notes contain certain covenants, which among other things, limit additional indebtedness, dividend payments, certain investments and transactions with affiliates.

Debt issuance costs of \$7 million were originally capitalized and are being amortized as interest expense over the term of the 11.25% Senior Notes. As a result of amortization and debt repurchases, the capitalized debt issuance costs have been reduced to \$3 million at December 31, 2001.

**GMAC Commercial Mortgage due 2003**

In June 2000, HQ Realty, Inc. (a wholly owned subsidiary of the Company) entered into a \$120 million floating-rate loan ("GMAC Mortgage") providing secured, non-recourse debt to finance the Company's world headquarters. HQ Realty, Inc. is a single purpose entity organized solely to own, hold, operate and manage the world headquarters which has been 100% leased to Level 3 Communications, LLC in Broomfield Colorado. Under the terms of the loan agreement, HQ Realty, Inc., will not engage in any business other than the ownership, management, maintenance and operation of the world headquarters. The assets of HQ Realty Inc. are not available to satisfy any third party obligations other than those of HQ Realty, Inc. In addition, the assets of the Company are not available to satisfy the obligations of HQ Realty, Inc. HQ Realty, Inc. received \$119 million of net proceeds after transaction costs. Level 3 was required to place \$13 million of the net proceeds in a restricted account. The release of these

funds is contingent upon Level 3's debt rating increasing to BBB by S&P and Baa2 by Moody's which did not occur in 2001.

The initial term of the GMAC Mortgage is 36 months with two one-year no cost extension options. Interest varies monthly with the 30 day London Interbank Offering Rate ("LIBOR") for U.S. Dollar Deposits as follows:

The Index plus:

- (1) 240 basis points during the Initial Term;
- (2) 250 basis points during the First Extension Option; and
- (3) 260 basis points during the Second Extension Option.

At December 31, 2001 the interest rate was 4.52%.

The GMAC Mortgage may not be prepaid during the first twenty four months. Thereafter, the GMAC Mortgage may be prepaid at par in whole or in part in multiples of \$100,000. The entire principal is due at maturity or at the end of the elected extension period. Interest only is due during the initial three-year term. Interest and amortization are due during the extension terms based on a 30 year amortization period with a balloon payment at maturity.

Debt issuance costs of \$1 million were capitalized and are being amortized as interest expense over the term of the GMAC Mortgage.

#### **Lehman Commercial Mortgage due 2004**

In December 2000, 85 Tenth Avenue, LLC (a wholly owned subsidiary of the Company) entered into a \$113 million floating-rate loan ("Lehman Mortgage") providing secured, non-recourse debt to finance the purchase and renovations of the New York Gateway facility. 85 Tenth Avenue, LLC is a single purpose entity organized solely to own, hold, sell, lease, transfer, exchange, operate and manage the New York Gateway facility. Under the terms of the loan agreement, 85 Tenth Avenue, LLC will not engage in any business other than the ownership, management, maintenance and operation of the New York Gateway facility. The New York Gateway facility has been 100% leased to Level 3 Communications, LLC. The assets of 85 Tenth Avenue, LLC are not available to satisfy any third party obligations other than those of 85 Tenth Avenue, LLC. In addition, the assets of the Company are not available to satisfy the obligations of 85 Tenth Avenue, LLC.

85 Tenth Avenue, LLC received \$105 million of net proceeds after transaction costs. Under the terms of the loan agreement, the gross loan proceeds plus \$32 million, deposited by 85 Tenth Avenue, LLC, are to be maintained in a Renovation Reserve account. The reserve is held by 85 Tenth Avenue, LLC as restricted cash and is maintained solely to perform the renovations of the New York Gateway facility. At December 31, 2001, approximately \$57 million remained in the reserve account.

The initial term of the Lehman Mortgage is 36 months with two (2) one year no cost extension options. There is a penalty if a principal payment is made prior to January 1, 2002. The entire principal is due at maturity or at the end of the elected extension period. Interest varies monthly with the 30 day LIBOR for U.S. Dollar Deposits plus approximately 350 basis points. Interest and amortization are due during the initial term based on a 20 year amortization period. At December 31, 2001 the interest rate was 5.64%.

Debt issuance costs of \$8 million were capitalized and are being amortized as interest expense over the term of the Lehman Mortgage.

In an effort to reduce the risk of increased interest rates related to the Lehman commercial mortgage, in January 2001 the Company entered into an interest rate cap agreement. The interest rate cap notional amount is \$113 million and has a maturity date of January 31, 2004. The terms of the agreement provide that the net interest expense related to the Lehman commercial mortgage will not exceed 8% plus 400 basis points. The Company has elected not to account for this transaction as a hedge as permitted by SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"). Upon inception of the agreement, the Company recorded an asset equal to the fair value of the interest rate cap of less than \$1 million. For twelve months ended December

31, 2001, the Company recorded, in the statement of operations, less than \$1 million in losses related to the change in the fair value of the interest rate cap.

The Company has elected not to complete the build-out of the New York Gateway facility due to the excess capacity in the local market. As a result, the Company is in negotiations with the lender to refinance the existing loan. The refinancing will likely result in the reduction of long term debt and the reserve account balance included in restricted securities. See Note 17.

### **6% Convertible Subordinated Notes due 2010**

In February 2000, the Company received \$836 million of net proceeds, after transaction costs, from a public offering of \$863 million aggregate principal amount of its 6% Convertible Subordinated Notes due 2010 ("Subordinated Notes 2010"). The Subordinated Notes 2010 are unsecured and subordinated to all existing and future senior indebtedness of the Company. Interest on the Subordinated Notes 2010 accrues at 6% per year and is payable semi-annually in cash on March 15 and September 15 beginning September 15, 2000. The principal amount of the Subordinated Notes 2010 will be due on March 15, 2010.

The Subordinated Notes 2010 may be converted into shares of common stock of Level 3 Communications, Inc. at any time prior to the close of business on the business day immediately preceding maturity, unless previously redeemed, repurchased or Level 3 Communications, Inc. has caused the conversion rights to expire. The conversion rate is 7.416 shares per each \$1,000 principal amount of Subordinated Notes 2010, subject to adjustment in certain events.

Prior to March 18, 2003, Level 3 Communications, Inc. at its option, may redeem the Subordinated Notes 2010, in whole or in part, at the redemption prices specified below plus accrued interest. Level 3 may exercise this option if the current market price of its common stock equals or exceeds triggering levels specified below for at least 20 trading days within any period of 30 consecutive trading days, including the last trading day of the period.

Period	Trigger Percentage	Redemption Price
March 15, 2001 through March 14, 2002.....	160% (\$215.74)	105.4%
March 15, 2002 through March 17, 2003.....	150% (\$202.26)	104.8%

On or after March 18, 2003, Level 3, at its option, may cause the conversion rights to expire. Level 3 may exercise this option only if the current market price exceeds approximately \$188.78 (which represents 140% of the conversion price) for at least 20 trading days within any period of 30 consecutive trading days, including the last trading day of that period. At December 31, 2001, no debt had been converted into shares of common stock.

Debt issue costs of \$27 million were originally capitalized and are being amortized as interest expense over the term of the Subordinated Notes. As a result of amortization and debt repurchases, the capitalized debt issuance costs have been reduced to \$18 million at December 31, 2001.

### **6% Convertible Subordinated Notes due 2009**

On September 14, 1999, the Company received \$798 million of proceeds, after transaction costs, from an offering of \$823 million aggregate principal amount of its 6% Convertible Subordinated Notes Due 2009 ("Subordinated Notes 2009"). The Subordinated Notes 2009 are unsecured and subordinated to all existing and future senior indebtedness of the Company. Interest on the Subordinated Notes 2009 accrues at 6% per year and is payable each year in cash on March 15 and September 15. The principal amount of the Subordinated Notes 2009 will be due on September 15, 2009. The Subordinated Notes 2009 may be converted into shares of common stock of the Company at any time prior to maturity, unless the Company has caused the conversion rights to expire. The conversion rate is 15.3401 shares per each \$1,000 principal amount of Subordinated Notes 2009, subject to adjustment in certain circumstances. On or after September 15, 2002, Level 3, at its option, may cause the conversion rights to expire. Level 3 may exercise this option only if the current market price exceeds approximately \$91.27 (which represents 140% of the conversion price) for 20 trading days within any period of 30 consecutive trading days including the



last day of that period. At December 31, 2001, less than \$1 million of debt had been converted into shares of common stock.

Debt issuance costs of \$25 million were originally capitalized and are being amortized as interest expense over the term of the Subordinated Notes 2009. As a result of amortization and debt repurchases, the capitalized debt issuance costs have been reduced to \$14 million at December 31, 2001.

The debt instruments above contain certain covenants which the Company believes it is in compliance with as of December 31, 2001.

Level 3 currently is using the proceeds from the senior securities, Senior Secured Credit Facility and subordinated notes for working capital, capital expenditures and other general corporate purposes in connection with the implementation of its business plan, including the acquisition of telecommunications assets.

The Company capitalized \$58 million, \$353 million and \$116 million of interest expense and amortized debt issuance costs related to network construction and business systems development projects for the years ended December 31, 2001, 2000 and 1999, respectively.

## **CPTC**

In July 2001, CPTC completed the refinancing of its development and construction debt. The \$135 million financing proceeds were used to repay CPTC's original lenders, repay subordinated debt carried by Orange County Transportation Authority and cover refinancing and prepayment costs. The prepayment costs and write-off of debt issuance costs on the old debt of \$9 million are reflected as an extraordinary loss, net of other gains, on early extinguishment of debt in the 2001 consolidated statement of operations. The debt carries an interest rate of 7.63% and requires principal payments in varying amounts through 2028. The debt is the obligation of CPTC and is nonrecourse to Level 3 Communications, Inc.

### **Future Debt Maturities:**

Scheduled maturities of long-term debt are as follows (in millions):  
2002-\$7; 2003-\$125; 2004-\$154; 2005-\$121; 2006-\$144 and \$5,665 thereafter.

### **(10) Employee Benefit Plans**

The Company applies the recognition provisions of SFAS No. 123, "Accounting for Stock Based Compensation" ("SFAS No. 123"). Under SFAS No. 123, the fair value of an option or other stock-based compensation (as computed in accordance with accepted option valuation models) on the date of grant is amortized over the vesting periods of the options in accordance with FASB Interpretation No. 28 "Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans" ("FIN 28"). Although the recognition of the value of the instruments results in compensation or professional expenses in an entity's financial statements, the expense differs from other compensation and professional expenses in that these charges, though permitted to be settled in cash, are generally settled through issuance of common stock.

The adoption of SFAS No. 123 has resulted in material non-cash charges to operations since its adoption in 1998, and will continue to do so. The amount of the non-cash charge will be dependent upon a number of factors, including the number of grants and the fair value of each grant estimated at the time of its award.

The Company recognized on the statement of operations a total of \$314 million, \$236 million and \$125 million of non-cash compensation in 2001, 2000 and 1999, respectively. Included in discontinued operations is non-cash compensation expense of \$7 million, \$5 million and \$1 million for fiscal 2001, 2000 and 1999, respectively. In addition, the Company capitalized \$17 million, \$12 million and \$10 million in 2001, 2000 and 1999, respectively, of non-cash compensation for those employees directly involved in the construction of the network or development of the business support systems.

The following table summarizes non-cash compensation expense and capitalized non-cash compensation for the three years ended December 31, 2001.

	2001		2000		1999	
	Expense	Capitalized	Expense	Capitalized	Expense	Capitalized
NQSO .....	\$ 9	\$ -	\$ 9	\$ -	\$ 3	\$ 1
Warrants .....	10	32	1	-	4	-
OSO .....	221	10	189	9	111	7
C-OSO .....	55	4	17	1	-	-
Restricted Stock .....	2	-	4	-	4	-
Stock Issued .....	-	-	5	-	-	-
Shareworks Match Plan .....	11	3	3	2	1	1
Shareworks Grant Plan .....	13	-	13	-	3	1
	-----	-----	-----	-----	-----	-----
	\$ 321	\$ 49	\$ 241	\$ 12	\$ 126	\$ 10
Discontinued Operations .....	(7)	-	(5)	-	(1)	-
	-----	-----	-----	-----	-----	-----
	\$ 314	\$ 49	\$ 236	\$ 12	\$ 125	\$ 10
	=====	=====	=====	=====	=====	=====

### Non-qualified Stock Options and Warrants

The Company issued approximately 9.8 million warrants to Peter Kiewit Sons' Inc ("Kiewit") as payment for certain construction services. The warrants, which allow Kiewit to purchase Common Stock at \$8 per share, were fully vested at issuance and will expire on June 30, 2009. The fair value of the warrants granted in 2001 was \$32 million and calculated using the Black-Scholes valuation model with a risk free interest rate of 4.8% and an expiration date of June 30, 2009. The Company used an expected volatility rate of 70% to reflect the longer exercise period. Kiewit has pledged these warrants as collateral to Level 3 while the two parties resolve outstanding claims with regard to the North American intercity network. If it is determined through the dispute resolution process, that Kiewit is liable for certain claims, it may settle, at Level 3's option, the obligation with cash or by returning all or part of the outstanding warrants.

In addition to the warrants issued to Kiewit, the Company had approximately 2.8 million warrants outstanding on December 31, 2001 ranging in prices from \$18.50 to \$29.00. Of these warrants, approximately 2.2 million are exercisable at December 31, 2001, with a weighted average exercise price of \$23.43 per warrant.

Transactions involving NQSO stock options granted are summarized as follows:

	Shares	Exercise Price Per Share	Weighted Average Exercise Price
Balance December 31, 1998.....	18,979,319	.12-41.25	6.50
Options granted.....	55,100	41.44-84.75	58.61
Options cancelled.....	(1,005,328)	.12-41.25	10.84
Options exercised.....	(3,950,528)	.12-41.25	5.60
	-----		
Balance December 31, 1999.....	14,078,563	.12-84.75	6.64
Options granted.....	230,000	21.69	21.69
Options cancelled.....	(228,029)	.12-61.75	9.58
Options exercised.....	(2,079,326)	.12-56.75	8.00
	-----		
Balance December 31, 2000.....	12,001,208	.12-84.75	6.63
Options granted.....	-	-	-
Options cancelled.....	(348,956)	1.76-56.75	10.18
Options exercised.....	(460,546)	.12-35.31	5.32
	-----		
Balance December 31, 2001.....	11,191,706	\$ .12-\$84.75	\$ 6.58
	=====	=====	=====
Options exercisable			
December 31, 1999.....	6,291,624	.12-\$41.25	6.13
December 31, 2000.....	7,166,636	.12-\$84.75	6.67
December 31, 2001.....	9,013,915	.12-\$84.75	6.70

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding as of 12/31/01	Weighted Average Remaining Life (years)	Weighted Average Exercise Price	Number Exercisable as of 12/31/01	Weighted Average Exercise Price
\$ 0.12- \$0.12 .....	82,807	6.27	\$ .12	81,134	\$ .12
1.76- 1.79 .....	18,914	6.33	1.76	9,962	1.76
4.04- 5.43 .....	7,965,203	5.33	5.11	6,638,203	5.05
6.20- 8.50 .....	2,604,793	6.05	6.94	1,767,768	6.97
17.50- 25.03 .....	235,839	3.41	21.77	235,839	21.77
26.80- 39.13 .....	241,383	1.54	30.67	241,383	30.67
40.38- 51.88 .....	25,667	1.70	41.43	25,292	41.36
56.00- 57.47 .....	10,500	2.46	56.91	8,834	56.81
61.75- 84.75 .....	6,600	2.28	84.75	5,500	84.75
	-----	-----	-----	-----	-----
	11,191,706	5.37	\$ 6.58	9,013,915	\$ 6.70
	=====	=====	=====	=====	=====

### Outperform Stock Option Plan

In April 1998, the Company adopted an outperform stock option ("OSO") program that was designed so that the Company's stockholders would receive a market return on their investment before OSO holders receive any return on their options. The Company believes that the OSO program aligns directly management's and stockholders' interests by basing stock option value on the Company's ability to outperform the market in general, as measured by the Standard & Poor's ("S&P") 500 Index. Participants in the OSO program do not realize any value from awards unless the Common Stock price outperforms the S&P 500 Index. When the stock price gain is greater than the corresponding gain on the S&P 500 Index (or less than the corresponding loss on the S&P Index), the value received for awards under the OSO plan is based on a formula involving a multiplier related to the level by which the Common Stock outperforms the S&P 500 Index. To the extent that the Common Stock outperforms the S&P 500, the value of OSOs to a holder may exceed the value of nonqualified stock options.

OSO awards are made quarterly to eligible participants on the date of the grant. Each award vests in equal quarterly installments over two years and has a four-year life. Awards granted prior to December 2000 typically have a two-

year moratorium on exercise from the date of grant. As a result, once a participant is 100% vested in the grant, the two-year moratorium expires. Therefore, awards granted prior to December 2000 have an exercise window of two years. Level 3 granted 3.1 million OSOs to employees in December 2000. Included in the grant were 2.1 million OSOs that vest 25% after six months with the remaining 75% vesting after 18 months. These OSOs and all additional OSOs granted after March 1, 2001 are exercisable immediately upon vesting and have a four-year life.

The fair value under SFAS No. 123 for the approximately 15.8 million OSOs granted to employees for services performed for the year ended December 31, 2001 was \$225 million. As of December 31, 2001, the Company had not yet recognized \$108 million of unamortized compensation costs for OSOs granted in 1999, 2000 and 2001.

