

LEVEL 3 COMMUNICATIONS INC

FORM 10-K/A (Amended Annual Report)

Filed 12/12/07 for the Period Ending 12/31/06

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

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-K/A

AMENDMENT NO. 1

(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, 2006

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)

80021-8869

(Zip code)

(720) 888-1000

(Registrant's telephone number including area code)

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

Common Stock, par value \$.01 per share

The NASDAQ Stock Market LLC

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

None

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒
No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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 (§ 229.405 of this chapter) 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. ☒

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

☒ Large accelerated filer

☐ Accelerated filer

☐ Non-accelerated filer

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

As of June 30, 2006 the aggregate market value of common stock held by non-affiliates of the registrant approximated \$3.53 billion based upon the closing price of the common stock as reported on the NASDAQ Global Select Market as of the close of business on that date. Shares of common stock held by each executive officer and director and by each entity that owns 10% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

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	1,536,789,595 as of November 2, 2007

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 2007 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K

Table of Contents

Explanatory Note	1
Part IV	
Item 15. Exhibits, Financial Statement Schedules	2
Index to Consolidated Financial Statements	F-1

EXPLANATORY NOTE

Level 3 Communications, Inc. is filing this Form 10-K/A-1 as an amendment to our Form 10-K for the fiscal year ended December 31, 2006, which was originally filed on March 1, 2007 (the “Original Filing”), to amend Part IV, Item 15 — “Exhibits, Financial Statement Schedules” as follows:

- Note 20 “Condensed Consolidating Financial Information” (“Note 20”) to our audited Consolidated Financial Statements for the fiscal year ended December 31, 2006 has been amended in order to present the information on an audited (rather than unaudited) basis.
- Note 20 has also been amended to add the last two sentences in the third paragraph of Note 20 to clarify the basis of presentation of the Condensed Consolidating Financial Information.
- Report of Independent Registered Public Accounting Firm has been amended to reflect dating the audit opinion as of December 12, 2007 with respect to the amendment to Note 20.

We are not otherwise changing Note 20 or making any other changes to our Consolidated Financial Statements for the fiscal year ended December 31, 2006.

Except as otherwise expressly noted herein, this Form 10-K/A-1 does not reflect events occurring after the March 1, 2007 filing of our original Form 10-K in any way, except to reflect the changes discussed in this Form 10-K/A-1. Accordingly, this Form 10-K/A-1 should be read in conjunction with the Original Filing.

We do not undertake to update any information or disclosures in, or exhibits to, the Original Filing to reflect events and circumstances occurring since the Original Filing. These matters are and will be addressed in our subsequent reports filed with the SEC.

Part IV

ITEM 15 . EXHIBITS, FINANCIAL STATEMENT SCHEDULES

- (a) Financial statements and financial statement schedules required to be filed for the registrant under Items 8 or 15 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 Certificate of Amendment to the Level 3 Communications, Inc. Certificate of Incorporation and the Level 3 Communications, Inc. Restated Certificate of Incorporation. (Exhibit 3 to the Registrant's Current Reports on Form 8-K filed on May 27, 2005 and May 17, 2006).
 - 3.2 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).
 - 3.3 Amended and Restated By-laws of Level 3 Communications, Inc. (Exhibit 3(ii) to the Registrant's Current Report on Form 8-K dated May 17, 2006).
 - 4.1.1 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).
 - 4.1.2 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).
 - 4.1.3 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).
 - 4.2 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).
 - 4.3 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).
 - 4.4 Indenture, dated as of February 29, 2000, between the Registrant and The Bank of New York as Trustee relating to the Registrant's 12 ⁷/₈ % Senior Discount Notes due 2010 (Exhibit 4.3 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 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).
 - 4.6 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).

- 4.7 Amended and Restated Indenture dated as of July 8, 2003, by and between the Company and The Bank of New York, as successor to IBJ Whitehall Bank & Trust Company, as trustee (amends and restates the Senior Debt Indenture, a Form of which was filed as an Exhibit to the Company's Registration Statement on Form S-3-File No. 333-68887) (Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed July 8, 2003).
- 4.8 First Supplemental Indenture, dated as of July 8, 2003, by and between the Company and The Bank of New York, as successor to IBJ Whitehall Bank & Trust Company, as Trustee (Exhibit 4.2 to the Registrant's Current Report on Form 8-K filed July 8, 2003).
- 4.9 Indenture, dated as of October 1, 2003, by and between Level 3 Communications, Inc., as Guarantor, Level 3 Financing, Inc. as Issuer and The Bank of New York as Trustee relating to the Level 3 Financing, Inc. 10.75% Senior Notes due 2011 (Exhibit 4.11 to the Registrant's Annual Report on Form 10-K for the year ending December 31, 2003).
- 4.10.1 Indenture, dated as of October 24, 2003, by and between the Registrant and The Bank of New York as Trustee relating to the Registrant's 9% Convertible Senior Discount Notes due 2013 (Exhibit 4.12 to the Registrant's Annual Report on Form 10-K for the year ending December 31, 2003).
- 4.10.2 First Supplemental Indenture, dated as of February 7, 2005, by and between the Company and The Bank of New York, as Trustee relating to the Registrant's 9% Convertible Senior Discount Notes due 2013. (Exhibit 4.12.2 to the Registrant's Annual Report on Form 10-K for the year ending December 31, 2005).
- 4.11 Supplemental Indenture, dated as of October 20, 2004, among Level 3 Financing, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated as of October 1, 2003, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 10.75% Senior Notes due 2014. (Exhibit 99.1 to the Registrant's Current Report on Form 8-K filed October 22, 2004).
- 4.12 Supplemental Indenture, dated as of October 20, 2004 among Level 3 Financing, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated as of October 1 2003, among Level 3 Financing, Inc. as Issuer, Level 3 Communications, Inc. as Guarantor and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 10.75% Senior Notes due 2011. (Exhibit 99.1 to the Registrant's Current Report on Form 8-K/A-1 filed October 22, 2004).
- 4.13 Indenture, dated December 2, 2004, among Level 3 Communications, Inc. and The Bank of New York. (Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed December 7, 2004).
- 4.14 Supplemental Indenture, dated December 1, 2004, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and The Bank of New York, as Trustee, relating to the Level 3 Financing 10.75% Senior Notes due 2011. (Exhibit 4.2 to the Registrant's Current Report on Form 8-K filed December 7, 2004).
- 4.15 Second Supplemental Indenture dated as of April 4, 2005, by and between Level 3 Communications, Inc. and the Bank of New York, as trustee (Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed April 8, 2005).
- 4.16 Indenture, dated as of January 13, 2006, among Level 3 Communications, Inc. as Issuer and The Bank of New York, as Trustee relating to the 11.50% Senior Notes Due 2010 (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated January 17, 2006).

- 4.17 Indenture, dated as of March 14, 2006, among Level 3 Communications, Inc., as Guarantor, Level 3 Financing, Inc., as Issuer and The Bank of New York, as Trustee, relating to the Floating Rate Senior Notes due 2011 of Level 3 Financing, Inc. (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated March 16, 2006).
- 4.18 Indenture, dated as of March 14, 2006, among Level 3 Communications, Inc., as Guarantor, Level 3 Financing, Inc., as Issuer and The Bank of New York, as Trustee, relating to the 12.25% Senior Notes due 2013 of Level 3 Financing, Inc. (Exhibit 4.2 to the Registrant's Current Report on Form 8-K dated March 16, 2006).
- 4.19 Third Supplemental Indenture between Level 3 Communications, Inc. and The Bank of New York, as Trustee, relating to up to \$345,000,000 aggregate principal amount of 3.5% Convertible Senior Notes due 2012, dated as of June 13, 2006 supplement to the Amended and Restated Indenture dated as of July 8, 2003 (Senior Debt Securities) (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated June 13, 2006).
- 4.20 Supplemental Indenture, dated as of October 12, 2006, among Level 3 Financing, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated as of March 14, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s Floating Rate Senior Notes due 2011 (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated October 17, 2006).
- 4.21 Supplemental Indenture, dated as of October 12, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, Supplementing the Indenture dated as of March 14, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s Floating Rate Senior Notes due 2011 (Exhibit 4.2 to the Registrant's Current Report on Form 8-K dated October 17, 2006).
- 4.22 Supplemental Indenture, dated as of October 12, 2006, among Level 3 Financing, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated as of March 14, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 12.25% Senior Notes due 2013 (Exhibit 4.3 to the Registrant's Current Report on Form 8-K dated October 17, 2006).
- 4.23 Supplemental Indenture, dated as of October 12, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated as of March 14, 2006, among Level 3 Financing, Inc., Level 3 Communications, Inc. and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 12.25% Senior Notes due 2013 (Exhibit 4.4 to the Registrant's Current Report on Form 8-K dated October 17, 2006).
- 4.24 Indenture, dated as of October 30, 2006, among Level 3 Communications, Inc., as Guarantor, Level 3 Financing, Inc., as Issuer, and The Bank of New York, as Trustee, relating to the 9.25% Senior Notes due 2014 of Level 3 Financing, Inc. (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated October 30, 2006).
- 4.25 Supplemental Indenture, dated as of December 27, 2006, among Level 3 Communications, Inc., Level 3 Financing, Inc., Level 3 Communications, LLC and The Bank of New York as Trustee, supplementing the Indenture dated as of October 1, 2003, among Level 3 Financing, Inc., as Issuer, Level 3 Communications, Inc., as Guarantor, and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 10.75% Senior Notes due 2011 2014 (Exhibit 4.2 to the Registrant's Current Report on Form 8-K dated December 28, 2006).