Transactions involving OSO stock awards granted are summarized below:

	Shares	Option Price Per Share		Weighted Average Option Price
Balance December 31, 1998.....	2,092,513	29.78-	37.13	34.85
Options granted.....	3,241,599	56.00-	78.50	66.58
Options cancelled.....	(157,623)	29.78-	78.50	51.31
Options exercised.....	(37,500)	29.78-	37.13	34.64
Balance December 31, 1999.....	5,138,989	29.78-	78.50	54.15
Options granted.....	5,402,553	26.87-	113.87	52.96
Options cancelled.....	(262,545)	26.87-	113.87	72.55
Options exercised.....	(214,409)	29.78-	37.13	36.28
Balance December 31, 2000.....	10,064,588	26.87-	113.87	53.50
Options granted.....	15,757,972	3.82-	25.31	9.52
Options cancelled.....	(1,758,725)	3.82-	113.87	25.69
Options expired.....	(406,387)	25.31-	113.87	48.65
Options exercised.....	(96,031)	3.82-	34.50	8.45
	-----			-----
Balance December 31, 2001.....	23,561,417	\$ 3.82-	\$ 113.87	\$ 26.43
	=====		=====	=====
Options vested as of:				
December 31, 1999.....	2,098,337	\$ 29.78-	\$ 78.50	\$ 44.69
December 31, 2000.....	4,237,277	29.78-	113.87	56.18
December 31, 2001.....	8,738,516	3.82-	113.87	47.33

		OSOs Outstanding at December 31, 2001		OSOs Vested at December 31, 2001	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Life (years)	Weighted Average Option Price	Number Vested	Weighted Average Option Price
\$ 3.82 - 5.58 .....	8,231,134	3.79	\$ 4.67	503,088	\$ 3.82
11.20 .....	4,160,329	3.42	11.20	1,034,762	11.20
25.31 - 37.12 .....	6,518,000	2.45	28.17	3,102,087	30.19
56.00 - 78.50 .....	3,436,553	1.75	68.61	3,239,972	68.14
87.23 - 113.87 .....	1,215,401	2.48	97.34	858,607	99.76
-----	-----	-----	-----	-----	-----
	23,561,417	2.99	\$26.43	8,738,516	\$ 47.33
	=====	=====	=====	=====	=====

Of the approximately 8.7 million OSO units vested at December 31, 2001, approximately 7.0 million units are exercisable due to the two year moratorium on OSOs granted prior to December 1, 2000.

In July 2000, the Company adopted a convertible outperform stock option program, ("C-OSO") as an extension of the existing OSO plan. The program is a component of the Company's ongoing employee retention efforts and offers similar features to those of an OSO, but provides an employee with the greater of the value of a single share of the Company's common stock at exercise, or the calculated OSO value of a single OSO at the time of exercise.

C-OSO awards were made to eligible employees employed on the date of the grant. The awards were made in September 2000, December 2000, and September 2001. The awards granted in 2000 vest over three years as follows: 1/6 of each grant at the end of the first year, a further 2/6 at the end of the second year and the remaining 3/6 in the third year. The September 2001 awards vest in equal quarterly installments over three years. Each award is immediately exercisable upon vesting. Awards expire four years from the date of the grant.

The fair value of the OSOs and C-OSOs granted in 2001 was calculated by applying a modified Black-Scholes formula with an S&P 500 expected dividend yield rate of 1.8% and an expected life of 2 years. The Company used an S&P 500 expected volatility rate of 23% and the Level 3 Common Stock expected volatility rate of 55%. The expected correlation factor of 0.81 was used to measure the movement of Level 3 stock relative to the S&P 500.

The fair value recognized under SFAS No. 123 for the approximately 5 million C-OSOs awarded to employees for services performed for the year ended December 31, 2001 was approximately \$37 million. As of December 31, 2001, the Company had not reflected \$64 million of unamortized compensation expense in its financial statements for C-OSOs awarded in 2000 and 2001.

Transactions involving C-OSO stock awards are summarized below:

	Shares	Option Price Per Share		Weighted Average Option Price
Balance December 31, 1999.....	-	\$	-	\$ -
Options granted.....	1,965,509	26.87 -	87.23	56.67
Options cancelled.....	(25,522)		87.23	87.23
	-----			
Balance December 31, 2000.....	1,939,987	26.87 -	87.23	56.67
Options granted.....	4,958,786		3.82	3.82
Options cancelled.....	(890,057)	3.82 -	87.23	28.07
Options expired.....	(7,822)		87.23	87.23
Options exercised.....	(35,366)	3.82 -	87.23	46.56
	-----			
Balance December 31, 2001.....	5,965,528	\$ 3.82 - \$	87.23	\$ 16.90
	=====	=====		=====
Options vested as of:				
December 31, 2000.....	-		-	-
December 31, 2001.....	622,675	\$ 3.82 - \$	87.23	\$ 24.70
	=====	=====		=====
	C-OSOs Outstanding at December 31, 2001		C-OSOs Exercisable at December 31, 2001	
	Number Outstanding	Weighted Average Remaining Life (years)	Weighted Average Option Price	Number Exercisable
Range of Exercise Prices				Weighted Average Option Price
\$ 3.82.....	4,458,961	3.7	\$ 3.82	371,580
26.87.....	789,594	2.9	26.87	131,599
87.23.....	716,973	2.7	87.23	119,496
	-----			-----
	5,965,528	3.5	\$ 16.90	622,675
	=====	=====	=====	=====

## Restricted Stock

In 2001, 2000 and 1999, approximately 96 thousand, 116 thousand and 17 thousand shares, respectively, of restricted stock were granted to employees. The restricted stock shares were granted to employees at no cost. The shares typically vest over a one to three year period; however, the employees are restricted from selling these shares for three years. The fair value of restricted stock granted in 2001, 2000 and 1999 of less than \$1 million, \$7 million and \$1 million, respectively, was calculated using the value of the Common Stock the day prior to the grant.

As of December 31, 2001, the Company had not yet recognized \$1 million of unamortized compensation costs for restricted stock granted since 1998.

### **Shareworks**

Level 3 has designed its compensation programs with particular emphasis on equity-based, long-term incentive programs. The Company has developed two plans under its Shareworks program: the Match Plan and the Grant Plan.

**Match Plan**-The Match Plan allows eligible employees to defer between 1% and 7% of their eligible compensation to purchase Common Stock at the average stock price for the quarter. Any full time employee is considered eligible on the first day of the calendar quarter after their hire. The Company matches the shares purchased by the employee on a one-for-one basis. Stock purchased with payroll deductions is fully vested. Stock purchased with the Company's matching contributions vests three years after the end of the quarter in which it was made.

The Company's quarterly matching contribution is amortized to compensation expense over the vesting period of 36 months. The Company's matching contributions were \$16 million, \$14 million and \$10 million under the Match Plan in 2001, 2000 and 1999, respectively.

As of December 31, 2001, the Company had not yet reflected unamortized compensation expense of \$19 million related to the Company's matching contributions.

**Grant Plan**-The Grant Plan enables the Company to grant shares of Common Stock to eligible employees based upon a percentage of employees eligible salary up to a maximum of 5%. Level 3 employees employed on December 31 of each year, who are age 21 or older with a minimum of 1,000 hours credited service are considered eligible. The shares granted are valued at the fair market value as of the last business day of the calendar year. All prior and future grants vest immediately upon the employee's third anniversary of joining the Shareworks Plan.

Foreign subsidiaries of the Company adopted Shareworks programs in 2000. These programs primarily include a grant plan and a stock purchase plan whereby employees may purchase Level 3 Common Stock at 80% of the share price at the beginning of the plan year.

### **Other**

The Company recorded approximately \$5 million of non-cash compensation expense for stock issued to employees during the year ended December 31, 2000. The non-cash compensation charge was based on the Company's stock price on the day prior to the grant. The Company did not issue stock to employees in 2001 and 1999.

### **401(k) Plan**

The Company and its subsidiaries offer its qualified employees the opportunity to participate in a defined contribution retirement plan qualifying under the provisions of Section 401(k) of the Internal Revenue Code. Each employee was eligible to contribute, on a tax deferred basis, a portion of annual earnings not to exceed \$10,500 in 2001. The Company does not match employee contributions and therefore does not incur any compensation expense related to the 401(k) plan.

## (11) Income Taxes

An analysis of the income tax (provision) benefit attributable to earnings (loss) from continuing operations before income taxes for the three years ended December 31, 2001 follows:

	2001	2000	1999
	(dollars in millions)		
Current:			
United States Federal.....	\$ -	\$ 50	\$ 161
State.....	-	(1)	3
	-	49	164
Deferred:			
United States Federal.....	1,357	255	56
State.....	-	-	-
	1,357	255	56
Valuation Allowance.....	(1,357)	(255)	-
Income Tax Benefit	\$ -	\$ 49	\$ 220
	=====	=====	=====

The United States and foreign components of earnings (loss) from continuing operations before income taxes follows:

	2001	2000	1999
	(dollars in millions)		
United States.....	\$ (4,508)	\$ (995)	\$ (578)
Foreign.....	(940)	(509)	(129)
	-----	-----	-----
	\$ (5,448)	\$ (1,504)	\$ (707)
	=====	=====	=====

A reconciliation of the actual income tax (provision) benefit and the tax computed by applying the U.S. Federal rate (35%) to the earnings (loss) from continuing operations, before income taxes for the three years ended December 31, 2001 follows:

	2001	2000	1999
	(dollars in millions)		
Computed Tax Benefit at Statutory Rate.....	\$ 1,907	\$ 526	\$ 247
State Income Taxes.....	-	(1)	2
Coal Depletion.....	1	2	2
Goodwill Amortization.....	(13)	(17)	(12)
Taxes on Unutilized Losses of Foreign Operations.....	(63)	(35)	(9)
Foreign Tax Credits.....	-	-	(10)
Other.....	(90)	(1)	-
Valuation Allowance.....	(1,742)	(425)	-
	-----	-----	-----
Income Tax Benefit.....	\$ -	\$ 49	\$ 220
	=====	=====	=====

For federal income tax reporting purposes, the Company has approximately \$1.8 billion of net operating loss carryforwards, net of previous carrybacks, available to offset future Federal taxable income. The net operating loss carryforwards expire in 2021 and are subject to examination by the tax authorities.

The Internal Revenue Code contains provisions which may limit the net operating loss carryforwards available to be used in any given year upon the occurrence of certain events, including significant changes in ownership interests.

For federal income tax reporting purposes, the Company has approximately \$19 million of alternative minimum tax credits available to offset future regular federal income tax. The credits can be carried forward until fully utilized.

The components of the net deferred tax assets (liabilities) for the years ended December 31, 2001 and 2000 were as follows:

	2001	2000
	(dollars in	millions)
Deferred Tax Assets:		
Net operating loss carryforwards .....	\$ 613	\$ 223
Compensation and related benefits .....	254	154
Investment in subsidiaries. ....	2	11
Provision for estimated expenses. ....	189	94
Investment in joint ventures. ....	52	69
Asset bases - accumulated depreciation .....	1,109	-
Other. ....	45	12
	-----	-----
Total Deferred Tax Assets.	2,264	563
Deferred Tax Liabilities:		
Investments in securities.....	9	18
Investments in joint ventures.....	-	4
Asset bases-accumulated depreciation.....	-	38
Coal sales.....	32	32
Provision for estimated expenses.....	-	12
Other.....	22	22
	-----	-----
Total Deferred Tax Liabilities.....	63	126
	-----	-----
Net Deferred Tax Assets before valuation allowance.....	2,201	437
Valuation Allowance Components:		
Net Deferred Tax Assets.....	(2,152)	(410)
Stockholders' Equity (primarily tax benefit from option exercises).....	(120)	(92)
	-----	-----
Net Deferred Tax Liabilities after Valuation Allowance.....	\$ (71)	\$ (65)
	=====	=====

The current net deferred tax assets at December 31, 2001 and 2000 are zero and \$15 million, respectively, after current valuation allowances of (\$206) million and (\$86) million and the non-current deferred tax liabilities are (\$71) million and (\$80) million, respectively, after non-current valuation allowance of (\$2,066) million and (\$416) million respectively.

#### (12) Stockholders' Equity

During August and December 2001, the Company issued approximately 15.9 million shares, valued at approximately \$72 million, in exchange for \$194 million in convertible subordinated notes. The Company recognized an extraordinary gain, after transaction costs and unamortized debt issuance costs, of \$117 million on these transactions.

In February 2000, the Company raised \$2.4 billion, after underwriting discounts and offering expenses, from an offering of 23 million shares of its common stock through an underwritten public offering. In March 1999, the Company raised \$1.5 billion, after underwriting discounts and offering expenses, from the offering of 28.75 million shares of its common stock through an underwritten public offering. The net proceeds from both offerings are being used for working capital, capital expenditures, acquisitions and other general corporate purposes in connection with the implementation of the Company's business plan.



Issuances of common stock, for sales, conversions, option exercises and acquisitions for the three years ended December 31, 2001 are shown below. The Level 3 Stock Plan permits option holders to tender shares to the Company to cover income taxes due on option exercises.

December 31, 1998.....	307,874,706
Shares Issued.....	28,750,000
Option and Shareworks Activity.....	4,371,578
Shares Issued for Acquisition.....	396,379
6% Convertible Notes Converted to Shares.....	4,064
	-----
December 31, 1999.....	341,396,727
Shares Issued.....	23,000,000
Option and Shareworks Activity.....	3,202,760
6% Convertible Notes Converted to Shares.....	383
	-----
December 31, 2000.....	367,599,870
Option and Shareworks Activity.....	1,245,093
Debt for Equity Exchanges.....	15,858,959
	-----
December 31, 2001.....	384,703,922
	=====

### (13) Industry and Geographic Data

SFAS No. 131 "Disclosures about Segments of an Enterprise and Related Information" 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 strategic business units that offer different products and serve different markets. The Company's reportable segments include: communications, information services, and coal mining. Other primarily includes the CPTC, equity investments, and other corporate assets and overhead not attributable to a specific segment.

EBITDA, as defined by the Company, consists of earnings (loss) before interest, income taxes, depreciation, amortization, non-cash operating expenses (including stock-based compensation and impairments) and other non-operating income or expense. The Company excludes non-cash compensation due to its adoption of the expense recognition provisions of SFAS No. 123. EBITDA is commonly used in the communications industry to analyze companies on the basis of operating performance. EBITDA is not intended to represent cash flow for the periods presented and is not recognized under Generally Accepted Accounting Principles ("GAAP").

The information presented in the tables following includes information for twelve months ended December 31, 2001, 2000 and 1999 for all statement of operations and cash flow information presented, and as of December 31, 2001 and 2000 for all balance sheet information presented. Revenue and the related expenses are attributed to countries based on where services are provided.

Industry and geographic segment financial information follows. Certain prior year information has been reclassified to conform with the 2001 presentation.

	Communications	Information Services	Coal Mining	Other	Total
	(dollars in millions)				
2001					
Revenue:					
North America.....	\$ 1,137	\$ 110	\$ 87	\$ 25	\$ 1,359
Europe.....	161	13	-	-	174
	-----	-----	-----	-----	-----
	\$ 1,298	\$ 123	\$ 87	\$ 25	\$ 1,533
	=====	=====	=====	=====	=====
EBITDA:					
North America.....	\$ (216)	\$ 4	\$ 23	\$ (7)	\$ (196)
Europe.....	(106)	2	-	-	(104)
	-----	-----	-----	-----	-----
	\$ (322)	\$ 6	\$ 23	\$ (7)	\$ (300)
	=====	=====	=====	=====	=====
Capital Expenditures:					
North America.....	\$ 2,131	\$ 17	\$ 5	\$ 1	\$ 2,154
Europe.....	171	-	-	-	171
	-----	-----	-----	-----	-----
	\$ 2,302	\$ 17	\$ 5	\$ 1	\$ 2,325
	=====	=====	=====	=====	=====
Depreciation and Amortization:					
North America.....	\$ 912	\$ 15	\$ 3	\$ 6	\$ 936
Europe.....	184	2	-	-	186
	-----	-----	-----	-----	-----
	\$ 1,096	\$ 17	\$ 3	\$ 6	\$ 1,122
	=====	=====	=====	=====	=====
2000					
Revenue:					
North America.....	\$ 744	\$ 103	\$ 190	\$ 22	\$ 1,059
Europe.....	113	12	-	-	125
	-----	-----	-----	-----	-----
	\$ 857	\$ 115	\$ 190	\$ 22	\$ 1,184
	=====	=====	=====	=====	=====
EBITDA:					
North America.....	\$ (442)	\$ 2	\$ 86	\$ 7	\$ (347)
Europe.....	(139)	4	-	-	(135)
	-----	-----	-----	-----	-----
	\$ (581)	\$ 6	\$ 86	\$ 7	\$ (482)
	=====	=====	=====	=====	=====
Capital Expenditures:					
North America.....	\$ 4,625	\$ 11	\$ 2	\$ -	\$ 4,638
Europe.....	989	1	-	-	990
	-----	-----	-----	-----	-----
	\$ 5,614	\$ 12	\$ 2	\$ -	\$ 5,628
	=====	=====	=====	=====	=====
Depreciation and Amortization:					
North America.....	\$ 436	\$ 18	\$ 5	\$ 6	\$ 465
Europe.....	112	2	-	-	114
	-----	-----	-----	-----	-----
	\$ 548	\$ 20	\$ 5	\$ 6	\$ 579
	=====	=====	=====	=====	=====
1999					
Revenue:					
North America.....	\$ 145	\$ 122	\$ 207	\$ 19	\$ 493
Europe.....	14	8	-	-	22
	-----	-----	-----	-----	-----
	\$ 159	\$ 130	\$ 207	\$ 19	\$ 515
	=====	=====	=====	=====	=====
EBITDA:					
North America.....	\$ (391)	\$ 8	\$ 81	\$ 6	\$ (296)
Europe.....	(88)	1	-	-	(87)
	-----	-----	-----	-----	-----
	\$ (479)	\$ 9	\$ 81	\$ 6	\$ (383)
	=====	=====	=====	=====	=====
Capital Expenditures:					
North America.....	\$ 2,583	\$ 12	\$ 3	\$ 1	\$ 2,599
Europe.....	786	-	-	-	786
	-----	-----	-----	-----	-----
	\$ 3,369	\$ 12	\$ 3	\$ 1	\$ 3,385
	=====	=====	=====	=====	=====

Depreciation and Amortization:					
North America.....	\$ 176	\$ 12	\$ 5	\$ 9	\$ 202
Europe.....	24	2	-	-	26
	-----	-----	-----	-----	-----
	\$ 200	\$ 14	\$ 5	\$ 9	\$ 228
	=====	=====	=====	=====	=====
Identifiable Assets					
December 31, 2001					
North America.....	\$ 5,547	\$ 74	\$ 303	\$1,603	\$ 7,527
Europe.....	1,763	5	-	37	1,805
Discontinued Asian Operations.....	74	-	-	-	74
	-----	-----	-----	-----	-----
	\$ 7,384	\$ 79	\$ 303	\$1,640	\$ 9,406
	=====	=====	=====	=====	=====
December 31, 2000					
North America.....	\$ 8,091	\$ 78	\$ 310	\$4,009	\$12,488
Europe.....	1,811	9	-	122	1,942
Discontinued Asian Operations.....	476	-	-	13	489
	-----	-----	-----	-----	-----
	\$ 10,378	\$ 87	\$ 310	\$4,144	\$14,919
	=====	=====	=====	=====	=====
Long-Lived Assets					
December 31, 2001					
North America.....	\$ 5,278	\$ 50	\$ 16	\$ 228	\$ 5,572
Europe.....	1,709	1	-	-	1,710
Discontinued Asian Operations.....	-	-	-	-	-
	-----	-----	-----	-----	-----
	\$ 6,987	\$ 51	\$ 16	\$ 228	\$ 7,282
	=====	=====	=====	=====	=====
December 31, 2000					
North America.....	\$ 7,548	\$ 49	\$ 15	\$ 217	\$ 7,829
Europe.....	1,660	3	-	-	1,663
Discontinued Asian Operations.....	382	-	-	-	382
	-----	-----	-----	-----	-----
	\$ 9,590	\$ 52	\$ 15	\$ 217	\$ 9,874
	=====	=====	=====	=====	=====

Product information for the Company's communications segment follows:

	Services	Reciprocal Compensation (dollars in millions)	Up-front Dark Fiber	Total
Communications Revenue				
2001				
North America.....	\$ 715	\$ 134	\$ 288	\$ 1,137
Europe.....	161	-	-	161
	-----	-----	-----	-----
	\$ 876	\$ 134	\$ 288	\$ 1,298
	=====	=====	=====	=====
2000				
North America.....	\$ 480	\$ 55	\$ 209	\$ 744
Europe.....	113	-	-	113
	-----	-----	-----	-----
	\$ 593	\$ 55	\$ 209	\$ 857
	=====	=====	=====	=====
1999				
North America.....	\$ 86	\$ 24	\$ 35	\$ 145
Europe.....	14	-	-	14
	-----	-----	-----	-----
	\$ 100	\$ 24	\$ 35	\$ 159
	=====	=====	=====	=====

The majority of North American revenue consists of services and products delivered within the United States. The majority of European revenue consists of services and products delivered within the United Kingdom. Transoceanic revenue is allocated equally between North America and Europe as it represents services provided between these two regions.

In 1999, Commonwealth Edison Company, a coal mining customer, accounted for 22% of total revenue.

The following information provides a reconciliation of EBITDA to loss from continuing operations for the three years ended December 31, 2001:

	2001	2000	1999
	(dollars	in millions)	
EBITDA . . . . .	\$ (300)	\$ (482)	\$ (383)
Depreciation and Amortization Expense . . . . .	(1,122)	(579)	(228)
Non-Cash Compensation Expense . . . . .	(314)	(236)	(125)
Non-Cash Impairment Expense . . . . .	(3,245)	-	-
	-----	-----	-----
Loss from Operations . . . . .	(4,981)	(1,297)	(736)
Other Income (Expense) . . . . .	(467)	(159)	34
Income Tax Benefit . . . . .	-	49	220
	-----	-----	-----
Loss from Continuing Operations . . . . .	\$ (5,448)	\$ (1,407)	\$ (482)
	=====	=====	=====

#### (14) Commitments and Contingencies

In May 2001, a subsidiary of the Company was named as a defendant in Bauer, et. al. v. Level 3 Communications, LLC, et al., a purported multi-state class action, filed in the U.S. District Court for the Southern District of Illinois and in July 2001, the Company was named as a defendant in Koyle, et. al. v. Level 3 Communications, Inc., et. al., a purported multi-state class action filed in the U.S. District Court for the District of Idaho. Both of these actions involve the Company's right to install its fiber optic cable network in easements and right-of-ways crossing the plaintiffs' land. In general, the Company obtained the rights to construct its network from railroads, utilities, and others, and is installing its network along the rights-of-way so granted. Plaintiffs in the purported class actions assert that they are the owners of lands over which the Company's fiber optic cable network passes, and that the railroads, utilities, and others who granted the Company the right to construct and maintain its network did not have the legal ability to do so. The action purports to be on behalf of a class of owners of land in multiple states over which the Company's network passes or will pass. The complaint seeks damages on theories of trespass, unjust enrichment and slander of title and property, as well as punitive damages. The Company has also received, and may in the future receive, claims and demands related to rights-of-way issues similar to the issues in the these cases that may be based on similar or different legal theories. Although it is too early for the Company to reach a conclusion as to the ultimate outcome of these actions, 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 them 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, future results of operations, or future cash flows.

#### Operating Leases

The Company is leasing rights of way, communications capacity and premises under various operating leases which, in addition to rental payments, require payments for insurance, maintenance, property taxes and other executory costs related to the lease. Certain leases provide for adjustments in lease cost based upon adjustments in the consumer price index and increases in the landlord's management costs. The lease agreements have various expiration dates through 2030.

The Company has obligations under non-cancelable operating leases for certain facilities and equipment. Future minimum payments for the next five years under these leases, including those identified in the restructuring analysis, consist of the following at December 31, 2001 (in millions):

2002.....	\$ 54
2003.....	53
2004.....	51
2005.....	51
2006.....	51
Thereafter.....	306
Total.....	\$566

Rent expense under non-cancelable lease agreements was \$79 million in 2001, \$52 million in 2000 and \$37 million in 1999.

#### (15) Related Party Transactions

Kiewit acted as the general contractor on several significant projects for the Company in 2001, 2000 and 1999. These projects include the Phoenix Data Center, the U.S. intercity network, certain metropolitan networks and certain Gateway sites, the Company's corporate headquarters and other office space in Colorado. Kiewit provided approximately \$693 million, \$1,764 million, and \$1,024 million of construction services related to these projects in 2001, 2000, and 1999 respectively. In 2001, Level 3 issued warrants, valued at \$32 million, in lieu of cash for services related to construction of the North American intercity network. It is anticipated that Kiewit will transfer a portion of these warrants to Walter Scott, Jr. and William L. Grewcock, directors of Level 3 and Kiewit, for consideration in 2002.

Level 3 also receives certain mine management services from Kiewit. The expense for these services was \$5 million for 2001, \$29 million for 2000, and \$33 million for 1999, and is recorded in selling, general and administrative expenses.

In September 2000, the Company sold its entire interest in Walnut Creek Mining Company to Kiewit for cash of \$37 million. The sale resulted in a pre-tax gain of \$21 million to the Company, which is included in gain on sale of assets in the accompanying consolidated statement of operations.

RCN purchased less than \$3 million, \$2 million and \$1 million of telecommunications services from the Company in 2001, 2000 and 1999, respectively.

#### (16) Other Matters

On January 18, 2001, Level 3 announced that in order to provide the Company with additional flexibility in funding its business plan, it filed a "universal" shelf registration statement with the Securities and Exchange Commission relating to \$3.0 billion of common stock, preferred stock, debt securities, warrants, stock purchase agreements and depository shares. The registration statement, (declared effective by the Securities and Exchange Commission on January 31, 2001), allows Level 3 to publicly offer these securities from time to time at prices and terms to be determined at the time of the offering. When combined with the remaining availability under its previously existing effective universal shelf registration statement, the availability under the registration statements allows Level 3 to offer an aggregate of up to approximately \$3.2 billion of securities.

It is customary in Level 3's industries to use various financial instruments in the normal course of business. These instruments include items such as letters of credit. Letters of credit are conditional commitments issued on behalf of Level 3 in accordance with specified terms and conditions. As of December 31, 2001, Level 3 had outstanding letters of credit of approximately \$47 million. The Company does not believe it is practicable to estimate the fair value of the letters of credit and does not believe exposure to loss is likely nor material.

## (17) Subsequent Events

On January 24, 2002 Level 3 completed the acquisition of the wholesale dial-up access business assets of McLeodUSA Incorporated (formerly Splitrock Services) for approximately \$50 million in cash consideration and the assumption of certain operating liabilities related to that business. The acquisition includes customer contracts, approximately 350 POPs (Points of Presence) across the U.S. and the related facilities, equipment and underlying circuits. In addition, the parties entered into certain operating agreements enabling McLeodUSA to continue to support its in-region customers. The acquisition enables Level 3 to provide managed modem service in all 50 states with a coverage area that includes 80 percent of the U.S. population, up from 37 states, and 57 percent of the U.S. population.

On February 8, 2002, Level 3 announced that Commonwealth Telephone had filed a registration statement with the Securities and Exchange Commission relating to the sale of 2,750,000 shares (plus 412,500 additional shares subject to the underwriters' over-allotment option) of Commonwealth Telephone common stock by a wholly-owned subsidiary of Level 3 Communications, Inc. On March 8, 2002, Commonwealth amended the filing to increase the number available for sale to 3,500,000 (plus 525,000 additional shares subject to over-allotment options). The 3.5 million shares represent approximately 33 percent of Level 3's economic ownership in Commonwealth Telephone and based on the March 11, 2002 closing price of \$39.83 per share, would result in approximately \$139 million of gross proceeds to the Company.

On February 22, 2002, the Company paid David C. McCourt, a Director of the Company, \$15 million for his 10% interest in Level 3 Telecom Holdings, Inc, the entity that holds the investments in RCN and Commonwealth Telephone.

From January 1, 2002 through March 13, 2002, Level 3 had retired approximately \$195 million face amount of debt securities, by issuing 7.4 million shares, valued at \$32 million and through Level 3 Finance, LLC using approximately \$34 million of cash. Level 3 expects to recognize an extraordinary gain of approximately \$130 million, after transaction and debt issuance costs, from these transactions in the first quarter of 2002.

On March 6, 2002, the Company completed the refinancing of the Lehman Commercial Mortgage. The terms of the agreement with iStar Financial Group include:  
reducing the outstanding loan amount to \$60 million through repayment, releasing the restrictions on \$57 million securities held in escrow and increasing the borrowing rate to 650 basis points over LIBOR.

On March 9, 2002, legislation was enacted that will enable the Company to carry its taxable net operating losses back five years. As a result, the Company expects to receive a Federal income tax refund of approximately \$120 million after it files its 2001 Federal income tax return carrying back the taxable loss to 1996. This benefit will be reflected in the first quarter 2002 financial statements in accordance with SFAS No. 109 "Accounting for Income Taxes".

On March 13, 2002, the Company acquired privately held CorpSoft, Inc. ("CorpSoft"), a major distributor, marketer and reseller of business software. Level 3 paid approximately \$89 million in cash and assumed approximately \$31 million in net debt to acquire CorpSoft. CorpSoft generated approximately \$1.1 billion in revenue in 2001 and had EBITDA of approximately \$18 million, excluding stock-based compensation, one-time restructuring charges and other non-recurring employee costs. Level 3 expects the acquisition will enable its information services business to leverage CorpSoft's customer base, worldwide presence and relationships to expand its portfolio of services. The Company believes that communications price performance will improve more rapidly than computing and data storage price performance. As a result, companies will, over time seek to gain information technology operating efficiency by acquiring software functionality and data storage capability as commercial services purchased and then delivered over broadband networks such as the Level 3 network. In addition, Level 3 expects to utilize its network infrastructure to facilitate the deployment of software to CorpSoft's customers. Revenue attributable to CorpSoft subsequent to the acquisition date, will be included in Minimum Telecom Revenue as defined in the Senior Secured Credit Facility.

As a result of this transaction, the Company believes it will remain in compliance with the terms and conditions of the Senior Secured Credit Facility until the second half of 2003. The Company's expectation assumes that it takes

no other actions, its sales levels do not improve beyond those experienced during the second half of 2001, and disconnects and cancellations trend down during the second half of 2002 in accordance with the Company's customer credit analysis.

Given other actions the Company may take, and based on its longer term expectations for improvements in its rate of sales, disconnects and cancellations, new product and service introductions and the potential for additional acquisitions, the Company believes it will continue to remain in compliance with the terms and conditions of the Senior Secured Credit Facility over the term of that agreement.

#### (18) Unaudited Quarterly Financial Data

	March		June		September		December	
	2001	2000	2001	2000	2001	2000	2001	2000
	(in millions except per share data)							
Revenue .	\$ 448	\$ 17	\$ 387	\$ 234	\$ 372	\$ 341	\$ 326	\$ 432
Loss from Operations.....	(413)	(272)	(572)	(298)	(396)	(308)	(3,600)	(419)
Net Loss.....	(535)	(271)	(731)	(281)	(437)	(351)	(3,275)	(552)
Loss per Share (Basic and Diluted):								
Net Loss from Continuing Operations.....	\$(1.41)	\$(.76)	\$(1.92)	\$(.74)	\$(1.35)	\$(.92)	\$(9.70)	\$(1.44)
Discontinued Operations.....	(.04)	(.01)	(.07)	(.03)	(.07)	(.04)	(1.40)	(.06)
Extraordinary Gain on Debt Extinguishment....	-	-	-	-	.25	-	2.56	-
Net Loss.....	\$(1.45)	\$(.77)	\$(1.99)	\$(.77)	\$(1.17)	\$(.96)	\$(8.54)	\$(1.50)

Loss per share was calculated for each three-month period on a stand-alone basis. As a result of stock transactions during the periods, the sum of the loss per share for the four quarters of each year may not equal the loss per share for the twelve month periods.

In the fourth quarter of 2001, the Company determined that, due to the continuing economic slowdown and continued over-capacity in certain areas of the telecommunications industry, the estimated future undiscounted cash flows attributable to certain assets would not exceed the current carrying value of the assets. The Company, therefore, recorded an impairment charge of \$3.2 billion to reflect the difference between the estimated fair value of the assets and their current carrying value.

As described in Note 3, the Company sold its Asian telecommunication operations to Reach Ltd. in January 2002. In accordance with SFAS No. 144, the Company classified these assets as held-for-sale and accordingly reclassified the losses attributable to the Asian operations to Discontinued Operations. In the fourth quarter of 2001, the Company recognized a loss of \$516 million within discontinued operations, equal to the difference between the carrying value of the Asian operations and its estimated fair value.

The Company repurchased approximately \$1.8 billion of its long-term debt using cash and equity in 2001. The Company recognized extraordinary gains of approximately \$93 million and \$981 million on these transactions in the third and fourth quarters of 2001, respectively.

## **Exhibit 10.4**

### **SHARE PURCHASE AGREEMENT**

This Share Purchase Agreement (the "Agreement") is entered into as of the 21st day of February, 2002, between Level 3 Holdings, Inc., a Delaware corporation ("Buyer"), and David C. McCourt ("Seller").

### **BACKGROUND**

Seller owns 84.21216 shares of Common Stock, par value \$.01 per share (the "Shares") of Level 3 Telecom Holdings, Inc., which Shares are subject to a shareholder agreement, dated as of June 10, 1993, between Seller and a predecessor to the Buyer, relative to an investment in C-TEC Corporation (together with any amendments thereto, the "Shareholder Agreement");

Buyer desires to purchase the Shares from Seller, and Seller desires to sell the Shares to Buyer, upon the terms and subject to the conditions set forth herein.

Buyer and Seller further desire to terminate the Shareholder Agreement, and any obligations related thereto, by either party, upon the terms and subject to the conditions set forth herein.

NOW, THEREFORE, in consideration of the foregoing and the mutual promises contained herein and intending to be legally bound hereby, the parties hereto agree as follows:

1. Purchase and Sale of Shares. Upon the basis of the representations and warranties herein contained, and the other terms of this Agreement, Buyer agrees to purchase the Shares from Seller, and Seller agrees to sell, transfer, assign and deliver the Shares to Buyer, free and clear of any liens security interests, encumbrances, claims, liabilities, restrictions and third party right ("Liens"). The purchase price for the Shares shall be \$15,000,000 ("Purchase Price"). The closing of the purchase and sale of the Shares (the "Closing") shall take place on February 22, 2002, (or on such other date as the parties may otherwise agree) at such location as the parties shall agree. At the Closing (i) Seller shall deliver to Buyer a certificate for the Shares duly endorsed or accompanied by stock powers duly endorsed in blank, with any required transfer tax stamps affixed thereto and (ii) Buyer shall deliver to Seller the Purchase Price in immediately available funds by wire transfer to an account of Seller with a bank designated by Seller, by notice to Buyer, not later than two business days prior to the date of the Closing (or if not so designated, then by certified or official bank check payable in immediately available funds to the order of Seller in such amount).



2. Shareholders Agreement. As further consideration for the transactions contemplated in this Agreement, the Shareholder Agreement, and any and all obligations related thereto, by either Seller or Buyer, are hereby cancelled and terminated in all respects and are deemed null, void, and of no effect whatsoever.