- 4.26 Indenture, dated as of February 14, 2007, among Level 3 Communications, Inc., as Guarantor, Level 3 Financing, Inc., as Issuer and The Bank of New York, as Trustee, relating to the Floating Rate Senior Notes due 2015 of Level 3 Financing, Inc. (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated February 20, 2007).
- 4.27 Indenture, dated as of February 14, 2007, among Level 3 Communications, Inc., as Guarantor, Level 3 Financing, Inc., as Issuer and The Bank of New York, as Trustee, relating to the 8.75% Senior Notes due 2017 of Level 3 Financing, Inc. (Exhibit 4.2 to the Registrant's Current Report on Form 8-K dated February 20, 2007).
- 4.28 Supplemental Indenture, dated as of February 23, 2007, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC, Broadwing Financial Services, Inc. and The Bank of New York, as Trustee, supplementing the Indenture dated as of March 14, 2006, among Level 3 Financing, Inc., as Issuer, Level 3 Communications, Inc., as Guarantor, and The Bank of New York as Trustee, relating to Level 3 Financing, Inc.'s 12.25% Senior Notes due 2013 (Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed February 26, 2007).
- 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 Form of Aircraft Time-Share Agreement (Exhibit 10.7 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2001).
- 10.4 Warrant Agreement, dated as of April 15, 2002, between the Registrant and Walter Scott, Jr. (Exhibit 10.9 to the Registrant's Annual Report on Form 10-K for 2002).
- 10.5 Assignment and Amendment Agreement, dated as of June 27, 2006, by and among Level 3 Financing, Inc., Level 3 Communications, Inc., Merrill Lynch Capital Corporation and the lenders named therein (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated June 30, 2006).
- 10.6 Guarantee Agreement, dated December 1, 2004, among Level 3 Communications, Inc., the Subsidiaries party thereto and Merrill Lynch Capital Corporation. (Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed December 7, 2004).
- 10.7 Collateral Agreement, dated December 1, 2004, among Level 3 Financing, Inc., Level 3 Communications, Inc., Level 3 Communications, LLC and Merrill Lynch Capital Corporation. (Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed December 7, 2004).
- 10.8 Indemnity, Subrogation and Contribution Agreement, dated December 1, 2004, among Level 3 Communications, Inc., Level 3 Financing, Inc., the Subsidiaries party thereto and Merrill Lynch Capital Corporation. (Exhibit 10.4 to the Registrant's Current Report on Form 8-K filed December 7, 2004).
- 10.9 Offering Proceeds Note Subordination Agreement, dated December 1, 2004, among Level 3 Communications, Inc., Level 3 Communications, LLC and Level 3 Financing, Inc. (Exhibit 10.5 to the Registrant's Current Report on Form 8-K filed December 7, 2004).
- 10.10 Loan Proceeds Note, dated December 1, 2004, issued by Level 3 Communications, LLC to Level 3 Financing. (Exhibit 10.6 to the Registrant's Current Report on Form 8-K filed December 7, 2004).

- 10.11 Loan Proceeds Note Collateral Agreement, dated December 1, 2004, among Level 3 Financing, Inc., Level 3 Communications, Inc. and Merrill Lynch Capital Corporation. (Exhibit 10.7 to the Registrant's Current Report on Form 8-K filed December 7, 2004).
- 10.12 Confirmation of OTC Convertible Note Hedge, dated December 2, 2004, from Merrill Lynch International to Level 3 Communications, Inc. (Exhibit 10.8 to the Registrant's Current Report on Form 8-K filed December 7, 2004).
- 10.13 Confirmation of OTC Warrant, dated December 2, 2004, from Merrill Lynch International to Level 3 Communications, Inc. (Exhibit 10.9 to the Registrant's Current Report on Form 8-K filed December 7, 2004).
- 10.14 Special Retention Bonus Agreement, dated February 28, 2006, by and between Software Spectrum, Inc. and Keith R. Coogan (filed as Exhibit 10.14 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2005).
- 10.15 Securities Purchase Agreement, dated as of February 18, 2005, among Level 3 Communications, Inc. and the Investors named therein (Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed February 22, 2005).
- 10.16 The 1995 Stock Plan (Amended and Restated April 1, 1998) as amended as of May 15, 2006 (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated May 17, 2006).
- 10.17 Form of Master Deferred Issuance Stock Agreement of Level 3 Communications, Inc. (Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed May 27, 2005).
- 10.18 Form of Level 3 Communications, Inc. Outperform Stock Option Master Award Agreement (Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed June 30, 2005).
- 10.19 Purchase Agreement by and among Level 3 Communications, LLC, PT Holding Company LLC, Progress Telecommunications Corporation, EPIK Communications Incorporated, Florida Progress Corporation, Odyssey Telecorp, Inc. and Level 3 Communications, Inc. dated as of January 25, 2006 (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated January 30, 2006).
- 10.20 Form of Registration Rights and Transfer Restriction Agreement by and among Level 3 Communications, Inc., PT Holding Company LLC, Progress Telecommunications Corporation, Caronet, Inc., and EPIK Communications Incorporated to be entered into on the closing of the transaction contemplated by the Purchase Agreement 2006 (Exhibit 10.2 to the Registrant's Current Report on Form 8-K dated January 30, 2006).
- 10.21 Agreement and Plan of Merger by and among Level 3 Communications, Inc., Eldorado Acquisition Three, LLC and TelCove, Inc. dated as of April 30, 2006. (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated April 19, 2006).
- 10.22 Registration Rights and Transfer Restriction Agreement, dated May 31, 2006, by and among Level 3 Communications, Inc., MCCC ICG Holdings LLC, Columbia Capital Equity Partners III(QP), L.P., Columbia Capital Partners III (Cayman), L.P., Columbia Capital Equity Partners III (AI), L.P., Columbia Capital Investors III, L.L.C., Columbia Capital Employees Investors III, L.L.C., M/C Venture Partners V, L.P., M/C Venture Investors, L.L.C., Chestnut Venture Partners, L.P., and Bear Investments, LLLP. (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated June 1, 2006).
- 10.23 Stock Purchase Agreement, dated July 20, 2006, among Level 3 Communications, Inc., Technology Spectrum, Inc. and Insight Enterprises, Inc. (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated July 26, 2006).