3. Release. As further consideration for the transaction contemplated in this Agreement, each of the parties hereby releases, relieves, waives and forever discharges the other party and its subsidiaries, parent, and affiliated companies and their respective shareholders, officers, directors, employees, agents, successors and assigns from any and all claims, demands, actions, damages, liabilities, and causes of action, whether known or unknown, which such party may have had, may presently have, or in the future may have or choose to have that directly or indirectly relate to or arise out of the Shareholder Agreement or relate to or arise out of Seller's investment or ownership in the Shares.

4. Representations and Warranties of Seller. Seller hereby represents and warrants to Buyer as follows:

(a) Seller has full power, capacity and right to execute and deliver this Agreement and to perform his obligations hereunder.

(b) This Agreement has been duly executed and delivered by Seller and constitutes the valid and binding agreement of Seller enforceable against Seller in accordance with its terms, except as such enforceability may be limited by bankruptcy, insolvency, reorganization, moratorium and other similar laws relating to creditors rights or general principles of equity.

(c) Seller is the record and beneficial owner of the Shares free and clear of any Liens. At the Closing, Seller will transfer and deliver to Buyer good and valid title to the Shares free and clear of any Lien.

(d) No approval, authorization, consent or filing is required by the Seller in connection with the execution, delivery and performance of this Agreement by Seller, except as may be required under the Securities Exchange Act of 1934.

(e) The execution, delivery and performance of this Agreement by Seller does not contravene or conflict with any material agreement, contract or other instrument, or any law, rule, regulation, order or decree, binding upon or applicable to the Seller.

5. Representations and Warranties of Buyer. Buyer hereby represents and warrants to Seller as follows:

- (a) Buyer has full power, capacity, authority and right to execute and deliver this Agreement and to perform its obligations hereunder.
- (b) This Agreement has been duly authorized by all necessary action and constitutes the valid and binding agreement of Buyer enforceable against Buyer in accordance with its terms, except as such enforceability may be limited by bankruptcy, insolvency, reorganization, moratorium and other similar laws relating to creditors rights or by general principles of equity.
- (c) No approval, authorization, consent or filing is required in connection with the execution, delivery and performance of this Agreement by Buyer, except as may be required under the Securities Exchange Act of 1934, as amended.
- (d) The execution, delivery and performance of this Agreement by Buyer does not contravene or conflict with the articles of incorporation or bylaws of Buyer or with any material agreement, contract or other instrument, or any law, rule, regulation, order or decree, binding upon or applicable to Buyer.

6. Miscellaneous.

- (a) The parties agree to cooperate with each other in executing and delivering all further documents necessary to effect the purchase and sale of the Shares, and both parties agree to cooperate with the other for purposes of effecting the other terms of this Agreement.
- (b) All representations, warranties, covenants, and obligations in this Agreement will survive the Closing.
- (c) Any provision of this Agreement may be amended or waived, if, but only if, such amendment or waiver is in writing and is signed by both parties hereto.
- (d) This Agreement shall be binding upon and inure to the benefit of each of the parties and their respective heirs, administrators, successors, assigns and legal representatives.
- (e) This Agreement shall be construed in accordance with and governed by the laws of the State of New York, without regard to the conflicts of law rules of such state (other than Section 5-104 of the General

**Obligations Law of the State of New York).**

- (f) The parties agree that the terms of this Agreement, and the discussion relating to this Agreement, are and shall remain confidential as between the parties, unless and to the extent disclosure is required by law, or to secure advice from a legal or tax advisor.
- (g) This Agreement contains the entire agreement of the parties hereto with respect to the purchase of the Shares and the other transactions contemplated herein, and supersedes all prior understandings and agreements of the parties with respect to the subject matters hereof.
- (h) This Agreement may be executed in counterparts each of which shall be an original with the same effect as if the signatures thereto and hereto were upon the same instrument. No provision of this Agreement is intended to confer upon any Person other than the parties hereto any rights or remedies hereunder.
- (i) If any term, provision, covenant or restriction of this Agreement is held by a court of competent jurisdiction or other authority to be invalid, void or unenforceable, the remainder of the terms, provisions, covenants and restrictions of this Agreement shall remain in full force and effect and shall in no way be affected, impaired or invalidated so long as the economic or legal substance of the transactions contemplated hereby is not affected in any manner materially adverse to any party. Upon such a determination, the parties shall negotiate in good faith to modify this Agreement so as to effect the original intent of the parties as closely as possible in an acceptable manner in order that the transactions contemplated hereby be consummated as originally contemplated to the fullest extent possible.
- (j) All notices, requests, consents and other communications required or permitted hereunder shall be in writing and shall be hand delivered or mailed postage prepaid by registered or certified mail or transmitted by facsimile transmission (with immediate telephonic confirmation thereafter),

(1) If to the Seller, to:

David C. McCourt c/o RCN Corporation 105 Carnegie Center Princeton, NY 08540-6215 Facsimile No.: (609) 919-8632

with a copy to:

Skadden, Arps, Slate, Meagher & Flom LLP Four Times Square New York, NY 10036-6522 Attention: Matthew A. Rosen and Howard L. Ellin Facsimile No.: (212) 735-2000

**or (2) If to the Buyer, to:**

Level 3 Holdings, Inc.  
1025 Eldorado Boulevard  
Broomfield, CO 80021  
Attention: General Counsel  
Facsimile No. (720) 888-5127

with a copy to:

Level 3 Communications, Inc.  
1025 Eldorado Boulevard  
Broomfield, CO 80021  
Attention: General Counsel  
Facsimile No. (720) 888-5127

Or at such other address as the Buyer or Seller each may specify by written notice to the others, and each such notice, request, consent and other communication shall for all purposes of the Agreement be treated as being effective or having been given when delivered if delivered personally, upon receipt of facsimile confirmation if transmitted by facsimile, or, if sent by mail, at the earlier of its receipt of 72 hours after the same has been deposited in a regularly maintained receptacle for the deposit of United States mail, addressed and postage prepaid as aforesaid.

IN WITNESS WHEREOF, each of the undersigned has duly executed, or caused its authorized officer to duly execute, this Agreement as of the date first set forth above.

**DAVID C. McCOURT**

*/s/ David C. McCourt*

*Level 3 Holdings, Inc.*

*By:           /s/ Thomas C. Stortz*  
*Name: Thomas C. Stortz*  
*Title: Vice President*

**Exhibit 10.5**

**LEVEL 3 COMMUNICATIONS, INC.**

and

**WILLIAM L. GREWCOCK**

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**Warrant Agreement**

**Dated as of March 11, 2002**

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WARRANT AGREEMENT (the "Agreement"), dated as of March 11, 2002, between Level 3 Communications, Inc., a Delaware corporation (the "Company"), and William L. Grewcock (the "Purchaser").

The Company proposes to issue Common Stock Purchase Warrants, as hereinafter described (the "Warrants"), to purchase up to an aggregate 1,514,840 shares of its Common Stock, par value \$.01 per share (the "Common Stock") (the shares of Common Stock issuable on exercise of the Warrants being referred to herein as the "Warrant Shares"). The Warrants will be issued in a single series.

In consideration of the foregoing and for the purpose of defining the terms and provisions of the Warrants and the respective rights and obligations thereunder of the Company and the registered owners of the Warrants (the "Holders"), the Company and the Purchaser hereby agree as follows:

**SECTION 1. Issuance of Warrants.** Concurrently with the execution and delivery of this Agreement, the Company is issuing and delivering to the Purchaser Warrants to purchase 1,514,840 Warrant Shares.

**SECTION 2. Transferability and Form of Warrant.**

**2.1 Registration.** The Warrants shall be numbered and shall be registered on the books of the Company as they are issued. The Company shall be entitled to treat the Holder of any Warrant as the owner in fact thereof for all purposes and shall not be bound to recognize any equitable or other claim or interest in such Warrant on the part of any other person, and shall not be liable for any registration of transfer of any Warrants which are registered or to be registered in the name of a fiduciary or the nominee of a fiduciary unless made with the actual knowledge that a fiduciary or nominee is committing a breach of trust in requesting such registration of transfer, or with such actual knowledge of such facts that its participation therein amounts to intentional conversion. The Warrants shall initially be registered in the name of the Purchaser.

**2.2 Form of Warrant.** The text of the Warrant and of the Purchase Form shall be substantially in the form set forth in Exhibit A attached hereto. The price per Warrant Share and the number of Warrant Shares issuable upon exercise of each Warrant are subject to adjustment upon the occurrence of certain events, all as hereinafter provided. The Warrants shall be executed on behalf of the Company by its Chairman of the Board, Chief Executive Officer, President or one of its Executive or Group Vice Presidents, under its corporate seal reproduced thereon attested by its Secretary or Assistant Secretary. The signature of any such officers on the Warrants may be manual or facsimile.

Warrants bearing the signatures of individuals who were at any time the proper officers of the Company shall bind the Company, notwithstanding that such individuals or any one of them shall have ceased to hold such offices prior to the delivery of such Warrants.

### SECTION 3. Term of Warrants; Exercise of Warrants.

3.1 Term of Warrants. Subject to the terms of this Agreement, the Holder shall have the right, which may be exercised at any time and from time to time, to purchase from the Company the number of fully paid and nonassessable Warrant Shares which the Holder may at the time be entitled to purchase upon exercise of such Warrant.

3.2 Vesting. The Warrants shall be vested as of the date of this Agreement. Each Warrant shall expire at 5:00 p.m., New York City time, on June 30, 2009 (the "Expiration Date").

3.3 Exercise of Warrants. Subject to the provisions of Section 3.4 hereof, a Warrant that is exercisable under this Agreement may be exercised upon surrender to the Company at its principal office of the certificate or certificates evidencing the Warrant or Warrants to be exercised, together with the Purchase Form on the reverse thereof duly filled in and signed, which signature (if not the Purchaser) shall be guaranteed by a bank or trust company or a broker or dealer which is a member of the National Association of Securities Dealers, Inc., and upon payment to the Company of the Warrant Price as defined in and determined in accordance with the provisions of Section 7 hereof for the number of Warrant Shares in respect of which such Warrants are then exercised (the "Exercise Amount"). Payment of the Exercise Amount shall be made (i) by payment to the Company in cash, by certified or official bank check, or by wire transfer of the Exercise Amount, (ii) by surrender to the Company for cancellation of securities (which may include Warrant Shares received in respect of such Warrants being exercised) of the Company having a Market Price (as hereinafter defined) on the date of exercise equal to the Exercise Amount; or (iii) by a combination of the methods described in clauses (i) and (ii) above, in each case at the option of the Holder. For purposes hereof, the term "Market Price" shall mean (1) the average of the daily closing price of a share of Common Stock or other securities of the Company, as the case may be, for the 15 consecutive trading days preceding the date the Warrant is presented for exercise on the principal national securities exchange on which the Common Stock, or securities are listed or admitted to trading or, (2) if not listed or admitted to trading on any national securities exchange, the average of the reported bid and asked prices during such 15 trading day period in the over-the-counter market as furnished by the National Quotation Bureau, Inc., or, if such firm is not then engaged in the business of reporting such prices, as furnished by any member of the National Association of Securities Dealers, Inc. selected by the Company or, (3) if the Common Stock or securities are not publicly traded, the Market Price for such day shall be the fair market value thereof determined jointly by the Company and the Holder; provided, however, that if pursuant to this subclause (3) such parties are unable to reach agreement within a reasonable period of time, the Market Price shall be determined in good faith by the independent investment banking firm selected jointly by the Company and the Holder or, if that selection cannot be made within 15 days, by an independent investment banking firm selected by the American Arbitration Association in accordance with its rules.

Subject to Section 3.4 and Section 4 hereof, upon the surrender of a Warrant that is exercisable under this Agreement and payment of the Warrant Price as aforesaid, the Company shall cause to be issued and delivered with all reasonable dispatch (but in not event later than (i) 5 business days after payment is received if payment is made in immediately available funds or by the surrender of securities and (ii) 10 business days after payment is received if payment is not made in immediately available funds or by the surrender of securities) to or upon the written order of the Holder and in such name or names as the Holder may designate, a certificate or certificates for the number of full Warrant Shares so purchased upon the exercise of such Warrants, together with cash, as provided in Section 8 hereof, in respect of any fractional Warrant Shares otherwise issuable upon such surrender. If permitted by applicable law, to the extent that the Warrant Price consideration consists solely of securities (which may include Warrant Shares received in respect of such Warrants being exercised) of the Company, the Warrant Shares so acquired (together with the related certificate or certificates) shall be deemed to have been acquired as of the date hereof. The rights of purchase represented by the Warrants shall be exercisable, at the election of the Holders thereof, either in full or from time to time in part and, in the event that a certificate evidencing Warrants is exercised in respect of less than all of the Warrant Shares purchasable on exercise at any time prior to the date of expiration of the Warrants, the Company shall, at the time of delivery of the certificate or certificates representing Warrant Shares, deliver to the Holder a new Warrant evidencing the rights to purchase the remaining Warrant Shares, which new Warrant shall in all other respects be identical to this Warrant.

**3.4 Cash in Lieu of Shares Upon Exercise of Warrants.** Prior to the exercise of any Warrants, the Holder shall give notice to the Company that such Holder intends to exercise all or a portion of the Warrants. Following such notice, the Company shall have the right, exercisable at its sole election, by giving notice to the Holder of such election within 10 business days of such notice, to pay to the Holder, in lieu of the issuance of the Warrant Shares which otherwise would be issued upon such exercise, and payment of the Warrant Price relating thereto, an amount equal to the product of (x) 99.8% of the difference between the Warrant Price and the current market price of the Common Stock on the date prior to the date on which the notice of exercise is given (determined as provided in Section 7.2(f)) (the "Spread") and (y) the number of shares which would have been issued upon exercise of the Warrants had the Company not made the election set forth herein. In the event the Company notifies the Holder that it does not intend to exercise its right to pay the Spread (or fails to notify the Holder of its intent within such 10 business day period), the Holder will have 60 days to obtain the funds necessary to acquire the shares of Common Stock pursuant to the Warrants and/or exercise the registration rights provided in Exhibit B. If the Holder fails to obtain the funds necessary to acquire the Common Stock within such 60 days, the requirement to provide the notices contemplated by this Section 3.4 shall once again be applicable. If the Holder exercises the Holder's registration rights, the Holder need not pay for the Warrant Shares until such registration shall become effective and the issuance of shares of Common Stock pursuant thereto shall have been consummated. The Company shall take all actions necessary to cause the certificates representing the Warrant Shares to be issued upon exercise of such Warrants to be issued to the Holder promptly following the payment of the Warrant Price by the Holder.

**3.5 Split Up, Combination and Exchange of Warrant Certificates.** At or prior to the Expiration Date, this Warrant, with or without other Warrants, may be split up, combined or



exchanged for an other Warrant or Warrants, entitling the Holder to purchase a like number of Warrant Shares as such surrendered Warrant or Warrants then entitled such Holder to purchase. Any Holder desiring to split up, combine or exchange this Warrant shall make such request in writing delivered to the Company, and shall surrender the Warrant or Warrants to be split up, combined or exchanged to the Company. Thereupon the Company shall within a reasonable period of time sign and deliver to such Holder a Warrant or Warrants, as the case may be, as so requested containing such legends as are required by this Agreement and applicable law.

3.6 Registration Rights. The Purchaser and the Holders shall have registration rights as set forth in Exhibit B hereto with respect to the Warrant Shares.

SECTION 4. Payment of Taxes. The Company will pay all documentary stamp taxes, if any, attributable to the initial issuance of Warrant Shares upon the exercise of Warrants; provided, however, that the Company shall not be required to pay any tax or taxes which may be payable in respect of any transfer involved in the issue or delivery of any Warrant or certificates for Warrant Shares in a name other than that of the Holder of such Warrants.

SECTION 5. Mutilated or Missing Warrants. In case any of the certificates evidencing the Warrants shall be mutilated, lost, stolen or destroyed, the Company will issue and deliver in exchange and substitution for and upon cancellation of the mutilated Warrant certificate, or in lieu of and substitution for the Warrant certificate lost, stolen or destroyed, a new Warrant certificate of like tenor and representing an equivalent right or interest, but only upon receipt of evidence reasonably satisfactory to the Company of such loss, theft or destruction of such Warrant and an indemnity or bond, if requested, also reasonably satisfactory to it. An applicant for such a substitute Warrant certificate shall also comply with such other reasonable regulations and pay such other reasonable charges as the Company may prescribe.

SECTION 6. Reservation of Warrant Shares; Purchase and Cancellation of Warrants.

6.1 Reservation of Warrant Shares. There have been reserved, and the Company shall at all times keep reserved, out of its authorized Common Stock, a number of shares of Common Stock sufficient to provide for the exercise of the rights of purchase represented by the outstanding Warrants. The transfer agent for the Common Stock and every subsequent transfer agent for any shares of the Company's capital stock issuable upon the exercise of any of the rights of purchase aforesaid will be irrevocably authorized and directed at all times to reserve such number of authorized shares as shall be required for such purpose. The Company will keep a copy of this Agreement on file with the transfer agent for the Common Stock and with every subsequent transfer agent for any shares of the Company's capital stock issuable upon the exercise of the rights of purchase represented by the Warrants. The Company may requisition from time to time from such transfer agent the stock certificates required to honor outstanding Warrants upon exercise thereof in accordance with the terms of this Agreement. The Company will supply such transfer agent with duly executed stock certificates for such purposes and will provide or otherwise make available any cash which may be payable as provided in Section 8 hereof. The Company will furnish such transfer agent a copy of all notices of adjustments and certificates related thereto. All Warrants surrendered in the exercise of the rights thereby evidenced shall be canceled.

6.2 Purchase of Warrants by the Company. In addition to its rights contained in this Agreement, the Company may, except as limited by applicable law, other agreements or herein, with the consent of the Holder, purchase or otherwise acquire Warrants at such times, in such manner and for such consideration as the Company and such Holder may deem appropriate.

6.3 Cancellation of Warrants. In the event the Company shall purchase or otherwise acquire Warrants, the certificates evidencing the same shall thereupon be canceled and retired. The Company shall cancel any Warrant certificate surrendered for exchange, substitution, transfer or exercise in whole or in part.

## SECTION 7. Warrant Price.

7.1 Unadjusted Warrant Price. The initial price at which Warrant Shares shall be purchasable upon exercise of Warrants shall be \$8.00 per share, subject to adjustment pursuant to Sections 7.2 through 7.5 hereof (the "Warrant Price").

7.2 Adjustments. The number and kind of securities purchasable upon the exercise of each Warrant and the Warrant Price shall be subject to adjustment as follows:

(a) Stock dividends, splits, etc. In case the Company shall at any time or from time to time after the date of this Agreement (i) declare or pay a dividend on any of its shares of Common Stock or make a distribution to all holders of shares of Common Stock in shares of Common Stock (or a series thereof), (ii) subdivide its outstanding shares of Common Stock into a greater number of shares, (iii) combine its outstanding shares of Common Stock into a smaller number of shares of Common Stock or (iv) issue by reclassification of its shares of Common Stock other securities of the Company (including any such reclassification in connection with a consolidation or merger in which the Company is the continuing company), the number of shares purchasable upon exercise of each Warrant immediately prior thereto shall be adjusted so that the Holder shall be entitled to receive solely the kind and number of shares or other securities of the Company that it would have owned or have been entitled to receive after the happening of any of the events described above had such Warrant been exercised immediately prior to the happening of such event or any record date with respect thereto. An adjustment made pursuant to this paragraph

(a) shall become effective immediately after the effective date of such event, retroactive to the record date, if any, for such event.

(b) Distribution of rights or warrants. In case the Company shall fix a record date for the issuance of rights or warrants to all holders of Common Stock (other than pursuant to the Rights Agreement, dated as of May 29, 1998, between the Company and Norwest Bank Minnesota, N.A., (now known as Wells Fargo Bank Minnesota, N.A.) as rights agent, or any successor agreement), entitling them to subscribe for or purchase shares of Common Stock at a price per share (or having a conversion price per share) that is lower on the date of issuance thereof than the then current market price per share of Common Stock (as defined in paragraph (f) below), the number of shares thereafter purchasable upon the exercise of each Warrant (at the price determined in accordance with paragraph (j) hereof) shall be determined by multiplying the number of shares theretofore purchasable upon exercise of each Warrant by a fraction, of which the

numerator shall be the number of shares of Common Stock outstanding on the date of issuance of such rights or warrants plus the number of additional shares of Common Stock offered for subscription or purchase (or into which the convertible securities so offered are initially convertible), and of which the denominator shall be the number of shares of Common Stock outstanding on the date of issuance of such rights or warrants plus the number of shares that the aggregate offering price of the total number of shares of Common Stock so offered (or the aggregate initial conversion price of the convertible securities so offered) would purchase at the then current market price per share of Common Stock. Such adjustment shall become effective immediately after the date such rights or warrants are issued, retroactive to the record date for the determination of stockholders entitled to receive such rights or warrants.

(c) Distributions of assets. In the event the Company shall fix a record date for the distribution to all holders of its shares of Common Stock (i) evidences of its indebtedness, (ii) securities (other than Common Stock or rights or warrants of the type described in Section 7.2(a) or (b)) or (iii) assets (including extraordinary cash dividends, but excluding regular distributions, including cash dividends, paid in the ordinary course), then in each case the Warrant Price shall be adjusted to a price determined by multiplying the Warrant Price in effect immediately prior to such distribution by a fraction, of which the numerator shall be the then current market price per share of Common Stock (as defined in paragraph (f) below) on the date of such distribution, less the then fair value (as determined in good faith by the Board of Directors of the Company, whose determination shall be conclusive and set forth in a certified resolution of the Board of Directors) of the portion of the assets or the securities or the evidences of indebtedness so distributed applicable to one share of Common Stock, and of which the denominator shall be the then current market price per share of Common Stock. Such adjustment shall be made whenever any such distribution is made, and shall become effective on the date of distribution, retroactive to the record date for the determination of stockholders entitled to receive such distribution.

(d) Issuance of Common Stock. In case the Company shall issue shares of Common Stock (excluding shares issued (i) in any of the transactions described in paragraph (a) hereof, (ii) upon conversion or exchange of securities convertible into or exchangeable for Common Stock, including the Warrants, (iii) to the Company's employees under bona fide employee benefit plans adopted by the Company, (iv) upon exercise of rights or warrants issued to the holders of Common Stock, but only if at the time of such issuance the current market price of the Common Stock is greater than or equal to the Warrant Price, (v) issued to acquire, or in connection with the acquisition of, all or any portion of a business as a going concern, whether such acquisition shall be effected by purchase of assets, exchange of securities, merger, consolidation or otherwise, (vi) upon exercise of rights or warrants issued in a firm commitment public offering, with an initial exercise price at least equal to the current market price at the date of issuance or (vii) in a firm commitment public offering), for a consideration per share of Common Stock less than the current market price per share of Common Stock (as defined in paragraph (f) hereof) on the date the Company fixes the offering price of such additional shares, the Warrant Price shall be adjusted immediately prior thereto by multiplying the Warrant Price in effect immediately prior to such issuance by a fraction,

of which the numerator shall be the total number of shares of Common Stock outstanding immediately prior to the issuance of such additional shares plus the number of shares of Common Stock which the aggregate consideration received (determined as provided in paragraph (g) hereof) for the issuance of such additional shares would purchase at the then current market price per share of Common Stock, and of which the denominator shall be the number of shares of Common Stock outstanding immediately after the issuance of such additional shares. Such adjustment shall be made successively whenever such an issuance is made.

(e) Issuance of convertible securities. In case the Company shall issue any securities convertible into or exchangeable for Common Stock (excluding securities issued in transactions described in paragraphs (a)(iv), (b) and (c) hereof) for a consideration per share of Common Stock initially deliverable upon conversion or exchange of such securities (determined as provided in paragraph (g) hereof) less than the current market price per share of Common Stock (as defined in paragraph (f) hereof) in effect immediately prior to the issuance of such securities, the Warrant Price shall be adjusted immediately thereafter so that it shall equal the price determined by multiplying the Warrant Price in effect immediately prior thereto by a fraction, of which the numerator shall be the number of shares of Common Stock outstanding immediately prior to the issuance of such securities plus the number of shares of Common Stock which the aggregate consideration received (determined as provided in paragraph (g) hereof) for such securities would purchase at the current market price per share of Common Stock, and of which the denominator shall be the number of shares of Common Stock outstanding immediately prior to such issuance plus the maximum number of shares of Common Stock deliverable upon conversion of or in exchange for such securities at the initial conversion or exchange price or rate. Such adjustment shall be made successively whenever such an issuance is made.

Upon the termination of the right to convert or exchange such securities, the Warrant Price shall be readjusted to such Warrant Price as would have been obtained had the adjustments made upon the issuance of such convertible or exchangeable securities been made upon the basis of the delivery of only the number of shares of Common Stock actually delivered upon conversion or exchange of such securities and upon the basis of the consideration actually received by the Company (determined as provided in paragraph (g) hereof) for such securities. Such a readjustment shall not affect the number of shares issued upon the exercise of any Warrants prior to the date the readjustment is made.

(f) Definition of market price. For the purpose of any computation under paragraphs (b), (c), (d) and (e) of this Section 7.2 and for the purpose of Section 3.4 hereof, the current market price per share of Common Stock at any date shall be deemed to be the average of the daily closing price per share for the 10 consecutive trading days commencing 20 trading days before such date. The closing price for each day shall be the last sale price or, in case no such sale takes place on such day, the average of the highest reported bid and lowest reported asked prices as furnished by the National Association of Securities Dealers Inc. through Nasdaq or a similar organization if Nasdaq is no longer reporting such information. If on any such trading day shares of Common

Stock are not quoted by any such organization, the fair value of such shares on such day, as determined in good faith by the Board of Directors of the Company, shall be used.

(g) Valuation of consideration. For purposes of any computation respecting consideration received pursuant to paragraphs (d) and (e) hereof, the following shall apply:

(i) in the case of the issuance of shares of Common Stock for cash, the consideration shall be the amount of such cash, provided that in no case shall any deductions be made for any commissions, discounts or other expenses incurred by the Company for any underwriting of the issue or otherwise in connection therewith;

(ii) in the case of the issuance of shares of Common Stock for a consideration in whole or in part other than cash, the consideration other than cash shall be deemed to be the fair market value thereof as determined in good faith by the Board of Directors of the Company (irrespective of the accounting treatment thereof), whose determination shall be conclusive and described in a certified resolution; and

(iii) in the case of the issuance of securities convertible into or exchangeable for shares of Common Stock, the aggregate consideration received therefor shall be deemed to be the consideration received by the Company for the issuance of such securities plus the additional minimum consideration, if any, to be received by the Company upon the conversion or exchange thereof (the consideration in each case to be determined in the same manner as provided in clauses (i) and (ii) of this paragraph (g)).

(h) Definition of shares of Common Stock. For the purposes of this

Section 7.2, the term "shares of Common Stock" shall mean (i) the class of stock designated as the Common Stock of the Company at the date of this Agreement or (ii) any other class of stock resulting from changes or reclassifications of such shares consisting solely of changes in par value, or from par value to no par value, or from no par value to par value. In the event that at any time, as a result of an adjustment made pursuant to paragraph (a) above, the Holders shall become entitled to purchase any shares of the Company other than shares of Common Stock, thereafter the number of such other shares so purchasable upon exercise of each Warrant and the Warrant Price of such shares shall be subject to adjustment from time to time in a manner and on terms as nearly equivalent as practicable to the provisions with respect to the Warrant Shares contained in Sections 7.2 through 7.3, inclusive as they would have been applied to the Warrant Shares.

(i) Minimum adjustment. No adjustment in the number of shares purchasable hereunder shall be required unless such adjustment would require an increase or decrease of at least one half (1/2) of one percent (1%) in the number of shares purchasable upon the exercise of each Warrant; provided, however, that any adjustments which by reason of this paragraph

(i) are not required to be made shall be carried forward and taken into account in any subsequent adjustment or upon any exercise of a Warrant.

(j) Warrant Price adjustment. Whenever the number of shares purchasable upon the exercise of each warrant is adjusted, as herein provided, the Warrant Price per share payable upon exercise of each Warrant shall be adjusted to the nearest cent by multiplying such Warrant Price immediately prior to such adjustment by a fraction, of which the numerator shall be the number of shares purchasable upon the exercise of each Warrant immediately prior to such adjustment, and of which the denominator shall be the number of shares so purchasable immediately thereafter.

(k) Notice of adjustment. Whenever the number of shares purchasable upon the exercise of each Warrant or the Warrant Price of such shares is adjusted, as herein provided, the Company shall promptly mail to each Holder, by first-class mail, postage prepaid, notice of such adjustment or adjustments.

(l) Company may reduce Warrant Price or increase number of shares purchasable. The Company may at its option, at any time during the term of the Warrants, reduce the then current Warrant Price, or increase the number of shares of Common Stock purchasable upon exercise of each Warrant, to any amount deemed appropriate by the Board of Directors of the Company.

(m) Consolidation, Merger, etc. In case the Company after the date hereof (a) shall consolidate with or merge into any other corporation, association, partnership, organization, business, individual, government or political subdivision thereof or a governmental agency ("Person") and shall not be the continuing or surviving corporation of such consolidation or merger, or (b) shall permit any other Person to consolidate with or merge into the Company and the Company shall be the continuing or surviving Person but, in connection with such consolidation or merger, shares of Common Stock or other securities shall be changed into or exchanged for stock or other securities of any other Person or cash or any other property, or (c) shall transfer all or substantially all of its properties or assets to any other Person, or (d) shall effect a capital reorganization or reclassification of the Common Stock or other securities (other than a capital reorganization or reclassification resulting in the issue of shares of Common Stock for which adjustment in the Warrant Price is otherwise provided in Section 7.2) (each a "Merger Event"), then, and in the case of each such Merger Event, proper provision shall be made so that, upon the basis and the terms and conditions as well as in the manner provided in this Agreement, the Holder, upon the exercise of a Warrant at any time after the consummation of such Merger Event, shall be entitled to receive (at the aggregate Warrant Price adjusted to reflect the modification of the number of Warrant Shares pursuant to this Section 7.2(m) in effect at the time of such consummation for all shares of Common Stock or other securities issuable upon such exercise immediately prior to such consummation), in lieu of the shares of Common Stock or other securities issuable upon such exercise prior to such consummation, the highest amount of securities, cash or other property to which such Holder would have been entitled as a stockholder upon such consummation if such Holder had exercised the rights represented by this Warrant immediately prior thereto (or, if applicable, immediately prior to the record date established in connection with any such Merger Event), subject to adjustments (subsequent to such consummation) as nearly equivalent as possible to the adjustments provided for in Sections 7.2 through 7.5.

In addition, for the period commencing on the date of this Agreement and terminating on the date that is the second anniversary of this Agreement, if the Company shall engage in any Merger Event wherein all of the outstanding Common Stock of the Company is acquired for consideration consisting of any property or asset other than the common stock of the acquiring company (the "Merger Consideration") (a "Special Merger Event"), the Company shall pay immediately prior to any record date for such Special Merger Event by issuing to the Holder shares of unregistered Common Stock an amount equal to the underlying value of any Warrants then held by the Holder absent the consummation of the Special Merger Event, calculated as of the record date of the Special Merger Event using a Black-Scholes derived option pricing model for a sixty (60) day historical period immediately preceding, and ending on, the record date for such Special Merger Event. In the event that a payment in the form of shares of unrestricted Common Stock is required by this Section 7.2(m) is required, it shall be a condition to the closing of any Special Merger Event that such shares of Common Stock so issued by the Company will be entitled to receive the consideration in the Special Merger Event. To the extent that the Merger Consideration consists of the common stock of the acquiring company and any other form of consideration, the payment required by this paragraph shall be pro rated in the same proportion as the common stock component of the Merger Consideration is to the other form of consideration component of the Merger Consideration.

**7.3 No Adjustment in Certain Cases.** Except as set forth in Section 7.2 hereof, no adjustment in respect of any dividends shall be made during the term of a Warrant or upon the exercise of a Warrant.

**7.4 Other Dilutive Events.** If any event occurs as to which, in the good faith opinion of the Board of Directors of the Company, the provisions of this Section 7.2 are not strictly applicable or if strictly applicable would not fairly protect the rights of the Holder in accordance with the essential intent and principles of such provisions, then the Board of Directors shall make an adjustment in the application of such provisions, in accordance with such essential intent and principles, so as to protect such rights as aforesaid, but in no event shall any adjustment have the effect of increasing the Warrant Shares as otherwise determined pursuant to any of the provisions of this Section 7.2.

**7.5 No Impairment.** The Company will not, by amendment of its certificate of incorporation or through reorganization, consolidation, merger, dissolution, sale of assets or any other voluntary action, avoid or seek to avoid the observance or performance of any of the terms of this Warrant, but will at all times in good faith assist in the carrying out of all such terms and in the taking of all such action as may be necessary or appropriate in order to protect the rights of the Holder against dilution or other impairment. Without limiting the generality of the foregoing, the Company will not increase the par value of any shares of stock receivable upon the exercise of this Warrant above the amount payable therefor upon such exercise, and at all times will take all such action as may be necessary or appropriate in order that the Company may validly and legally issue fully paid and nonassessable stock upon the exercise of this Warrant.

**7.6 Statement on Warrants.** Irrespective of any adjustments in the Warrant Price or the number or kind of shares purchasable upon the exercise of the Warrants, Warrants

theretofore or thereafter issued may continue to express the same price and number and kind of shares as are stated in the Warrants initially issuable pursuant to this Agreement, but shall be modified and replaced upon the request of the Holders thereof.

SECTION 8. Fractional Interests. The Company shall not be required to issue fractional Warrant Shares on the exercise of Warrants. If more than one Warrant shall be presented for exercise in full at the same time by the same Holder, the number of full Warrant Shares which shall be issuable upon the exercise thereof shall be computed on the basis of the aggregate number of Warrant Shares purchasable on exercise of the Warrants so presented. If any fraction of a Warrant Share would, except for the provisions of this Section 8, be issuable on the exercise of any Warrant (or specified portion thereof), the Company shall pay an amount in cash equal to the closing price for one share of the Common Stock, as defined in paragraph (f) of Section 7.2, on the trading day immediately preceding the date the Warrant is presented for exercise, multiplied by such fraction.

#### SECTION 9. Rights and Notices.

9.1 No Rights as Stockholders; Notices to Holders. Nothing contained in this Agreement or in any of the Warrants shall be construed as conferring upon the Holders or their transferees, the right to vote or to receive dividends or to consent or to receive notice as stockholders in respect of any meeting of stockholders for the election of directors of the Company or any other matter, or any rights whatsoever as stockholders of the Company. If, however, at any time prior to the expiration of the Warrants and prior to their exercise, any of the following events shall occur:

(a) the Company shall declare any dividend payable in any securities upon its shares of Common Stock or make any distribution (other than a regular cash dividend, as such dividend may be increased from time to time) to the holders of its shares of Common Stock; or

(b) the Company shall offer to the holders of its shares of Common Stock any cash, additional shares of Common Stock or other securities of the Company or any right to subscribe for or purchase any thereof; or

(c) a dissolution, liquidation or winding up of the Company (other than in connection with a consolidation, merger, sale, transfer or lease of all or substantially all of its property, assets and business as an entirety) shall be proposed,

then in any one or more of said events the Company shall give notice in writing of such event as provided in Section 10 hereof, such giving of notice to be completed at least 30 days prior to the date fixed as a record date or the date of closing the transfer books for the determination of the stockholders entitled to such dividend, distribution, or subscription rights or for the determination of stockholders entitled to vote on such proposed dissolution, liquidation or winding up or the date of expiration of such offer. Such notice shall specify such record date or the date of closing the transfer books or the date of expiration, as the case may be. Failure to mail or receive such notice or any defect therein or in the publication or mailing thereof shall not



affect the validity of any action in connection with such dividend, distribution, liquidation or winding up, or such offer.