- 10.24 Registration Rights Agreement, dated as of August 2, 2006, between Level 3 Communications, Inc. and Cheshire Holding Corp., as agent for the security holders of Looking Glass Networks Holding Co., Inc. (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated August 3, 2006).
- 10.25 Consent, dated as of August 7, 2006, by Level 3 Communications, Inc. relating to that certain Securities Purchase Agreement, dated as of February 18, 2005, by and among Level 3 Communications, Inc. and the Investors named on Exhibit A Thereto (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated August 7, 2006).
- 10.26 Agreement and Plan of Merger among Level 3 Communications, Inc., Level 3 Services, LLC, Level 3 Colorado, Inc. and Broadwing Corporation, dated as of October 16, 2006 (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated October 17, 2006).
- 10.27 Registration Agreement, dated October 30, 2006, among Level 3 Communications, Inc., Level 3 Financing, Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated, Morgan Stanley & Co. Incorporated, Credit Suisse Securities (USA) LLC, J.P. Morgan Securities Inc. and Wachovia Capital Markets, LLC relating to Level 3 Financing, Inc.'s 9.25% Senior Notes due 2014 (Exhibit 4.2 to the Registrant's Current Report on Form 8-K dated October 30, 2006).
- 10.28 Agreement and Plan of Merger, dated as of October 16, 2006, as Amended by the First Amendment to Agreement and Plan of Merger Dated as of November 21, 2006, among Level 3 Communications, Inc., Level 3 Services, LLC, Level 3 Colorado, LLC (n/k/a Level 3 Colorado, Inc.) and Broadwing Corporation (attached as Annex A to the proxy statement/prospectus included in the registrant's Registration Statement on Form S-4 (333-138462) (Incorporated by reference to Exhibit 2.1 to the Registrant's Registration Statement on Form S-4 (333-138462))). (Exhibit 10.1 to the Registrant's Current Report on Form 8-K/A dated November 27, 2006).
- 10.29 Registration Agreement, dated December 28, 2006, among Level 3 Communications, Inc., Level 3 Financing, Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated, Morgan Stanley & Co. Incorporated, Credit Suisse Securities (USA) LLC, Citigroup Global Markets Inc. and Wachovia Capital Markets, LLC relating to Level 3 Financing, Inc.'s 9.25% Senior Notes due 2014 (Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated December 28, 2006).
- 10.30 Exchange Agreement, dated as of January 11, 2007, among Level 3 Communications, Inc., Southeastern Asset Management, Inc., on behalf of its investment advisory clients, and Legg Mason Opportunity Trust, a series of Legg Mason Investment Trust, Inc. (Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated January 17, 2007).
- 10.31 Registration Agreement, dated February 14, 2007, among Level 3 Communications, Inc., Level 3 Financing, Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated, Credit Suisse Securities (USA) LLC, Citigroup Global Markets Inc., Morgan Stanley & Co. Incorporated and Wachovia Capital Markets, LLC relating to Level 3 Financing, Inc.'s Floating Rate Senior Notes due 2015 (Exhibit 4.3 to the Registrant's Current Report on Form 8-K dated February 20, 2007).
- 10.32 Registration Agreement, dated February 14, 2007, among Level 3 Communications, Inc., Level 3 Financing, Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated, Credit Suisse Securities (USA) LLC, Citigroup Global Markets Inc., Morgan Stanley & Co. Incorporated and Wachovia Capital Markets, LLC relating to Level 3 Financing, Inc.'s 8.75% Senior Notes due 2017 (Exhibit 4.4 to the Registrant's Current Report on Form 8-K dated February 20, 2007).
- 12 Statements re computation of ratios. (Exhibit 12 to the registrant's Form 10-K for the year ending December 31, 2006)
- 21 List of subsidiaries of the Company. (Exhibit 21 to the registrant's Form 10-K for the year ending December 31, 2006)

- 23 Consent of KPMG LLP.
- 31.1 Rule 13a-14(a)/15d-14(a) Certification of the Chief Executive Officer.
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of the Chief Financial Officer.
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes- Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes- Oxley Act of 2002.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, this 12th day of December, 2007.

LEVEL 3 COMMUNICATIONS, INC.

By: /s/ ERIC J. MORTENSEN
Eric J. Mortensen
Senior Vice President, Controller and
Principal Accounting Officer

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	<u>Page</u>
Report of Independent Registered Public Accounting Firm	F-2
Financial Statements as of December 31, 2006 and 2005 and for each of the three years ended December 31, 2006:	
Consolidated Statements of Operations	F-5
Consolidated Balance Sheets	F-6
Consolidated Statements of Cash Flows	F-7
Consolidated Statements of Changes in Stockholders' Equity (Deficit)	F-9
Consolidated Statements of Comprehensive Loss	F-10
Supplementary Stockholders' Equity (Deficit) Information	F-10
Notes to Consolidated Financial Statements	F-11

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 Registered Public Accounting Firm

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

We have audited the accompanying consolidated balance sheets of Level 3 Communications, Inc. and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, cash flows, changes in stockholders' equity (deficit), and comprehensive loss for each of the years in the three-year period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Level 3 Communications, Inc. and subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Level 3 Communications, Inc.'s internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 1, 2007 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

/s/ **KPMG LLP**

Denver, Colorado
March 1, 2007, except as to Note 20,
which is as of December 12, 2007

Report of Independent Registered Public Accounting Firm

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

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that Level 3 Communications, Inc. maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Level 3 Communications, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

In our opinion, management's assessment that Level 3 Communications, Inc. maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, Level 3 Communications, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Level 3 Communications, Inc. acquired ICG Communications, Inc. on May 31, 2006; Telcove, Inc. on July 24, 2006; and Looking Glass Networks Holding Co., Inc. on August 2, 2006. Management excluded from its assessment of Level 3 Communications, Inc.'s internal control over financial reporting as of December 31, 2006, these acquired businesses' internal control over financial reporting associated with total assets of \$1.3 billion and total revenues of \$246 million included in the consolidated financial statements of Level 3 Communications, Inc. and subsidiaries as of and for the year ended December 31,

2006. Our audit of internal control over financial reporting of Level 3 Communications, Inc. also excluded an evaluation of the internal control over financial reporting of ICG Communications, Inc., Telcove, Inc., and Looking Glass Networks Holding Co., Inc.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Level 3 Communications, Inc. as of December 31, 2006 and 2005, and the related consolidated statements of operations, cash flows, changes in stockholders' equity (deficit), and comprehensive loss for each of the years in the three-year period ended December 31, 2006, and our report dated March 1, 2007 expressed an unqualified opinion on those consolidated financial statements.

/s/ **KPMG LLP**

Denver, Colorado
March 1, 2007

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
For each of the three years ended December 31, 2006

	<u>2006</u>	<u>2005</u>	<u>2004</u>
	<small>(dollars in millions, except per share data)</small>		
Revenue:			
Communications	\$ 3,311	\$ 1,645	\$ 1,685
Coal mining	67	74	91
Total revenue	<u>3,378</u>	<u>1,719</u>	<u>1,776</u>
Costs and Expenses (exclusive of depreciation and amortization shown separately below):			
Cost of revenue:			
Communications	1,460	463	436
Coal mining	57	53	67
Total cost of revenue	<u>1,517</u>	<u>516</u>	<u>503</u>
Depreciation and amortization	730	647	671
Selling, general and administrative	1,258	769	822
Restructuring and impairment charges	13	23	14
Total costs and expenses	<u>3,518</u>	<u>1,955</u>	<u>2,010</u>
Operating Loss	(140)	(236)	(234)
Other Income (Expense):			
Interest income	64	35	13
Interest expense	(648)	(530)	(485)
Gain (loss) on early extinguishment of debt, net	(83)	—	197
Other, net	19	29	32
Total other income (expense)	<u>(648)</u>	<u>(466)</u>	<u>(243)</u>
Loss from Continuing Operations Before Income Taxes	(788)	(702)	(477)
Income Tax Expense	(2)	(5)	(1)
Loss from Continuing Operations	<u>(790)</u>	<u>(707)</u>	<u>(478)</u>
Discontinued Operations:			
Income from discontinued operations	13	20	20
Gain on sale of discontinued operations	33	49	—
Income from Discontinued Operations	<u>46</u>	<u>69</u>	<u>20</u>
Net Loss	<u>\$ (744)</u>	<u>\$ (638)</u>	<u>\$ (458)</u>
Earnings (Loss) Per Share of Common Stock (Basic and Diluted):			
Loss from Continuing Operations	\$ (0.79)	\$ (1.01)	\$ (0.70)
Income from Discontinued Operations	.05	0.10	0.03
Net Loss	<u>\$ (0.74)</u>	<u>\$ (0.91)</u>	<u>\$ (0.67)</u>

See accompanying notes to consolidated financial statements.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
December 31, 2006 and 2005

	<u>2006</u>	<u>2005</u>
	<small>(dollars in millions, except per share data)</small>	
<i>Assets</i>		
Current Assets:		
Cash and cash equivalents	\$ 1,681	\$ 379
Marketable securities	235	176
Restricted cash and securities	46	34
Receivables, less allowances for doubtful accounts of \$17 and \$17, respectively	326	392
Current assets of discontinued operations	—	597
Other	101	92
Total Current Assets	2,389	1,670
Property, Plant and Equipment, net	6,468	5,632
Marketable Securities	—	234
Restricted Cash and Securities	90	75
Goodwill and Other Intangibles, net	919	291
Noncurrent Assets of Discontinued Operations	—	264
Other Assets, net	128	111
Total Assets	<u>\$ 9,994</u>	<u>\$ 8,277</u>
<i>Liabilities and Stockholders' Equity (Deficit)</i>		
Current Liabilities:		
Accounts payable	\$ 391	\$ 367
Current portion of long-term debt	5	—
Accrued payroll and employee benefits	92	79
Accrued interest	143	102
Deferred revenue	142	199
Current liabilities of discontinued operations	—	539
Other	156	137
Total Current Liabilities	929	1,423
Long-Term Debt, less current portion	7,357	6,023
Deferred Revenue	753	737
Other Liabilities	581	570
Commitments and Contingencies		
Stockholders' Equity (Deficit):		
Preferred stock, \$.01 par value, authorized 10,000,000 shares: no shares outstanding	—	—
Common stock, \$.01 par value, authorized 2,250,000,000 shares: 1,178,423,105 outstanding in 2006 and 817,767,818 outstanding in 2005	12	8
Additional paid-in capital	9,305	7,759
Accumulated other comprehensive income (loss)	(4)	(51)
Accumulated deficit	(8,939)	(8,192)
Total Stockholders' Equity (Deficit)	374	(476)
Total Liabilities and Stockholders' Equity (Deficit)	<u>\$ 9,994</u>	<u>\$ 8,277</u>