9.2 Reports to Holders. If at any time while any Warrants are outstanding the Company is no longer subject to the reporting requirements of Section 12 or 15 of the Securities Exchange Act of 1934, the Company will cause annual and quarterly reports to be sent to the Holders that shall contain such financial statements and other information concerning the business and affairs of the Company as would be required to permit Holders to sell securities of the Company pursuant to Rule 144 of the Securities Act of 1933, as amended (the "Securities Act"), including information required to be included in annual and quarterly reports filed with the Securities and Exchange Commission pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 by an issuer registered therewith pursuant to Section 12 of said Act.

SECTION 10. Notices. Any notice pursuant to this Agreement by any Holder to the Company, shall be in writing and shall be delivered in person or by facsimile transmission, or mailed first class, postage prepaid to the Company, at its principal office, Attention: General Counsel. Any notice pursuant to this Agreement by the Company to the Holders, shall be in writing and shall be mailed first class, postage prepaid, or otherwise delivered, to such Holders at their respective addresses on the books of the Company. Each party hereto may from time to time change the address to which notices to it are to be delivered or mailed hereunder by notice to the other party.

SECTION 11. Successors. Except as expressly provided herein to the contrary, all the covenants and provisions of this Agreement by or for the benefit of the Company and the Purchaser shall bind and inure to the benefit of their respective successors and permitted assigns hereunder.

SECTION 12. Merger or Consolidation of the Company. The Company will not merge or consolidate with or into, or sell, transfer or lease all or substantially all of its property to, any other corporation unless the successor or purchasing corporation, as the case may be (if not the Company), shall expressly assume, by supplemental agreement, the due and punctual performance and observance of each and every covenant and condition of this Agreement to be performed and observed by the Company.

SECTION 13. Private Placement.

The Purchaser hereby represents that:

(a) The Purchaser understands that the offering and sale of the Warrants is intended to be exempt from registration under the Securities Act pursuant to Section 4(2) of the Securities Act.

(b) To the extent that the Purchaser has employed any investment banker, broker or finder or incurred any liability for any brokerage fees, commissions or finder's fees in connection with the transactions contemplated by this Agreement, the Purchaser shall be responsible for the payment of any such fees or commissions.

(c) The Purchaser understands that the Warrants have not been, and will not be, registered under any securities laws, state or federal; that the Warrants must be held indefinitely unless they are subsequently registered under applicable securities laws or an exemption from such registration is available; that the Company is under no obligation to register the Warrants or in complying with any exemption from registration. In addition, the Purchaser understands that the Warrant Shares have not been, and may not be, registered under any securities laws, state or federal; that the Warrant Shares must be held indefinitely unless they are subsequently registered under applicable securities laws or an exemption from such registration is available; that except as provided in this Agreement, the Company is under no obligation to register the Warrant Shares or to assist in complying with any exemption from registration.

(d) The Purchaser agrees that it will not transfer, by way of gift or otherwise, or sell the Warrants or any part thereof or the Warrant Shares, unless such Warrants or Warrant Shares, as applicable, have been registered under the Securities Act or it first obtains, at its own expense, an opinion of counsel reasonably satisfactory to the Company that the transfer of such Warrants or Warrant Shares may be effected without registration under the Securities Act, provided that no opinion shall be necessary to effect a transfer to affiliates of the Purchaser, to the extent the Purchaser or such person confirms the representations set forth in this Section 13.

(e) The Purchaser is not acquiring the Warrants as a result of (i) any advertisement, article, notice or other communication published in any newspaper, magazine, or similar media or broadcast over television or radio or (ii) any seminar meeting whose attendees had been invited as a result of, subsequent to, or pursuant to any of the foregoing.

(f) The Purchaser understands that there will be no public market for the Warrants.

(g) The Purchaser (i) has carefully evaluated the risks of investing in the Company, (ii) has no need for liquidity in this investment, and (iii) should it decide to exercise the Warrants, will be able to bear the substantial economic risks of an investment in the Warrant Shares.

(h) The Purchaser has sufficient knowledge and experience in financial, tax and business matters to enable him to utilize the information made available to him in connection with the purchase of the Warrants, to evaluate the merits and risks of the prospective investment and to make an informed investment decision with respect thereto.

(i) The Purchaser acknowledges that the Company is relying upon the representations and warranties contained herein in determining to make the sale of the Warrants, and the Purchaser consents to such reliance.

(j) The Purchaser has received and carefully reviewed financial information pertaining to the Company, has had a reasonable opportunity to ask questions of and

receive answers from the Company and its directors, officers and employees concerning the Warrants and the business and affairs of the Company, and, all such questions have been answered to the full satisfaction of the Purchaser. No oral representations have been made or oral information furnished in connection with the sale of Warrants which were in any way relied upon by the Purchaser.

(k) Company Excluded Information. The Purchaser acknowledges and agrees that the Company may possess material information not generally known by the public or by the Purchaser regarding the Company, its business, its condition (financial or otherwise) and its prospects (collectively, the "Company Excluded Information"), and the Purchaser agrees that the Company shall have no liability to the Purchaser to the extent the Purchaser incurs or otherwise suffers any liability, loss, expense, cost or damage arising out of or relating to the non-disclosure of the Company Excluded Information.

SECTION 14. Legends. Certificates evidencing the Warrants issued pursuant to this Agreement and any Warrant Shares shall bear the following legend:

"The securities evidenced hereby have not been registered under the Securities Act of 1933, as amended (the "Act"), or any state securities law, and may not be transferred except pursuant to an effective registration under the Act and such state securities laws or in a transaction which, in the opinion of counsel reasonably satisfactory to the Company, qualifies as an exempt transaction under the Act and applicable state securities laws and the rules and regulations promulgated thereunder.

In addition, such securities are subject to the terms of that certain Warrant Agreement, dated as of March 11, 2002, by and between the Company and William L. Grewcock, including certain restrictions on transfer. A copy of such Agreement has been filed with the Secretary of the Company and is available upon request."

SECTION 15. Applicable Law. This Agreement and each Warrant issued hereunder shall be governed by and constructed in accordance with the laws of the State of Delaware, without giving effect to principles of conflict of laws thereof.

SECTION 16. Benefits of this Agreement. Nothing in this Agreement shall be construed to give to any person or corporation other than the Company and the Holders any legal or equitable right, remedy or claim under this Agreement; but this Agreement shall be for the sole and exclusive benefit of the Company and the Holders.

SECTION 17. Counterparts. This Agreement may be executed in any number of counterparts and each of such counterparts shall for all purposes be deemed to be an original, and all such counterparts shall together constitute but one and the same instrument.

SECTION 18. Captions. The captions of the Sections and subsections of this Agreement have been inserted for convenience only and shall have no substantive effect.

SECTION 19. Miscellaneous.

(a) If any term or provision of this Agreement is held by a court of competent jurisdiction or other authority to be invalid, void, unenforceable or against its regulatory policy, the remainder of the terms, provisions, covenants and restrictions of this Agreement shall remain in full force and effect and shall in no way be affected, impaired or invalidated.

(b) Except as otherwise provided herein, each party hereto shall pay its own expenses incurred with this Agreement.

[Signature Page Follows]

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed, all as of the day and year first above written.

**LEVEL 3 COMMUNICATIONS, INC.**

*By: /S/ Neil J. Eckstein  
Name: Neil J. Eckstein  
Title: Vice President*

**WILLIAM L. GREWCOCK**

*/S/ William L. Grewcock*

## EXHIBIT A

THE SECURITIES EVIDENCED HEREBY HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"), OR ANY STATE SECURITIES LAW, AND MAY NOT BE TRANSFERRED EXCEPT PURSUANT TO AN EFFECTIVE REGISTRATION UNDER THE ACT AND SUCH STATE SECURITIES LAWS OR IN A TRANSACTION WHICH, IN THE OPINION OF COUNSEL REASONABLY SATISFACTORY TO THE COMPANY, QUALIFIES AS AN EXEMPT TRANSACTION UNDER THE ACT AND APPLICABLE STATE SECURITIES LAWS AND THE RULES AND REGULATIONS PROMULGATED THEREUNDER.

IN ADDITION, SUCH SECURITIES ARE SUBJECT TO THE TERMS OF THAT CERTAIN WARRANT AGREEMENT, DATED AS OF MARCH 11, 2002, BY AND BETWEEN THE COMPANY AND WILLIAM L. GREWCOCK, INCLUDING CERTAIN RESTRICTIONS ON TRANSFER. A COPY OF SUCH AGREEMENT HAS BEEN FILED WITH THE SECRETARY OF THE COMPANY AND IS AVAILABLE UPON REQUEST.

VOID AFTER 5:00 P.M., New York City time, June 30, 2009

### Warrants to Purchase

[Number of Warrant Shares]  
Shares of Common Stock

### LEVEL 3 COMMUNICATIONS, INC. COMMON STOCK PURCHASE WARRANTS

This certifies that, for value received, \_\_\_\_\_ or registered assigns (the "Holder"), is entitled to purchase from Level 3 Communications, Inc., a Delaware corporation, (the "Company"), at any time after 9:00 a.m., New York City time, on December 31, 2001 and prior to 5:00 p.m., New York City time, on June 30, 2009, at the purchase price of \$8.00 per share (the "Warrant Price"), the number of shares of its Common Stock, par value \$.01 per share (the "Common Stock"), shown above. The number of shares purchasable upon exercise of the Common Stock Purchase Warrants (the "Warrants") and the Warrant Price are subject to adjustment from time to time as set forth in the Warrant Agreement referred to below. Outstanding Warrants not exercised prior to 5 p.m., New York City time, on June 30, 2009 shall thereafter be void.

Warrants may be exercised in whole or in part by presentation of this Warrant Certificate with the Purchase Form on the reverse side hereof duly executed, which signature (if not the Purchaser) shall be guaranteed by a bank or trust company or a broker or dealer which is a member of the National Association of Securities Dealers, Inc., and simultaneous payment of the Warrant Price at the principal office of the Company. Payment of such price shall be made in cash or by certified or official bank check or as otherwise provided in the Warrant Agreement

referred to below. As provided in the Warrant Agreement referred to below, the Warrant Price and the number of kind of shares which may be purchased upon the exercise of the Warrants evidenced by this Warrant Certificate are, upon the happening of certain events, subject to modification and adjustment.

This Warrant Certificate is issued under and in accordance with a Warrant Agreement dated as of March 11, 2002 between the Company and William L. Grewcock and is subject to the terms and provisions contained in the Warrant Agreement, to all of which the Holder of this Warrant Certificate by acceptance hereof consents. A copy of the Warrant Agreement may be obtained by the Holder hereof upon written request to the Company.

Upon any partial exercise of the Warrants evidenced by this Warrant Certificate, there shall be issued to the Holder hereof a new Warrant Certificate in respect of the shares of Common Stock as to which the Warrants evidenced by this Warrant Certificate shall not have been exercised. This Warrant Certificate may be exchanged at the office of the Company by surrender of this Warrant Certificate properly endorsed either separately or in combination with one or more other Warrant Certificates for one or more new Warrant Certificates evidencing the right of the Holder thereof to purchase the aggregate number of shares as were purchasable on exercise of the Warrants evidenced by the Warrant Certificate or Certificates exchanged. No fractional shares will be issued upon the exercise of any Warrant, but the Company will pay the cash value thereof determined as provided in the Warrant Agreement. This Warrant Certificate is transferable at the office of the Company in the manner and subject to the limitations set forth in the Warrant Agreement.

The Holder hereof may be treated by the Company and all other persons dealing with this Warrant Certificate as the absolute owner hereof for any purpose and as the person entitled to exercise the rights represented hereby, or to the transfer hereof on the books of the company, any notice to the contrary notwithstanding, and until such transfer on such books, the Company may treat the Holder hereof as the owner for all purposes.

Neither the Warrants nor this Warrant Certificate entitles any Holder to any of the rights of a stockholder of the Company.

DATED:

**LEVEL 3 COMMUNICATIONS, INC.**

By:

**Attest:**



## PURCHASE FORM

(To be executed upon exercise of Warrant)

### To LEVEL 3 COMMUNICATIONS, INC.:

The undersigned hereby irrevocably elects to exercise the right of purchase represented by the within Warrant Certificate for, and to purchase thereunder, \_\_\_\_\_ shares of Common Stock, as provided for therein, and tenders herewith payment of the purchase price in full in the form of cash or a certified or official bank check in the amount of \$\_\_\_\_\_ or securities in the amount of \$\_\_\_\_\_ pursuant to the non-cash exercise provisions set forth in the Warrant Agreement dated as of December 31, 2001 between the Company and Kiewit Construction Company.

Please issue a certificate or certificates for such shares of Common Stock in the name of, and pay any cash for any fractional share to:

PLEASE INSERT SOCIAL SECURITY OR  
OTHER IDENTIFYING NUMBER OF PURCHASER

NAME  
(Please Print Name & Address)

Address

Signature

NOTE: The above signature should  
correspond exactly with the name  
on the face of this Warrant  
Certificate or with the name of  
the assignee appearing in the  
assignment form below.

And, if said number of shares shall not be all the shares purchasable under the within Warrant Certificate, a new Warrant Certificate is to be issued in the name of said undersigned for the balance remaining of the share purchasable thereunder less any fraction of a share paid in cash.

## **ASSIGNMENT**

(To be executed only upon assignment of Warrant Certificate)

For value received, \_\_\_\_\_ hereby sells, assigns and transfers unto \_\_\_\_\_ the within Warrant Certificate, together with all right, title and interest therein, and does hereby irrevocably constitute and appoint \_\_\_\_\_ attorney, to transfer said Warrant Certificate on the books of the within-named Company, with full power of substitution in the premises.

Dated:

NOTE: The above signature should correspond  
exactly with the name on the face of this  
Warrant Certificate.

**PLEASE INSERT SOCIAL SECURITY OR OTHER IDENTIFYING NUMBER OF ASSIGNEE**

## **Exhibit B**

### **REGISTRATION RIGHTS**

(a) At any time after December 31, 2003, and subject to the restrictions contained in this Agreement, upon a written request to register under the Securities Act of 1933, as amended, by the Purchaser, or by the Holders of (i) Warrants representing the right to purchase Warrant Shares and/or (ii) Warrant Shares, which in the aggregate comprise 50% or more of the Common Stock issuable upon exercise of the Warrants (the "Majority Holders"), the Company shall promptly prepare and file no later than 45 days following any such request at its sole expense, a registration statement with the Securities and Exchange Commission (the "Commission") to register the resale of the Warrant Shares to be received by any Holder, and any other shares of Common Stock held by the Purchaser (the "Registrable Securities"). However, in no event will the Company be required to file more than one such registration statement and the Company shall not be required to file a registration statement relating to the registration of the Warrants. The Company shall notify all other Holders of Registrable Securities of such registration, and shall allow such Holders a reasonable opportunity to participate in such registration. Subject to subsection (c) hereof, the Holders acknowledge that the Company may include in such registration statement shares of Common Stock to be sold for the account of other holders of Common Stock or the Company.

(b) The obligations of the Company to use its best efforts to cause the Registrable Securities to be registered under the Securities Act are subject to the following limitations:

(i) The Company shall be entitled to postpone for up to 120 days in any twelve-month period the filing of any registration statement otherwise required to be prepared and filed by it pursuant to subsection (a) if, at the time it receives a request for such registration, the Company determines, in its reasonable judgment, that such registration and sale would materially interfere with any financing, acquisition, corporate reorganization or other material transaction involving the Company or any of its subsidiaries and promptly gives the Holders written notice of such determination. If the Company shall so postpone the filing of a registration statement, the requesting party or parties shall have the right to withdraw the request for registration by giving written notice to the Company within 30 calendar days after receipt of the notice of postponement (and, in the event of such withdrawal, such request shall not be counted for purposes of determining the number of requests for registration to which the Holders are entitled pursuant to subsection (a)).

(ii) A registration statement with respect to a registration requested pursuant to subsection (a) that has not become effective within 120 days following any such request shall not be counted for the purpose of determining the number of requests for registration to which the Holders are entitled pursuant to subsection (a) unless agreed to by the Purchaser and by the Majority Holders or more of the Registrable Securities outstanding. Notwithstanding the foregoing, in the event that such failure to become effective is the result of action or inaction on the part of the Purchaser or the Majority Holders, such registration statement shall

be counted for purposes of determining the number of requests for registration under subsection (a).

(iii) The Company shall pay the costs of one such registration statement filed pursuant to subsection (a), including without limitation all registration and filing fees, fees and expenses of compliance with securities or Blue Sky laws (including counsel's fees and expenses in connection therewith), printing expenses, messenger and delivery expenses, internal expenses of the Company (including all salary and expenses of its officers and employees performing legal or accounting services), listing fees and expenses, and fees and expenses of the Company's counsel, independent accountants and other persons retained or employed by the Company in connection with such registration statement (provided that the selling Holders shall pay all underwriters discounts, commissions and fees, the fees and expenses of counsel to the Holders and all other costs and expenses incurred by such Holders).

(c) Priority in Requested Registrations. If a requested registration involves an underwritten offering, and the managing underwriter shall advise the Company in writing (with a copy to each holder of Registrable Securities requesting registration) that, in its opinion, the number of securities requested to be included in such registration (including securities of the Company which are not Registrable Securities) exceeds the number which can be sold in such offering within a price range acceptable to the holders of a majority of the Registrable Securities requested to be included in such registration, the Company will include in such registration, to the extent of the number which the Company is so advised can be sold in such offering, (i) first, Registrable Securities requested to be included in such registration by the holder or holders of Registrable Securities, pro rata among the holders thereof such holders requesting such registration on the basis of the number of such securities requested to be included by such holders and (ii) second, securities the Company proposes to sell and other securities of the Company included in such registration by the holders thereof.

(d) Upon any such registration statement becoming effective, the Company shall use its best efforts to keep such registration statement current for a period of six (6) months or such lesser period as the parties may agree (but in no event beyond the completion of the distribution or distributions being made pursuant thereto). The Company shall make such filings, and will use its best efforts to cause such filings to become effective, so that the securities being registered shall be registered or qualified for sale under the securities or Blue Sky laws of such jurisdictions as shall be reasonably appropriate for the distribution of the securities covered by the registration statement; provided, however, that the Company shall not be required to register as a broker or dealer in any jurisdiction where it is not presently so registered or to qualify as a foreign corporation to do business under the laws of any jurisdiction in which it is not then qualified or to file any general consent to service of process. The Company will furnish to the selling Holders such numbers of copies of a prospectus, including a preliminary prospectus, in conformity with the requirements of the Securities Act and such other related documents as the selling Holders may reasonably request in order to effect the sale of the securities to be offered and sold by the selling Holders, but only while the Company is required to cause the registration statement to remain current.

(e) To effect any such registration, and if requested by the Majority Holders, the Company and the selling Holders shall enter into with an investment banking firm, selected by the Majority Holders and reasonably satisfactory to the Company, an underwriting agreement containing customary representations and warranties and provisions relating to indemnification and contribution (including appropriate indemnification and contribution between the selling Holders as selling stockholders and the Company and other customary provisions).

(f) Except as may otherwise be provided in any underwriting agreement entered into by the Company and the Holders, in the event of any registered offering of shares of Common Stock pursuant to this Agreement in which any of the Holder's shares of Common Stock are sold, and as the sole and exclusive remedy of the Holders:

(i) The Company will indemnify and hold harmless, to the fullest extent permitted by law, the Holders and each person, if any, who controls each Holder within the meaning of the Securities Act, from and against any and all losses, damages, claims, liabilities, joint or several, costs and expenses (including any amounts paid in any settlement effected with the Company's consent) to which the Holders or any such controlling person may become subject under the Securities Act, state securities or blue sky laws, common law or otherwise, insofar as such losses, damages, claims, liabilities (or actions or proceedings in respect thereof), costs or expenses arise out of or are based upon (x) any untrue statement or alleged untrue statement of any material fact contained in the registration statement or included prospectus, as amended or supplemented, or (y) the omission or alleged omission to state therein a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances in which they are made, not misleading, and the Company will reimburse the Holders and each such controlling person of the Holders promptly upon demand for any reasonable legal or any other expenses incurred by them in connection with investigating, preparing to defend or defending against or appearing as a third-party witness in connection with such loss, claim, damage, liability, action or proceeding; provided, however, that the Company will not be liable to any Holder in any such case to the extent that any such loss, damage, liability, cost or expense arises out of or is based upon an untrue statement or alleged untrue statement or omission or alleged omission so made in conformity with information furnished by such Holder or such controlling persons in writing specifically for use in the preparation thereof. Such indemnity shall remain in full force and effect regardless of any investigation made by or on behalf of any Holder or any controlling person of the Investor, and shall survive the transfer of such securities by the Investor.

(ii) Each Holder will indemnify and hold harmless, to the fullest extent permitted by law, the Company and each person, if any, who controls the Company from and against any and all losses, damages, claims, liabilities, joint or several, costs or expenses (including any amounts paid in any settlement with such Holder's consent) to which the Company or any such controlling person may become subject under the Securities Act, state securities or blue sky laws, common law or otherwise, insofar as such losses, damages, claims, liabilities (or

actions or proceedings in respect thereof), costs or expenses arise out of or are based upon any untrue or alleged untrue statement of any material fact contained in the registration statement or included prospectus, as amended or supplemented, or arise out of or are based upon the omission or the alleged omission to state therein a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances in which they were made, not misleading, in each case to the extent, but only to the extent, that such untrue statement or alleged untrue statement or omission or alleged omission was so made in strict conformity with written information furnished by such Holder specifically for use in the preparation thereof and such Holder will reimburse the Company and each such controlling person of the Company promptly upon demand for any reasonable legal or any other expenses incurred by them in connection with investigating, preparing to defend or defending against or appearing as a third-party witness in connection with such loss, claim, damage, liability, action or proceeding. Such indemnity shall remain in full force and effect regardless of any investigation made by or on behalf of the Company or any controlling person of the Company, and shall survive the transfer of such securities by the Holder. Each Holder, by allowing its shares of Common Stock or Warrant Shares to be included in the registration statement, agrees to the terms of this Exhibit B.

(iii) Promptly after receipt by an indemnified party pursuant to the provisions of subsection (f)(i) or (ii) of this Exhibit B of notice of the commencement of any action involving the subject matter of the foregoing indemnity provisions, such indemnified party will, if a claim thereof is to be made against the indemnifying party pursuant to the provisions of said subsection (f)(i) or (ii), promptly notify the indemnifying party of the commencement thereof; but the omission to notify the indemnifying party will not relieve it from any liability which it may have to any indemnified party otherwise hereunder, except to the extent of actual prejudice. In case such action is brought against any indemnified party and it notifies the indemnifying party of the commencement thereof, the indemnifying party shall have the right to participate in, and, to the extent that it may wish, jointly with any other indemnifying party similarly notified, to assume the defense thereof with counsel reasonably satisfactory to such indemnified party; provided, however, if the defendants in any action include both the indemnified party and the indemnifying party and there is a conflict of interest which would prevent counsel for the indemnifying party from also representing the indemnified party, the indemnified party or parties shall have the right to select one separate counsel to participate in the defense of such action on behalf of such indemnified party or parties. After notice from the indemnifying party to such indemnified party of its election so to assume the defense thereof, the indemnifying party will not be liable to such indemnified party pursuant to the provisions of said subsection (f)(i) or (ii) for any legal or other expense subsequently incurred by such indemnified party in connection with the defense thereof other than reasonable costs of investigation, unless

(x) the indemnified party shall have employed counsel in accordance with the proviso of the preceding sentence, (y) the indemnifying party shall not have employed counsel

reasonably satisfactory to the indemnified party to represent the indemnified party within a reasonable time after the notice of the commencement of the action, or (z) the indemnifying party agrees in writing to bear such expenses. No indemnifying party will consent to entry of any judgment or enter into any settlement which does not include as an unconditional term thereof the giving by the claimant or plaintiff to such indemnified party of a release from all liability in respect to such claim or litigation.

(iv) If recovery is not available under the foregoing indemnification provisions, for any reason other than as specified therein, the parties entitled to indemnification by the terms thereof shall be entitled to contribution to liabilities and expenses, except to the extent that contribution is not permitted under Section 11(f) of the Securities Act. In determining the amount of contribution to which the respective parties are entitled, there shall be considered the parties' relative knowledge and access to information concerning the matter with respect to which the claim was asserted, the opportunity to correct and prevent any statement or omission, and any other equitable considerations appropriate under the circumstances.

(g) If, at any time after December 31, 2003, the Company shall determine to register any of its equity securities either for its own account or for the account of a security holder or holders exercising their respective demand registration rights, other than a registration relating solely to employee benefit plans, a registration on Form S-4 or any successor or substitute form or a registration relating solely to a Commission Rule 145 transaction, or a registration on any registration form which does not permit secondary sales or does not include substantially the same information as would be required to be included in a registration statement covering the sale of Registrable Securities, the Company will (i) promptly give to each of the Holders a written notice thereof (which shall include a list of the jurisdictions in which the Company intends to attempt to qualify such securities under the applicable blue sky or other state securities laws); and (ii) include in such registration (and any related qualification under blue sky laws or other compliance), and in any underwriting involved therein, all the Warrant Shares specified in a written request or requests, made by the Holders within twenty (20) days after receipt of the written notice from the Company described in clause (i) above, except as set forth in paragraph (h) below. Such written request may specify all or a part of the Holders' Warrant Shares.

(h) If the registration of which the Company gives notice is for a registered public offering involving an underwriting, the Company shall so advise each of the Holders as a part of the written notice given pursuant to paragraph (g). In such event, the right of each of the Holders to registration pursuant to paragraph (g) shall be conditioned upon such Holders' participation in such underwriting and the inclusion of such Holders' Warrant Shares in the underwriting to the extent provided herein. The Holders whose shares are to be included in such registration shall (together with the Company and the other stockholders distributing their securities through such underwriting (the "Other Stockholders")) enter into an underwriting agreement in customary form with the representative of the underwriter or underwriters selected for underwriting by the Company. Notwithstanding any other provision of paragraph (g) and this paragraph (h), if the representative determines that marketing factors require a limitation on

the number of shares to be underwritten, the representative may (subject to the allocation priority set forth below) limit the number of Warrant Shares to be included in the registration and underwriting. The Company shall so advise all holders of securities requesting registration, and the number of shares of securities that are entitled to be included in the registration and underwriting shall be allocated in the following manner: The securities to be sold by the Company and securities held by persons who by contractual right initiated the demand for such registration ("Demanding Holders") shall not be subject to reduction. The securities of the Company held by Holders, and Other Stockholders of the Company (other than securities held by Demanding Holders) shall be reduced, on a pro rata basis (based on the number of shares proposed to be sold by such Holders and other stockholders), by such minimum number of shares as is necessary to comply with such limitation. If any of the Holders or Demanding Holders or any officer, director or Other Stockholder disapproves of the terms of any such underwriting, such holder may elect to withdraw therefrom by written notice to the Company and the underwriter. Any Warrant Shares or other securities excluded or withdrawn from such underwriting shall be withdrawn from such registration.



**Exhibit 10.6**

**FORM OF PROMISSORY NOTE AND PLEDGE AGREEMENT**  
(Greater Than \$200,000 Principal Amount)

\$ Broomfield, Colorado  
[DATE]

FOR VALUE RECEIVED, the undersigned, [NAME], an individual residing at [ADDRESS] (the "Borrower"), hereby unconditionally promises to pay to LEVEL 3 COMMUNICATIONS, INC., a Delaware corporation (the Lender") at 1025 Eldorado Blvd., Broomfield, CO 80021 (as hereinafter defined) in lawful money of the United States and in immediately available funds, the principal amount shown as outstanding on Schedule 1 to this Note and Pledge Agreement (this "Note") but in an amount not to exceed [DOLLAR AMOUNT] (\$ ). The principal amount shall be paid in full on [DATE], subject to acceleration of the maturity as provided below (the "Maturity Date").

Borrower shall be entitled to borrow up to the maximum principal amount of [DOLLAR AMOUNT] Dollars of this Note, but shall not be entitled to reborrow any amounts pre-paid under this Note.

The unpaid principal amount of this Note and Pledge Agreement (this "Note") shall bear simple interest at the rate of [PRIME RATE OF INTEREST ON THE DATE OF THE NOTE]% per annum, computed on the basis of 12 months of 30 days per month. Interest shall accrue during the term of this Note and be payable at maturity or upon payment in full, whichever occurs first.

Borrower will make all payments (including pre-payments) under this Note of principal and interest, by certified or bank cashier's check to the order of the Lender at 1025 Eldorado Blvd., Broomfield, CO 80021, Attn: Vice President and Assistant General Counsel, or at a different place if required by the Lender. If the Borrower desires to pay any amounts due under this Note by wire transfer, the Borrower shall provide verbal notice of this request to the Group Vice President and General Counsel of lender at telephone number 720-888-2514 at least one business day prior to a desired payment date. Lender will provide to Borrower appropriate wire transfer instructions for such payment.

The Borrower shall have the right to pre-pay all or any portion of this Note at any time, without penalty; provided that interest shall continue to accrue on the unpaid portion of the principal amount of this Note at the rate of interest indicated above.

Any amount due hereunder not paid when due shall bear interest at a rate equal to 2% above the interest rate otherwise in effect. Notwithstanding the foregoing, the interest rate hereunder shall not exceed the maximum rate permitted by applicable law from time to time.

The holder of this Note is authorized to endorse on Schedule 1 to this Note, or on a continuation thereof which shall be attached hereto and made a part hereof, the date and

amount of each borrowing under this Note and payment of principal and interest on this Note, but the failure to do so shall not affect the liability of the undersigned. All such notations shall be prima facie evidence of the matters so noted.

As collateral for the repayment in full of the principal of and interest on this Note and Pledge Agreement, together with all costs of enforcement (including reasonable attorneys' fees) of this Note and Pledge Agreement (the "Obligations"), the undersigned does hereby grant to the Lender a security interest in the property described on Schedule 2 hereto, whether now owned or hereafter acquired, and wherever located, together with all proceeds thereof (the "Collateral"). This security interest created hereunder is a continuing security interest and shall remain in effect until the indefeasible payment in full in cash of all Obligations. Borrower hereby represents to Lender that Schedule 2 contains an accurate value of the Collateral, both encumbered value and unencumbered value, as the case may be.

Lender acknowledges that it is the Borrower's intention to pursue a sale of the Collateral and to use the proceeds of such sales to repay the Obligations. Borrower agrees to use his commercially reasonable efforts to effect the sales of the Collateral. Notwithstanding the foregoing, all proceeds relating to the Collateral shall be held by the Borrower in trust for the Lender and shall immediately upon receipt be turned over to the Lender as pre-payment or full payment of the Obligations hereunder. All certificates or instruments representing or evidencing any Collateral, shall be delivered to and held by or on behalf of the Lender pursuant hereto, shall be in suitable form for transfer by delivery, and shall be accompanied by all necessary instruments of transfer or assignment, duly executed in blank.

So long as any of the Obligations remain unpaid, the Borrower will not assign, pledge, mortgage or otherwise encumber any of the Collateral other than any pledge, mortgage or other encumbrance noted on Schedule 2. Lender acknowledges that it is the Borrower's intention to pursue a sale of the Collateral and to use the proceeds of such sales to repay the Obligations. The Borrower will warrant and defend the right and title herein granted to the Lender in and to the Collateral (and all right, title, and interest represented by the Collateral) against the claims and demands of all persons whomsoever unless contemporaneously with the sale of such Collateral, the Borrower shall make a prepayment of the outstanding principal of this Note and Pledge Agreement in the amount of the proceeds from such sale. The Borrower agrees that at any time, and from time to time, at the expense of the Borrower, the Borrower will promptly execute and deliver all further instruments, and take all further action, that may be necessary or desirable, or that the Lender may reasonably request, in order to perfect and protect any security interest granted or purported to be granted hereby or to enable the Lender to exercise and enforce its rights and remedies hereunder with respect to any Collateral.

The following events shall each constitute an Event of Default hereunder:

(a) failure of the Borrower to pay any amount of principal of any of the Obligations when due, (b) failure of the Borrower to pay any amount of interest on any of the Obligations within three (3) business days of when due; (c) failure of the security interest, if any, purported to be created hereby to be a first priority perfected security interest free and clear of all liens, security interests or other encumbrances of any nature whatsoever, unless otherwise waived by Lender, (d) failure of the Borrower to comply with any covenant or agreement contained herein which failure

remains unremedied for a period of 10 days, (e) the Borrower shall become a debtor under applicable federal or state bankruptcy or insolvency laws (f) the Borrower shall no longer be a full-time employee of the Lender or (g) the death of the Borrower.

Upon the occurrence and continuance of an Event of Default, the Lender shall (a) be entitled to vote all Investment Property (as defined in the Uniform Commercial Code of the State of New York (the "UCC") constituting Collateral, (b) be entitled to receive, hold and/or apply to the payment of the Obligations any dividends payable in respect of the Collateral and (d) have all the rights and remedies of a secured party under the Uniform Commercial Code of the State of New York (the "UCC"). The Borrower shall take such steps from time to time as may be requested by the Lender to ensure that the security interest created hereby shall constitute a first priority security interest under applicable law, including the UCC. The principal residence of the Borrower is [ADDRESS]. To the extent notice of any sale or disposition of Collateral is required under applicable law, the Borrower agrees that 10 calendar days' notice shall constitute reasonable notice of any such sale or disposition.

The Borrower agrees that in any sale of any of the Collateral whenever an Event of Default shall have occurred and be continuing, the Lender is hereby authorized to comply with any limitation or restriction in connection with such sale as it may be advised by counsel is necessary in order to avoid any violation of applicable law (including compliance with such procedures as may restrict the number of prospective bidders and purchasers, require that such prospective bidders and purchasers have certain qualifications, and restrict such prospective bidders and purchasers to persons who will represent and agree that they are purchasing for their own account for investment and not with a view to the distribution or resale of such Collateral), or in order to obtain any required approval of the sale or of the purchaser by any governmental regulatory authority or official, and the Borrower further agrees that such compliance shall not result in such sale being considered or deemed not to have been made in a commercially reasonable manner, nor shall the Lender be liable nor accountable to the Borrower for any discount allowed by the reason of the fact that such Collateral is sold in compliance with any such limitation or restriction.

The Borrower hereby irrevocably appoints the Lender the Borrower's attorney-in-fact, with full authority in the place and stead of the Borrower and in the name of the Borrower or otherwise, from time to time in the Lender's discretion, upon the occurrence and during the continuance of an Event of Default, to take any action and to execute any instrument (including stock powers and proxies) which the Lender may deem necessary or advisable to accomplish the purposes of this Note. The foregoing appointment is coupled with an interest.

Upon the occurrence of any one or more of the Events of Default, all principal and all accrued interest then remaining unpaid on this Note shall become, or may be declared to be, immediately due and payable, without notice.