See accompanying notes to consolidated financial statements.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
For each of the three years ended December 31, 2006

	<u>2006</u>	<u>2005</u>	<u>2004</u>
	(dollars in millions)		
Cash Flows from Operating Activities:			
Net Loss	\$ (744)	\$ (638)	\$ (458)
Income from discontinued operations	(46)	(69)	(20)
Loss from continuing operations	(790)	(707)	(478)
Adjustments to reconcile loss from continuing operations to net cash provided by (used in) operating activities of continuing operations:			
Depreciation and amortization	730	647	671
(Gain) loss on debt extinguishments, net	83	—	(197)
Loss on impairments	8	9	—
Gain on sale of property, plant and equipment, Commonwealth Telephone shares and other assets	(7)	(9)	(30)
Non-cash compensation expense attributable to stock awards	84	51	43
Deferred revenue	(53)	(121)	(66)
Amortization of debt issuance costs	19	16	16
Accreted interest on long-term debt discount	38	33	75
Accrued interest on long-term debt	32	30	(27)
Change in working capital items net of amounts acquired:			
Receivables	131	3	(6)
Other current assets	8	(15)	13
Payables	(23)	(12)	(16)
Other current liabilities	(32)	(26)	(117)
Other	(7)	(17)	(3)
Net Cash Provided by (Used in) Operating Activities of Continuing Operations	221	(118)	(122)
Cash Flows from Investing Activities:			
Proceeds from sales and maturities of marketable securities	280	584	70
Purchases of marketable securities	(98)	(648)	(410)
Decrease (increase) in restricted cash and securities, net	(21)	(4)	21
Capital expenditures	(392)	(300)	(272)
Advances (to) from discontinued operations, net	18	13	7
Acquisitions, net of cash acquired, and investments	(749)	(379)	(69)
Proceeds from sale of discontinued operations, net of cash sold	307	82	—
Proceeds from sale of Commonwealth shares	—	—	41
Proceeds from sale of property, plant and equipment, and other investments	7	11	19
Net Cash Used in Investing Activities	\$ (648)	\$ (641)	\$ (593)

(continued)

See accompanying notes to consolidated financial statements.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
For each of the three years ended December 31, 2006

	<u>2006</u>	<u>2005</u>	<u>2004</u>
	(dollars in millions)		
Cash Flows from Financing Activities:			
Long-term debt borrowings, net of issuance costs	\$ 2,256	\$ 943	\$ 985
Payments on and repurchases of long-term debt, including current portion and refinancing costs	(1,110)	(130)	(1,027)
Equity offering	543	—	—
Net Cash Provided by (Used in) Financing Activities	<u>1,689</u>	<u>813</u>	<u>(42)</u>
Discontinued Operations (Revised—See Note 1):			
Net cash provided by (used in) discontinued operating activities	(20)	(5)	58
Net cash used in investing activities	(23)	(22)	(4)
Net cash used in financing activities	—	(1)	(1)
Effect of exchange rates on cash and cash equivalents	—	(4)	3
Net Cash Provided by (Used in) Discontinued Operations	<u>(43)</u>	<u>(32)</u>	<u>56</u>
Effect of Exchange Rates on Cash and Cash Equivalents	<u>10</u>	<u>(13)</u>	<u>15</u>
Net Change in Cash and Cash Equivalents	<u>1,229</u>	<u>9</u>	<u>(686)</u>
Cash and Cash Equivalents at Beginning of Year:			
Cash and cash equivalents of continuing operations	379	338	1,080
Cash and cash equivalents of discontinued operations	<u>73</u>	<u>105</u>	<u>49</u>
Cash and Cash Equivalents at End of Year:			
Cash and cash equivalents of continuing operations	<u>\$ 1,681</u>	<u>\$ 379</u>	<u>\$ 338</u>
Cash and cash equivalents of discontinued operations	<u>\$ —</u>	<u>\$ 73</u>	<u>\$ 105</u>
Supplemental Disclosure of Cash Flow Information:			
Cash interest paid	\$ 559	\$ 451	\$ 421
Income taxes paid	—	—	11
Noncash Investing and Financing Activities:			
Common stock issued for acquisitions	\$ 904	\$ 313	\$ —
Amendment and restatement of \$730 million credit agreement	730	—	—
Long-term debt issued in exchange transaction	619	—	—
Long-term debt retired in exchange transaction	692	—	—
Settlement of debt obligation and current liabilities with restricted securities	—	13	—
Decrease in deferred revenue related to acquisitions	10	2	—

See accompanying notes to consolidated financial statements.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (DEFICIT)
For each of the three years ended December 31, 2006

	<u>Common Stock</u>	<u>Additional Paid-in Capital</u>	<u>Accumulated Other Comprehensive Income (Loss)</u> (dollars in millions)	<u>Accumulated Deficit</u>	<u>Total</u>
Balances at December 31, 2003	\$ 7	\$ 7,360	\$ (90)	\$ (7,096)	\$ 181
Common Stock:					
Stock plan grants	—	22	—	—	22
Shareworks plan	—	34	—	—	34
401(k) plan	—	17	—	—	17
Convertible Note Hedge and Warrant (See Note 15)	—	(62)	—	—	(62)
Net Loss	—	—	—	(458)	(458)
Other Comprehensive Income	—	—	109	—	109
Balances at December 31, 2004	7	7,371	19	(7,554)	(157)
Common Stock:					
WilTel acquisition	1	312	—	—	313
Stock plan grants	—	37	—	—	37
Shareworks plan	—	24	—	—	24
401(k) plan	—	15	—	—	15
Net Loss	—	—	—	(638)	(638)
Other Comprehensive Loss	—	—	(70)	—	(70)
Balances at December 31, 2005	8	7,759	(51)	(8,192)	(476)
Adjustment for EITF No. 04-6	—	—	—	(3)	(3)
Adjusted balances at December 31, 2005	8	7,759	(51)	(8,195)	(479)
Common Stock:					
Acquisitions	2	902	—	—	904
Equity offering, net of offering costs	2	541	—	—	543
Stock plan grants	—	60	—	—	60
Shareworks plan	—	25	—	—	25
401(k) plan	—	18	—	—	18
Net Loss	—	—	—	(744)	(744)
Other Comprehensive Income	—	—	47	—	47
Balances at December 31, 2006	<u>\$ 12</u>	<u>\$ 9,305</u>	<u>\$ (4)</u>	<u>\$ (8,939)</u>	<u>\$ 374</u>

See accompanying notes to consolidated financial statements.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
For each of the three years ended December 31, 2006

	<u>2006</u>	<u>2005</u>	<u>2004</u>
	(dollars in millions)		
Net Loss	\$ (744)	\$ (638)	\$ (458)
Other Comprehensive Income (Loss) Before Income Taxes:			
Foreign currency translation income (losses)	45	(72)	29
Unrealized holding gains (losses) on marketable equity securities and other arising during period	(1)	(1)	(2)
Reclassification adjustment for losses included in net loss	3	3	82
Other Comprehensive Income (Loss), Before Income Taxes	47	(70)	109
Income Tax Benefit Related to Items of Other Comprehensive Income (Loss)	—	—	—
Other Comprehensive Income (Loss), Net of Income Taxes	47	(70)	109
Comprehensive Loss	<u>\$ (697)</u>	<u>\$ (708)</u>	<u>\$ (349)</u>

SUPPLEMENTARY STOCKHOLDERS' EQUITY (DEFICIT) INFORMATION

	<u>Net Foreign Currency Translation Adjustment</u>	<u>Other</u>	<u>Total</u>
	(dollars in millions)		
Accumulated other comprehensive income (loss):			
Balance at December 31, 2003	\$ (84)	\$ (6)	\$ (90)
Change	134	(25)	109
Balance at December 31, 2004	50	(31)	19
Change	(69)	(1)	(70)
Balance at December 31, 2005	(19)	(32)	(51)
Change	48	(1)	47
Balance at December 31, 2006	<u>\$ 29</u>	<u>\$ (33)</u>	<u>\$ (4)</u>

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 enterprises primarily engaged in communications and coal mining. Fifty-percent-owned mining joint ventures are consolidated on a pro rata basis. All significant intercompany accounts and transactions have been eliminated.

On December 23, 2005, Level 3 acquired WilTel Communications Group, LLC and its operating subsidiaries (“WilTel”). In addition the Company acquired Progress Telecom, LLC (“Progress Telecom”) on March 20, 2006, ICG Communications, Inc. (“ICG Communications”) on May 31, 2006, TelCove, Inc. (“TelCove”) on July 24, 2006 and Looking Glass Networks Holding Co., Inc. (“Looking Glass”) on August 2, 2006. The WilTel, Progress Telecom, ICG Communications, TelCove and Looking Glass results of operations, cash flows and financial position are included in the consolidated financial statements from the respective dates of their acquisition (See Note 2).

On September 7, 2006, Level 3 sold Software Spectrum, Inc. (“Software Spectrum”), the Company’s software reseller business, to Insight Enterprises, Inc. (“Insight Enterprises”). On November 30, 2005, Level 3 sold (i)Structure, LLC (“(i)Structure”), Level 3’s wholly owned IT infrastructure management outsourcing subsidiary to Infocrossing, Inc. (“Infocrossing”). The two businesses comprised Level 3’s information services segment. The results of operations, financial condition and cash flows for the Software Spectrum and (i)Structure businesses have been classified as discontinued operations in the consolidated financial statements and related footnotes for all periods presented in this report (See Note 3).

Communications

The Company’s communications business provides a broad range of integrated communications services primarily in the United States and Europe as 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). The Company has created, through a combination of construction, purchase and leasing of facilities and other assets, an advanced international, end-to-end, facilities-based communications network. The Company has built, and continues to upgrade, the network based on optical and Internet Protocol technologies in order to leverage the efficiencies of these technologies to provide lower cost communications services.

Revenue for communications services, including private line, wavelengths, colocation, Internet access, managed modem, voice, video and dark fiber, is recognized monthly as the services are provided based on contractual amounts expected to be collected. Management establishes appropriate revenue reserves to address, where significant, circumstances that at the time services are rendered, collection is not reasonably assured either due to credit risk, the potential for billing disputes or other reasons. Reciprocal compensation revenue is recognized only when an interconnection agreement is in place with another carrier.

Certain sale and long-term indefeasible right of use or IRU agreements of dark fiber and capacity are required to be accounted for in the same manner as sales of real estate with property improvements or integral equipment. This accounting treatment results in the deferral of the cash that has been received and the recognition of revenue ratably over the term of the agreement (currently up to 20 years).

Termination revenue is recognized when a customer discontinues service prior to the end of the contract period, for which Level 3 had previously received consideration and for which revenue recognition was deferred. Termination revenue is also recognized when customers are required to make termination penalty payments to Level 3 to settle contractually committed purchase amounts that the customer no longer expects to meet or when a customer and Level 3 renegotiate a contract under which Level 3 is no longer obligated to provide services for consideration previously received and for which revenue recognition has been deferred. Termination revenue is reported in the same manner as the original service provided, and amounted to \$11 million, \$133 million and \$113 million and in 2006, 2005 and 2004, respectively (See Note 4).

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.

Level 3's customer contracts require the Company to meet certain service level commitments. If Level 3 does not meet the required service levels, it may be obligated to provide credits, usually in the form of free service, for a short period of time. The original services that resulted in the credits are not included in revenue and, to date, have not been material.

Cost of revenue for the communications business includes leased capacity, right-of-way costs, access charges and other third party costs directly attributable to the network, but excludes depreciation and amortization and related impairment expenses. The Company also includes in communications cost of revenue the satellite transponder lease costs, the package delivery costs and the blank tape media costs attributable to its video distribution business.

The Company recognizes the cost of network services as they are incurred in accordance with contractual requirements. The Company disputes incorrect billings from its suppliers of network services. The most prevalent types of disputes include disputes for circuits that are not disconnected by its supplier on a timely basis and usage bills with incorrect or inadequate information. Depending on the type and complexity of the issues involved, it may and often does take several quarters to resolve the disputes.

In determining the amount of the cost of network service expenses and related accrued liabilities to reflect in its financial statements, the Company considers the adequacy of documentation of disconnect notices, compliance with prevailing contractual requirements for submitting these disconnect notices and disputes to the provider of the network services, and compliance with its interconnection agreements with these carriers. Significant judgment is required in estimating the ultimate outcome of the dispute resolution process, as well as any other amounts that may be incurred to conclude the negotiations or settle any litigation. Actual results could vary from the estimated amounts accrued for disputes.

Although it has not done so recently, the Company may periodically enter into agreements to acquire network assets from other telecommunications service carriers. These carriers may in turn acquire network assets from Level 3. Transactions in which Level 3 transfers network assets to and acquires network assets from the same third party at or about the same time are referred to as "contemporaneous transactions." These transactions would generally be recorded as non-monetary exchanges of similar assets at book value, as these transactions do not represent the culmination of an earnings process. Contemporaneous transactions do not result in the recognition of revenue. Net cash or other monetary assets paid or received in contemporaneous transactions are recorded as an adjustment to the book value of the transferred property. The adjusted book value becomes the carrying value of the transferred property, plant and equipment. The Company did not enter into these types of agreements during the three years ended December 31, 2006. Beginning January 1, 2006, the Company measures non-monetary assets exchanges at fair value in accordance with SFAS No. 153, "Exchanges of Non-Monetary Assets", ("SFAS No. 153").

Concentration of Credit Risk

The Company provides communications services to a wide range of wholesale and enterprise customers, ranging from well capitalized national carriers to smaller, early stage companies. The Company has in place policies and procedures to review the financial condition of potential and existing customers and concludes that collectibility of revenue and other out-of-pocket expenses is probable prior to the 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. As a result of the WilTel acquisition in 2005 and the Progress Telecom, ICG Communications, TelCove and Looking Glass acquisitions in 2006, the total number of customers increased to approximately 18,000 at December 31, 2006. A significant portion of WilTel's revenue is attributable to SBC Services, Inc., a wholly owned subsidiary of AT&T Inc. ("SBC") and as a result, due to the credit worthiness of SBC, the Company does not believe its overall credit risk has increased significantly. The policies and procedures for reviewing the financial condition and recognizing revenues of these additional customers related to the acquisitions remained consistent with those described above. The Company has from time to time entered into agreements with value-added resellers and other channel partners to reach consumer and enterprise markets for voice services. The Company has policies and procedures in place to evaluate the financial condition of these resellers prior to initiating service to the final customer. The Company is not immune from the effects of the downturn in the communications 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 different industries and geographic areas and remedies provided by the terms of contracts and statutes.

A significant portion of Level 3's communications service revenue was concentrated among a limited number of customers through the end of 2006. Revenue attributable to AT&T Inc. and subsidiaries, including SBC Communications, Bell South Communications and Cingular Wireless (assuming those companies were subsidiaries for all of 2006), amounted, on an aggregate basis, to \$1.1 billion for the year ended December 31, 2006, representing approximately 32 percent of consolidated revenue for the year and is included within the Communications segment in the consolidated statements of operations. Prior to the acquisition of WilTel in December 2005, AT&T Inc. and subsidiaries was not a significant customer of the Company. Revenue from Time Warner Inc. and subsidiaries, including America Online, amounted, on an aggregate basis, to \$220 million, \$288 million and \$374 million for the years ended December 31, 2006, 2005 and 2004, respectively, representing approximately 7 percent, 8 percent and 10 percent of consolidated revenue for the respective years and is included within the Communications segment in the consolidated statements of operations. Given the expected reduction in the SBC Contract Services revenue and the overall increase in revenue from acquisition activity concentration of revenue among a limited number of customers is expected to be reduced in periods subsequent to 2006. However, if Level 3 would lose one or more major customers, or if one or more major customers significantly decreased its orders for Level 3 services, the Company's communications business would be materially and adversely affected.

The Company's DSL aggregation services were primarily provided to a single customer on an exclusive basis in certain markets, which exclusivity expired at the end of the first quarter of 2005. The customer completed the migration of its existing DSL customers to its own network during the third quarter of 2005 .

Discontinued Information Services

On September 7, 2006, Level 3 sold Software Spectrum, Inc. ("Software Spectrum"), the Company's software reseller business, to Insight. On November 30, 2005, Level 3 sold (i)Structure, Level 3's wholly owned IT infrastructure management outsourcing subsidiary to Infocrossing. The two businesses comprised Level 3's information services segment. The results of operations, financial condition and cash flows for the Software Spectrum and (i)Structure businesses have been classified as discontinued

operations in the consolidated financial statements and related footnotes for all periods presented in this report (See Note 3).