All parties now and hereafter liable with respect to this Note, whether maker, principal, surety, guarantor, endorser or otherwise, hereby waive presentment, demand, protest and all other notices of any kind. The Borrower agrees to indemnify the Lender against all losses, claims, expenses and liabilities incurred by the Lender in connection with the

enforcement of this Note, including the payment of legal fees and disbursements of counsel (including in-house counsel) to the Lender.

No amendment to or waiver of any provision of this Note nor consent to any departure by the Borrower herefrom shall in any event be effective unless the same shall be in writing and signed by the Lender, and then such waiver or consent shall be effective only in the specific instance and for the specific purpose for which it is given.

**THIS NOTE SHALL BE GOVERNED BY, AND CONSTRUED AND INTERPRETED IN ACCORDANCE**

**WITH, THE LAW OF THE STATE OF NEW YORK.**

All notices hereunder shall be given in writing and shall be deemed delivered when received by the other party hereto at the address set forth below such party's signature or at such other address as may be specified by such party from time to time or, if mailed, on the fifth calendar day after being deposited in the mails, postage prepaid, so addressed.

THE LENDER AND THE BORROWER HEREBY KNOWINGLY, VOLUNTARILY AND INTENTIONALLY WAIVE ANY RIGHTS THEY MAY HAVE TO A TRIAL BY JURY IN RESPECT OF ANY LITIGATION BASED HEREON, OR ARISING OUT OF, UNDER, OR IN CONNECTION WITH, THIS NOTE AND PLEDGE AGREEMENT, OR ANY COURSE OF CONDUCT, COURSE OF DEALING, STATEMENTS (WHETHER VERBAL OR WRITTEN) OR ACTIONS OF THE LENDER OR THE BORROWER. THE BORROWER ACKNOWLEDGES AND AGREES THAT IT HAS RECEIVED FULL AND SUFFICIENT CONSIDERATION FOR THIS PROVISION AND THAT THIS PROVISION IS A MATERIAL

**INDUCEMENT FOR THE LENDER ENTERING INTO THIS NOTE AND PLEDGE AGREEMENT AND PROVIDING THE  
LOANS EVIDENCED HEREBY.**

[NAME],  
as Borrower

**Address:**

**ACCEPTED:  
LEVEL 3 COMMUNICATIONS, INC.**

By:  
Name  
Title:  
Address: 1025 Eldorado Blvd.  
Broomfield, CO 80021

**Schedule 1**

**Borrowings of Principal**

**Date Amount of Principal Borrowed Total Principal Borrowed**

**Payments of Principal and Interest**

**Date Amount of Interest Amount of Principal**

## Schedule 2

### Description of Collateral

The Collateral includes the following items or types of property, whether now owned or hereafter acquired and wherever located:

Collateral	Value	Encumbrances	Unencumbered	Description	Value
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**FROM OF PROMISSORY NOTE**  
(Less Than or Equal to \$200,000 Principal Amount)

\$ Broomfield, Colorado  
[DATE]

FOR VALUE RECEIVED, the undersigned, [NAME], an individual with a business address 1025 Eldorado Blvd., Broomfield, Colorado 80021 (the "Borrower"), hereby unconditionally promises to pay to LEVEL 3 COMMUNICATIONS, INC., a Delaware corporation (the "Lender") at 1025 Eldorado Blvd., Broomfield, Colorado 80021 (as hereinafter defined) in lawful money of the United States and in immediately available funds, the principal amount of [DOLLAR AMOUNT] (\$ ). The principal amount shall be paid in full on [DATE], subject to acceleration of the maturity as provided below.

The unpaid principal amount of this Note (this "Note") shall bear interest at the rate of [PRIME RATE AS OF DATE OF NOTE]% per annum, computed on the basis of the actual number of days elapsed prior to payment over a year of 365 days. Interest shall be payable upon the earlier of (i) prepayment of any principal amount hereof (interest being due and payable upon the amount of principal prepaid) and (ii) maturity.

Any amount due hereunder not paid when due shall bear interest at a rate equal to 2% above the interest rate otherwise in effect. Notwithstanding the foregoing, the interest rate hereunder shall not exceed the maximum rate permitted by applicable law from time to time.

The holder of this Note is authorized to endorse on Schedule 1 to this Note or on a continuation thereof which shall be attached hereto and made a part hereof the date and amount of each payment of principal and interest on this Note, but the failure to do so shall not affect the liability of the undersigned. All such notations shall be prima facie evidence of the matters so noted.

The following events shall each constitute an Event of Default hereunder:

(a) failure of the Borrower to pay any amount of principal or interest on any of the Obligations when due, (b) the Borrower shall no longer be a full time employee of the Lender or any of its subsidiaries, (c) failure of the Borrower to comply with any covenant or agreement contained herein which failure remains unremedied for a period of 10 days or (d) the Borrower shall become a debtor under applicable federal or state bankruptcy or insolvency laws.

The Borrower hereby irrevocably appoints the Lender the Borrower's attorney-in-fact, with full authority in the place and stead of the Borrower and in the name of the Borrower or otherwise, from time to time in the Lender's discretion, upon the occurrence and during the continuance of an Event of Default, to take any action and to execute any instrument (including stock powers and proxies) which the Lender may deem necessary or advisable to accomplish the purposes of this Note. The foregoing appointment is coupled with an interest.



The obligations of the Borrower hereunder are subject to optional prepayment in whole or in part at any time without premium or penalty.

Upon the occurrence of any one or more of the Events of Default, all principal and all accrued interest then remaining unpaid on this Note shall become, or may be declared to be, immediately due and payable, without notice.

All parties now and hereafter liable with respect to this Note, whether maker, principal, surety, guarantor, endorser or otherwise, hereby waive presentment, demand, protest and all other notices of any kind. The Borrower agrees to indemnify the Lender against all losses, claims, expenses and liabilities incurred by the Lender in connection with the enforcement of this Note, including the payment of legal fees and disbursements of counsel (including in-house counsel) to the Lender.

No amendment to or waiver of any provision of this Note nor consent to any departure by the Borrower herefrom shall in any event be effective unless the same shall be in writing and signed by the Lender, and then such waiver or consent shall be effective only in the specific instance and for the specific purpose for which it is given.

**THIS NOTE SHALL BE GOVERNED BY, AND CONSTRUED AND INTERPRETED IN ACCORDANCE**

**WITH, THE LAW OF THE STATE OF NEW YORK.**

All notices hereunder shall be given in writing and shall be deemed delivered when received by the other party hereto at the address set forth below such party's signature or at such other address as may be specified by such party from time to time or, if mailed, on the fifth calendar day after being deposited in the mails, postage prepaid, so addressed.

THE LENDER AND THE BORROWER HEREBY KNOWINGLY, VOLUNTARILY AND INTENTIONALLY WAIVE ANY RIGHTS THEY MAY HAVE TO A TRIAL BY JURY IN RESPECT OF ANY LITIGATION BASED HEREON, OR ARISING OUT OF, UNDER, OR IN CONNECTION WITH, THIS NOTE AND PLEDGE AGREEMENT, OR ANY COURSE OF CONDUCT, COURSE OF DEALING, STATEMENTS (WHETHER VERBAL OR WRITTEN) OR ACTIONS OF THE LENDER OR THE BORROWER. THE BORROWER ACKNOWLEDGES AND AGREES THAT IT HAS RECEIVED FULL AND SUFFICIENT CONSIDERATION FOR THIS PROVISION AND THAT THIS PROVISION IS A MATERIAL INDUCEMENT FOR THE LENDER ENTERING INTO THIS NOTE AND PLEDGE AGREEMENT AND PROVIDING THE LOANS EVIDENCED HEREBY.

[NAME], as Borrower

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**ACCEPTED:**  
**LEVEL 3 COMMUNICATIONS, INC.**

By:  
Name:  
Title:

**Schedule 1**

**Payments of Principal and Interest**

**Date Amount of Interest Amount of Principal**

**Exhibit 10.7****FORM OF AIRCRAFT TIME-SHARE AGREEMENT**

THIS AIRCRAFT TIME SHARE AGREEMENT is made and entered as of \_\_\_\_\_, 2001, between LEVEL 3 COMMUNICATIONS, LLC, a Delaware limited liability company ("Operator"), with offices at 1025 Eldorado Boulevard Broomfield, Colorado, 80021 and \_\_\_\_\_ ("User"), with an address of \_\_\_\_\_.

**PRELIMINARY STATEMENT.** Operator agrees to provide aircraft to User on a time sharing basis under Federal Aviation Regulation ("FAR") sections 91.501(b)(6) and (c)(1) (the "Aircraft") and User agrees to pay for such usage upon the terms herein. The Aircraft presently owned or leased by Operator and available for User's use are listed on the attached Schedule A. This Agreement does not prohibit Operator, in its discretion, from increasing or decreasing the number or type of Aircraft subject to this Agreement.

NOW, THEREFORE, in consideration of the promises, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Operator and User agree as follows:

1. **Consideration.** Operator shall incur and pay all costs and expenses associated with operation of the Aircraft, including all fuel, oil and other supplies necessary for Aircraft use and maintenance, all airport charges, landing and tie down fees, and all pilots' living expenses, food and transportation when an Aircraft is required by User to be away from its home base of operation. User shall reimburse Operator for the costs of fuel and pilot expenses at a fixed rate determined by Operator to be reasonably allocable to User's use of the Aircraft pursuant hereto. However, such share of allocable costs shall not in any event exceed the costs permitted to be charged by Operator to User pursuant to Section 91.501(d) of the Federal Aviation Regulations, or any successor or replacement regulations. Operator will invoice User for expenses as incurred and permissible under FAR SEC. 91.501 which will be due upon receipt. Payment of reimbursement shall be made in full to Operator at 1025 Eldorado Boulevard, Broomfield, Colorado, 80021, or as otherwise agreed by the parties.
2. **Taxes.** The amounts paid by User under Section 91.501(d) for Time-Sharing agreements are subject to a Federal Excise tax as imposed under I.R.C. SEC. 4261. It is the responsibility of Operator to collect and remit the tax on the amounts paid. The Operator is responsible for the collection and payment of all other State or Federal taxes that may arise under this agreement.
3. **Operational Control.** Operator shall at all times during the use of the Aircraft by the User be responsible for and retain full and complete operational control of the Aircraft. Operator is responsible for providing the crew, the physical and technical operation of the Aircraft, and the safe performance of all

flights. Operator will furnish two experienced and competent pilots satisfactory to the User on all occasions when any Aircraft is in use. Such pilots shall be under the direction and control of Operator at all times. One of such pilots shall be the captain of the Aircraft and at all times shall have full control of its operations, and the judgment of such pilot as to the suitability of the weather, terrain, mechanical condition or capacity of the Aircraft and other similar decisions shall be conclusive. The Aircraft shall be operated in compliance with the Operator's current aircraft operating manual.

4. Aircraft Use. Operator and User agree to use the Aircraft covered by this Agreement in accordance with the time-share provisions contained in 91.501 of the Federal Aviation Regulations, as well as any other applicable portions of FAR Part 91.

5. Maintenance. Operator, at its own cost and expense, will service, maintain, and repair the Aircraft in compliance with all maintenance standards of the Aircraft and all requirements of FAR Part 91. Operator will also provide suitable hangar and storage facilities for the Aircraft at its own expense. Aircraft maintenance and inspection takes precedence over Aircraft scheduling unless such maintenance or inspections can be safely deferred in accordance with applicable laws and regulations and within the sound discretion of the captain.

6. Insurance. Operator, at its own expense, shall cause to be kept in full force and effect with regard to its Aircraft, liability insurance upon the Aircraft with limits for bodily injury and for property damage, which are satisfactory to the User.

7. Indemnification. Operator agrees to indemnify, defend, and hold the User harmless from any claims, suits, liabilities, losses, costs or expense for injury to persons, or damage to property in any way arising out of the operation of the Aircraft.

8. Term. This agreement shall be effective as of \_\_\_\_\_, 2001, shall continue in full force and effect for a term of one year, and shall be automatically renewed for continuous periods of one year without re-execution. Any party may terminate this Agreement at any time for any or no reason by giving thirty (30) days' prior written notice to the other party of its intention to terminate. This Agreement supersedes any prior agreements between the parties relating to Aircraft operations and use.

9. Assignment. No party shall have the right to assign its interest or rights hereunder, in whole or part, without the prior written consent of the other party, except that the Operator may assign its interest hereunder to a wholly-owned affiliate without the consent of the User.

10. Notice. Any statement, consent, or notice required or permitted by this Agreement shall be given by mail to the party concerned at the addresses listed above except that notice with respect to the operation or use of the Aircraft may be given by telephone.

11. Warranties. User warrants to Operator that during the use of the Aircraft said Aircraft shall not be used or employed, except as authorized by the Federal Aviation Regulations. Operator warrants that each of the Aircraft listed herein have been maintained under Part 91 of the Federal Aviation Regulations for the twelve (12) month period immediately preceding the date of this Agreement.

12. No Carriage For Compensation or Hire. It is understood and agreed that Operator and User shall neither sell seats to passengers or space for cargo, nor in any manner otherwise use any of the Aircraft listed herein for the carriage of goods or passengers for compensation or hire, and that the Aircraft is operated within the applicable rules of Subpart D of Part 91 of the Federal Aviation Regulations during the operation of this agreement.

13. Counterparts. This Agreement may be executed in counterparts, all of which when executed shall constitute an original.

14. Truth-In-Leasing Statement Under FAR 91.23.

AN EXECUTED COPY OF THIS AGREEMENT WILL BE MAILED TO THE FEDERAL AVIATION ADMINISTRATION, FLIGHT STANDARDS TECHNICAL DIVISION, POST OFFICE BOX 25724, OKLAHOMA CITY, OKLAHOMA 73125, WITHIN 24 HOURS OF THE TIME OF EXECUTION HEREOF.

THE AIRCRAFT LISTED AND REFERENCED HEREIN HAVE BEEN MAINTAINED AND INSPECTED UNDER FAR PART 91 FOR THE 12 MONTH PERIOD PRECEDING THE DATE HEREOF. SAID AIRCRAFT WILL BE MAINTAINED AND INSPECTED UNDER PART 91 OF THE FEDERAL AVIATION REGULATIONS FOR OPERATIONS TO BE CONDUCTED UNDER THIS AGREEMENT DURING THE DURATION OF THIS AGREEMENT.

OPERATOR, LOCATED AT THE ABOVE LISTED ADDRESS, IS CONSIDERED TO BE IN OPERATIONAL CONTROL OF THE AIRCRAFT AND UNDERSTANDS AND IS FAMILIAR WITH ITS RESPONSIBILITIES WITH REGARD TO THE OPERATION OF AIRCRAFT UNDER THE FEDERAL AVIATION REGULATIONS.

A COPY OF THIS AGREEMENT SHALL BE CARRIED ON EACH AIRCRAFT AT ALL TIMES AND SHALL BE MADE AVAILABLE FOR REVIEW UPON REQUEST BY THE ADMINISTRATOR OR HIS REPRESENTATIVE.

AN EXPLANATION OF THE FACTORS BEARING ON OPERATIONAL CONTROL AND THE PERTINENT FEDERAL AVIATION REGULATIONS CAN BE OBTAINED FROM THE NEAREST FAA FLIGHT STANDARDS DISTRICT OFFICE.

**OPERATOR CERTIFIES THAT IT UNDERSTANDS THE OPERATOR'S RESPONSIBILITIES FOR COMPLIANCE WITH APPLICABLE FEDERAL AVIATION REGULATIONS.**

IN WITNESS WHEREOF, the parties hereto have cause this Agreement to be executed on their behalf by their duly authorized representatives, as of the date first above written.

Operator:	
LEVEL 3 COMMUNICATIONS, LLC	User:
By: _____	_____
Name: _____	_____

Title: \_\_\_\_\_

**SCHEDULE A**

Aircraft	FAA Registration No.
Dassault Falcon Model 50	N78LT
Dassault Falcon Model 50	N56LT
Dassault Falcon Model 900	N349K

## Exhibit 21

Name	Jurisdiction
Level 3 Communications, Inc.	Delaware
Level 3 Finance, LLC	Delaware
(i)Structure, Inc.	Delaware
Level 3 Communications, LLC	Delaware
BTE Equipment, LLC	Delaware
Level 3 International, Inc.	Delaware
Level 3 Holdings, B.V.	Netherlands
Level 3 Communications Limited	United Kingdom
Level 3 Holdings, Inc.	Delaware
KCP, Inc.	Delaware



## **EXHIBIT 23.1**

### **CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS**

As independent public accountants, we hereby consent to the incorporation of our report dated January 29, 2002, except with respect to the matters discussed in Note 17, as to which the date is March 13, 2002, on the consolidated financial statements of Level 3 Communications, Inc. as of December 31, 2001 and 2000 and for each of the three years ended December 31, 2001, included in this Annual Report on Form 10-K, into Level 3 Communications, Inc.'s previously filed Registration Statements on Forms S-3 (File Nos. 333-53914, 333-91899, 333-68887 and 333-71713) and on Forms S-8 (File Nos. 333-79533, 333-42465, 333-68447, 333-58691 and 333-52697).

*/S/ Arthur Andersen LLP*

*Denver, Colorado*

*March 13, 2002*

## EXHIBIT 23.2

### CONSENT OF INDEPENDENT ACCOUNTANTS

We hereby consent to the incorporation by reference in the Registration Statements on Form S-3 (No. 333-53914, 333-91899, 333-68887 and 333-71713) and on Form S-8 (No. 333-79533, 333-42465, 333-68447, 333-58691 and 333-52697) of Level 3 Communications, Inc. of our report dated March 2, 2001 relating to the financial statements and financial statement schedules of RCN Corporation and Subsidiaries as of December 31, 2000 and 1999, which is incorporated by reference in this Form 10-K.

*s/ PricewaterhouseCoopers LLP*

*Philadelphia, Pennsylvania  
March 18, 2002*

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**End of Filing**

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