Software Spectrum is a global reseller of business software, primarily to large and medium sized businesses. Revenue is recognized as either an agency fee, whereby sales under certain licensing programs permit Software Spectrum to recognize only a service fee paid by the software publisher as revenue, or on a “gross” basis in which case the Company recognizes the full value of the software sold as revenue. Accounting literature provides guidance to enable companies to determine whether revenues from the reselling of goods and services should be recorded on a “gross” or “net” basis. The Company believes that the facts and circumstances, particularly those involving pricing and credit risk indicate that the majority of Software Spectrum’s sales should be recorded on a “gross” basis. The latitude and ability of Software Spectrum to establish the selling price to the customer is an important indication of “gross” revenue reporting. The assumption of credit risk is another important factor in determining “gross” versus “net” reporting. Software Spectrum has the responsibility to pay suppliers for all products ordered, regardless of when, or if, it collects from its customers. Software Spectrum is also solely responsible for determining the creditworthiness of its customers.

Microsoft Corporation, a significant supplier of software to Software Spectrum, changed certain licensing programs in 2001 whereby new enterprise-wide licensing arrangements are priced, billed and collected directly by Microsoft. In 2003, several other suppliers, for whom Software Spectrum resells products and services, began adopting this type of program. Software Spectrum will continue to provide sales and support services related to these transactions and will earn a service fee directly from the software publishers for these activities. Under this licensing program, Software Spectrum only recognizes the service fee paid by the software publisher as revenue and not the entire value of the software. The Company continues to sell products under various licensing programs, but beginning in 2003, has experienced an increase in the level of sales under these new programs and management expects further adoption of agency licensing programs in the future. If Microsoft and other software publishers are able to successfully implement and sell a significant amount of software under this program, or it is determined that the accounting for reselling of the software should be recorded on a “net” basis, the Company may experience a significant decline in information services revenue, but will also experience a comparable decline in cost of revenue.

Microsoft is the primary provider of business software to the Company’s Software Spectrum business. If Microsoft should successfully implement programs for the direct sale of software through volume purchase agreements or other arrangements intended to exclude the distribution or resale channel, Software Spectrum’s results of operations would be materially and adversely affected.

In 2005, Microsoft notified Software Spectrum of proposed changes to Microsoft’s sales agency program which, after being finalized by Microsoft, went into effect for customer contracts entered into after July 1, 2006. All contracts completed prior to July 1, 2006, were grandfathered under the previously existing sales agency program. Under the revised program for agency type sales as currently drafted, the number of performance metrics against which Software Spectrum is measured and the standard of performance on those metrics are expected to increase. Based on a preliminary evaluation of Microsoft’s proposed program changes, Software Spectrum expects that the amount of agency fees it earns from Microsoft will be reduced over the three-year period in which it is implemented. Due to the grandfathering of existing sales agency program sales, however, Software Spectrum anticipates that the program changes will not have a significant effect on Software Spectrum’s results of operation or financial position in 2006.

Revenue is recognized from software sales at the time of product shipment, or in accordance with the terms of licensing contracts, when the price to the customer is fixed, and collectibility is reasonably assured. Revenue from maintenance contracts is recognized when invoiced, the license period has commenced, when the price to the customer is fixed, and collectibility is reasonably assured, as Software Spectrum has

no future obligations associated with future performance under these maintenance contracts. Advance billings are recorded as deferred revenue until services are provided.

Cost of revenue for Software Spectrum includes direct costs of the licensing activity and costs to purchase and distribute software. The costs directly attributable to advance billings are deferred and included in other current and noncurrent assets in the consolidated balance sheet. Rebate income received from software publishers is recognized as a reduction of cost of revenue in the period in which the rebate is earned based on a systematic allocation of the total rebate income considered probable of being realized.

Concentration of Credit Risk

The Company's customer base consists of several thousand accounts including corporations, government agencies, educational institutions, non-profit organizations and other business entities. For the year ended December 31, 2005, no single customer represented more than 10 percent of information services revenue.

Coal Mining

Historically, coal sold by Level 3's coal mining operations has been sold primarily under long-term contracts with public 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 2006, 2005 and 2004. The remainder of Level 3's sales are made on the spot market. Costs of revenue related to coal sales include costs of mining and processing, estimated reclamation costs, royalties and production taxes.

The long-term contracts for the delivery of coal establish the price, volume, and quality requirements of the coal to be delivered. The contracts also contain provisions for periodic price adjustments through the use of indices for items such as materials, supplies and labor. Other portions of the price are adjusted for changes in production taxes, royalties and changes in cost due to new legislation or regulation. These contractual adjustments are recognized in revenue as the changes occur and become billable to the customers.

The terms and conditions of the long-term contracts generally require the customer to meet annual contractual commitments. Thus, the customer has the ability to defer or accelerate coal shipments during the year to meet its requirements. Revenue under these contracts is recognized when coal is actually shipped to the customer.

Concentration of Credit Risk

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.

Selling, General and Administrative Expenses

Selling, general and administrative expenses include salaries, wages and related benefits (including non-cash charges for stock based compensation), property taxes, travel, insurance, rent, contract maintenance, advertising and other administrative expenses. Selling, general and administrative expenses also include network related expenses such as network facility rent, utilities and maintenance costs.

Advertising Costs

Level 3 expenses the cost of advertising as incurred. Advertising expense is included as a component of selling, general and administrative expenses in the accompanying consolidated statements of operations.

Advertising expense was \$8 million, \$6 million and \$17 million for the years ended December 31, 2006, 2005 and 2004, respectively.

Rent Expense

The Company recognizes rent expense on a straight-line basis over the term of the lease based on the future minimum rental payments during the lease term.

Stock-Based Employee Compensation

The Company has accounted for stock-based employee compensation using a fair value based method pursuant to SFAS No. 123 "Accounting for Stock-Based Compensation" ("SFAS No. 123") since 1998. For the years ended December 31, 2005 and 2004, the Company recognized expense using the accelerated vesting methodology of FASB Interpretation No. 28 "Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans" ("FIN 28") (See Note 15). Beginning January 1, 2006, Level 3 adopted the provisions of SFAS No. 123R, "Share-Based Payment" ("SFAS No. 123R"). Under SFAS No. 123R, the Company separates each award into vesting tranches and recognizes expense for each tranche over the vesting period in the same manner as under FIN 28. The adoption of SFAS No. 123R did not have a material effect on the Company's financial position or results of operations.

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 straight-line and accelerated (for certain coal assets) methods based on the following useful lives:

Facility and Leasehold Improvements	10 - 40 years
Network Infrastructure (including fiber and conduit)	12 - 25 years
Operating Equipment	4 - 7 years
Furniture, Fixtures, Office Equipment and Other	2 - 7 years

During 2006, Level 3 determined that the period it expects to use its existing fiber and certain equipment is longer than the remaining useful lives as originally estimated. As a result, the Company extended the depreciable life of its existing fiber from 7 years to 12 years, its existing transmission equipment from 5 to 7 years and its existing IP equipment from 3 years to 4 years.

Leasehold improvements are depreciated over the shorter of their estimated useful lives or lease terms that are reasonably assured.

Depletion on mineral properties is provided on a units-of-extraction basis determined in relation to coal committed under sales contracts. The Company's coal mining business does not use its coal reserve estimates for purposes of depletion but, rather, depletes the properties over the estimated recoverable tons of coal that are required to be delivered under existing coal contracts.

Earnings (Loss) Per Share

Basic earnings (loss) per share have been computed using the weighted average number of shares outstanding during each period. Diluted earnings (loss) per share is computed by including the dilutive effect of common stock that would be issued assuming conversion or exercise of outstanding convertible notes, stock options, stock based compensation awards and other dilutive securities. No such items were included in the computation of diluted loss per share in 2006, 2005 or 2004 because the Company incurred a loss from continuing operations in each of these periods and the affect of inclusion would have been anti-dilutive.

Trade Accounts Receivable

Trade accounts receivable are recorded at the invoiced amount and can bear interest. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company determines the allowance based on an analysis of the aging of the accounts receivable balance. The Company reviews its allowance for doubtful accounts quarterly. Past due balances over 90 days and over a specified amount are reviewed individually for collectibility. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The Company does not have any off-balance sheet credit exposure related to its customers.

Restricted Cash and Securities

The Company classifies any cash or investments that collateralize outstanding letters of credit, long-term debt, or certain operating or performance obligations of the Company as restricted cash. The Company also classifies cash or investments restricted to fund certain reclamation liabilities as restricted cash. The classification of restricted cash on the consolidated balance sheet as current or noncurrent is dependent on the duration of the restriction and the purpose for which the restriction exists.

Long-Lived Assets

The Company segregates identifiable intangible assets acquired in an acquisition from goodwill. In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"), goodwill is no longer amortized, and is evaluated for impairment at least annually.

Other intangible assets primarily include customer contracts, customer relationships and technology acquired in business combinations. The intangible assets with estimated useful lives are amortized on a straight-line basis over the expected period of benefit which ranges from 2 to 15 years. Certain intangibles acquired in the WiTel and TelCove transactions have an indefinite life. In accordance with SFAS No. 142, the Company evaluates its indefinite lived intangible assets for impairment annually or as circumstances change that could affect the recoverability of the carrying amount of the assets.

The Company at least annually, or as events or circumstances change that could affect the recoverability of the carrying value of its long-lived assets, conducts a comprehensive review of the carrying value of its assets to determine if the carrying amount of the assets are recoverable in accordance with SFAS No. 144 "Accounting for the Impairment or Disposal of Long-lived Assets." This review requires the identification of the lowest level of identifiable cash flows for purposes of grouping assets subject to review. The estimate of undiscounted cash flows includes long-term forecasts of revenue growth, gross margins and capital expenditures. All of these items require significant judgment and assumptions. An impairment loss may exist when the 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.

For purposes of this review, Level 3 has historically separately evaluated colocation facilities, certain additional conduits and its communication network (including network equipment, fiber, conduits and customer premise equipment) as these were the lowest levels with separately identifiable cash flows for the grouping of assets. Beginning in 2006, the Company stopped evaluating colocation assets separately and began including them in the communications network grouping due to changes in the nature of the cash flows from the delivery of colocation services. The majority of the Company's colocation customers now purchase other services in conjunction with their colocation services thereby reducing the independence of colocation services cash flows from other services. In addition, the percentage of colocation space used to support the communications network asset has increased over time.

Management's estimate of the future cash flows attributable to its long-lived assets and the fair value of its businesses involve significant uncertainty. Those estimates are based on management's assumptions of future results, growth trends and industry conditions. The impairment analysis of long-lived assets also requires management to make certain subjective assumptions and estimates regarding the expected future use of certain empty conduits included in the network asset group and the expected future use of certain empty conduit evaluated for impairment separately from the network asset group.

Accounting for Asset Retirement Obligations

The Company follows the policy of providing an accrual for reclamation of mined properties in accordance with SFAS No. 143, "Accounting for Asset Retirement Obligations" ("SFAS No. 143"), based on the estimated total cost of restoration of such properties to meet compliance with laws governing surface mining. These estimated costs are calculated based on the expected future risk adjusted cash flows to remediate such properties discounted at a risk-free rate. The Company also provides an accrual for obligations related to certain colocation leases and right-of-way agreements in accordance with SFAS No. 143, based on the estimated total cost of restoration of such properties to their original condition. These estimated obligations are calculated based on the expected future discounted cash flows using the Company's estimated weighted average cost of capital at the time the obligation is incurred and applying a probability factor for conditional restoration obligations. Changes in expected future cash flows are discounted at interest rates that were in effect at the time of the original estimate for downward revisions to such cash flows, and at interest rates in effect at the time of the change for upward revisions in the expected future cash flows.

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. The U.S. net operating losses not utilized can be carried forward for 20 years to offset future taxable income. The majority of the foreign jurisdiction net operating losses not utilized can be carried forward indefinitely. 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.

Comprehensive Income (Loss)

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

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 loss. A significant portion of the Company's foreign subsidiaries have the Euro as the functional currency, which experienced significant fluctuations against the U.S. dollar during 2006, 2005 and 2004. As a result, the Company has experienced significant foreign currency translation adjustments that are recognized as a component of accumulated other comprehensive income (loss) in stockholders' equity (deficit) and in the

statement of comprehensive loss in accordance with SFAS No. 52 “Foreign Currency Translation.” The Company considers its investments in its foreign subsidiaries to be long-term in nature.

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. The most critical estimates and assumptions are made in determining the allowance for doubtful accounts, revenue reserves, recoverability of long-lived assets, useful lives of long-lived assets, accruals for estimated liabilities that are probable and estimatable, cost of revenue disputes for the communications services, unfavorable contract liabilities set up in purchase accounting and asset retirement obligations. Actual results could differ from those estimates and assumptions.

Recently Issued Accounting Pronouncements

The FASB issued SFAS No. 153, “Exchanges of Non-Monetary Assets”, which was effective for Level 3 starting January 1, 2006. Under SFAS No. 153, the Company will measure assets exchanged at fair value, as long as the transaction has commercial substance and the fair value of the assets exchanged is determinable within reasonable limits. A non-monetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The adoption of SFAS No. 153 did not have a material effect on the Company’s financial position or results of operations as Level 3 is a party to a limited number of non-monetary transactions and those transactions have not been material.

Emerging Issues Task Force (“EITF”) Issue No. 04-6, “Accounting for Stripping Costs Incurred during Production in the Mining Industry” (“EITF No. 04-6”) establishes appropriate accounting for stripping costs incurred during the production phase and is effective for fiscal years beginning after December 15, 2005. EITF No. 04-6 concludes that stripping costs incurred during the production phase of a mine are variable production costs that should be included in the costs of the inventory produced during the period that the stripping costs are incurred. EITF No. 04-6 further defines inventory produced as mineral that has been extracted. As a result, stripping costs related to exposed, but not extracted mineral are expensed as incurred rather than deferred until the mineral is extracted. The Company’s coal mining business previously deferred stripping costs and amortized these costs over the period in which the underlying coal is mined. The Company’s adoption of EITF No. 04-6 required it to adjust by \$3 million beginning retained earnings (accumulated deficit) for the amount of prepaid stripping costs previously deferred as of January 1, 2006.

In June 2006, the FASB issued Interpretation No. 48, “Accounting for Uncertainty in Income Taxes—An Interpretation of FASB Statement No. 109,” (“FIN No. 48”). FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with FASB Statement No. 109, “Accounting for Income Taxes.” FIN No. 48 also prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return that results in a tax benefit. Additionally, FIN No. 48 provides guidance on de-recognition, income statement classification of interest and penalties, accounting in interim periods, disclosure, and transition. This interpretation is effective for fiscal years beginning after December 15, 2006. The adoption of FIN No. 48 is not expected to have a material effect on the Company’s consolidated results of operations or financial condition.

In June 2006, the FASB ratified the consensus on EITF Issue No. 06-3, “How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement”

("EITF No. 06-3"). The scope of EITF No. 06-3 includes any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer and may include, but is not limited to, sales, use, value added, Universal Service Fund ("USF") contributions and some excise taxes. The Task Force concluded that entities should present these taxes in the income statement on either a gross or a net basis, based on their accounting policy, which should be disclosed pursuant to APB Opinion No. 22, "Disclosure of Accounting Policies." If such taxes are significant and are presented on a gross basis, the amounts of those taxes should be disclosed. The consensus on EITF No. 06-3 will be effective for interim and annual reporting periods beginning after December 15, 2006. The Company currently records USF contributions on a gross basis in its consolidated statements of operations, but records sales, use, value added and excise taxes billed to its customers on a net basis in its consolidated statements of operations. The adoption of EITF No. 06-3 is not expected to have a material effect on the Company's consolidated results of operations or financial condition.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin ("SAB") No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Current Year Misstatements." SAB No. 108 requires analysis of misstatements using both an income statement (rollover) approach and a balance sheet (iron curtain) approach in assessing materiality and provides for a one-time cumulative effect transition adjustment. The Company adopted SAB No. 108 for the year ended December 31, 2006. The adoption of SAB No. 108 did not have a material effect on the Company's results of operations and financial condition.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. This statement is effective for fiscal years beginning after November 15, 2007 and interim periods within that fiscal year. The Company is currently assessing the potential effect that the adoption of SFAS No. 157 will have on its financial statements.

On December 21, 2006, the FASB issued FASB Staff Position No. EITF 00-19-2, "Accounting for Registration Payment Arrangements" ("FSP EITF 00-19-2"). FSP EITF 00-19-2 addresses an issuer's accounting for registration payment arrangements. FSP EITF 00-19-2 specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement, whether issued as a separate agreement or included as a provision of a financial instrument or other agreement, should be separately recognized and measured in accordance with SFAS No. 5, "Accounting for Contingencies" ("SFAS No. 5"). A "registration payment arrangement" is defined as an arrangement that specifies that the issuer will endeavor (1) to file a registration statement for the resale of specified financial instruments and/or for the resale of equity shares that are issuable upon exercise or conversion of specified financial instruments and for that registration statement to be declared effective by the SEC. The arrangement requires the issuer to transfer consideration to the counterparty if the registration statement for the resale of the financial instrument or instruments subject to the arrangement is not declared effective or if effectiveness of the registration statement is not maintained. FSP EITF 00-19-2 specifies that if the transfer of consideration under a registration payment arrangement is probable and can be reasonably estimated at inception, the contingent liability under the registration payment arrangement shall be included in the allocation of proceeds from the related financing transaction using the measurement guidance in SFAS No. 5. FSP EITF 00-19-2 also requires certain disclosures about the terms of each registration payment arrangement, even if the likelihood of the issuer having to make any payments under the arrangement is remote. FSP EITF 00-19-2 is effective immediately for registration payment arrangements entered into after December 21, 2006 and for fiscal years beginning after December 31, 2006, and interim periods within those fiscal years, for registration payment arrangements entered into prior to the issuance of FSP EITF 00-19-2. The Company adopted FSP EITF 00-19-2 for the

year ended December 31, 2006. The adoption of FSP EITF 00-19-2 did not have a material effect on the Company's results of operations and financial condition.

Reclassifications

Certain current and prior year amounts have been reclassified to conform to the December 31, 2006 presentation.

The Company has separately disclosed the operating, investing and financing portion of the cash flows attributable to its discontinued operations for all periods presented.

(2) Acquisitions

In 2006, the Company embarked on a strategy to expand its presence in metropolitan markets and began offering services to enterprise customers through its Business Markets Group. This strategy will allow the Company to terminate traffic over its owned facilities rather than paying third parties to terminate the traffic. The expansion into new metro markets should also provide additional opportunities to sell services to bandwidth intensive businesses on the Company's national and international networks. In order to expedite the expansion of its metro business, Level 3 acquired Progress Telecom, ICG Communications, TelCove and Looking Glass in 2006. The results of operations attributable to each acquisition are included in the consolidated financial statements from the date of acquisition.

Looking Glass Acquisition: On August 2, 2006, Level 3 completed the acquisition of Looking Glass, a privately held Illinois-based telecommunications company. The consideration paid by Level 3 consisted of approximately \$13 million in cash, including \$4 million of transaction costs, and approximately 21 million shares of Level 3 common stock valued at \$84 million. In addition, at the closing, Level 3 repaid approximately \$67 million of Looking Glass liabilities. The transaction purchase price is not subject to any post-closing adjustments.

Level 3 entered into certain transactions with Looking Glass prior to the acquisition of Looking Glass by Level 3, whereby Level 3 received cash for communications services to be provided in the future and which was originally recognized as deferred revenue. As a result of the acquisition, Level 3 can no longer amortize this deferred revenue into earnings and, accordingly, reduced the purchase price applied to the net assets acquired in the Looking Glass transaction by \$2 million, the amount of the unamortized deferred revenue balance on August 2, 2006.

TelCove Acquisition: On July 24, 2006, Level 3 completed the acquisition of TelCove, a privately held Pennsylvania-based telecommunications company. Under terms of the agreement, Level 3 paid \$446 million in cash and issued approximately 150 million shares of Level 3 common stock, valued at \$623 million. In addition, Level 3 repaid \$132 million of TelCove debt and acquired \$13 million in capital leases in the transaction. Also, the Company paid third party costs of approximately \$15 million related to the transaction, which included certain costs incurred by TelCove. The transaction price is not subject to any post-closing adjustments.

Level 3 entered into certain transactions with TelCove prior to the acquisition of TelCove by Level 3, whereby Level 3 received cash for communications services to be provided in the future and which was originally recognized as deferred revenue. As a result of the acquisition, Level 3 can no longer amortize this deferred revenue into earnings and, accordingly, reduced the purchase price applied to the net assets acquired in the TelCove transaction by \$3 million, the amount of the unamortized deferred revenue balance on July 24, 2006.

ICG Communications: On May 31, 2006, Level 3 acquired all of the stock of ICG Communications, a privately held Colorado-based telecommunications company, from MCCC ICG Holdings, LLC excluding certain assets and liabilities. Under the terms of the purchase agreement, Level 3 purchased ICG Communications for an aggregate consideration consisting of approximately 26 million shares of Level 3 common stock, valued at \$131 million, and approximately \$45 million in cash. The Company also incurred costs of less than \$1 million related to the transaction. Post-closing adjustments, primarily working capital and other contractual matters resulted in additional consideration of approximately \$3 million, of which \$1 million was paid in the third quarter of 2006 and \$2 million was recorded as a liability at December 31, 2006 and paid in the first quarter of 2007.

Level 3 entered into certain transactions with ICG Communications prior to the acquisition of ICG Communications by Level 3, whereby Level 3 received cash for communications services to be provided in the future and which was originally recognized as deferred revenue. As a result of the acquisition, Level 3 can no longer amortize this deferred revenue into earnings and, accordingly, reduced the purchase price applied to the net assets acquired in the ICG Communications transaction by \$1 million, the amount of the unamortized deferred revenue balance on May 31, 2006.

Progress Telecom: On March 20, 2006, Level 3 completed its acquisition of all of the membership interests of Progress Telecom from PT Holding Company LLC (“PT Holding”) excluding certain specified assets and liabilities of Progress Telecom. Progress Telecom was owned by PT Holding which is jointly owned by Progress Energy, Inc. and Odyssey Telecorp, Inc. Under the terms of the purchase agreement, Level 3 purchased Progress Telecom for an aggregate purchase price consisting of approximately \$69 million in cash and approximately 20 million shares of Level 3 common stock, valued at \$66 million. The purchase price was subsequently reduced by \$2 million for working capital and other contractual matters. The Company received payment of the \$2 million adjustment in July 2006.

Level 3 entered into certain transactions with Progress Telecom prior to the acquisition of Progress Telecom by Level 3, whereby Level 3 received cash for communications services to be provided in the future and which was originally recognized as deferred revenue. As a result of the acquisition, Level 3 can no longer amortize this deferred revenue into earnings and, accordingly, reduced the purchase price applied to the net assets acquired in the Progress Telecom transaction by \$4 million, the amount of the unamortized deferred revenue balance on March 20, 2006.

WilTel: On December 23, 2005, the Company completed the acquisition of WilTel from Leucadia National Corporation and its subsidiaries (together “Leucadia”). The consideration paid consisted of approximately \$390 million in cash (which included a \$16 million adjustment for estimated excess working capital), plus \$100 million in cash to reflect Leucadia’s having complied with its obligation to leave that amount of cash in WilTel, and 115 million newly issued unregistered shares of Level 3 common stock, valued at \$313 million.

The Company also incurred costs of approximately \$7 million related to the transaction. The cash purchase price was subject to post-closing adjustments based on actual working capital and other contractual items as of the closing date. In March 2006, Leucadia and Level 3 agreed that the purchase price for WilTel should decrease by approximately \$27 million as a result of working capital and other contractual post-closing adjustments. Level 3 received payment of the \$27 million adjustment in April 2006.

The final valuation indicated that the fair value of the identifiable assets acquired exceeded the total of the purchase price paid and the liabilities assumed in the transaction. As a result, the excess value was applied against the fair value of the long-lived assets obtained in the transaction. The \$27 million post-closing adjustment resulted in an additional decrease in long-lived assets in the first quarter of 2006.

Level 3 entered into certain transactions with WilTel prior to the acquisition of WilTel by Level 3, whereby it received cash for communications services to be provided in the future. As a result of the acquisition, Level 3 can no longer amortize this deferred revenue into earnings and accordingly, reduced the purchase price applied to the net assets acquired in the WilTel transaction by \$2 million, the amount of the unamortized deferred revenue balance on December 23, 2005.

The acquisition includes all of WilTel's communications business and WilTel's Vyvx video transmission business. The acquisition also includes a multi-year contract between SBC Service, Inc. and WilTel ("SBC Contract Services Agreement"). Recently, SBC Services, Inc. became a subsidiary of AT&T Inc. ("AT&T") (together "SBC") and announced its intention to migrate the services provided by WilTel to the merged SBC Services, Inc. and AT&T network. WilTel and SBC amended the SBC Contract Services Agreement to run through 2009. The agreement provides a gross margin purchase commitment of \$335 million from December 2005 through the end of 2007, and \$75 million from January 2008 through the end of 2009. SBC has satisfied \$268 million of the December 2005 to the end of 2007 gross margin purchase commitment through December 31, 2006. As of December 31, 2006, the remaining minimum gross margin commitment under the agreement to be utilized in 2007 was approximately \$67 million, and \$75 million from January 2008 through the end of 2009. Originating and terminating access charges paid to local phone companies are passed through to SBC in accordance with a formula that approximates cost. Additionally, the SBC Contract Services Agreement provides for the payment of \$50 million from SBC if certain performance criteria are met by Level 3 in 2006 and 2007. The Company met the required performance criteria and recorded revenue of \$25 million in 2006 under the agreement. Level 3 is eligible to earn another \$25 million in 2007 if it meets the performance criteria.

As specified in the purchase agreement with Leucadia, WilTel transferred certain excluded assets to Leucadia and Leucadia assumed certain excluded liabilities. The excluded assets included all cash and cash equivalents in excess of \$100 million at closing, all marketable securities, WilTel's headquarters building located in Tulsa, Oklahoma and certain other miscellaneous assets. In addition, WilTel assigned to Leucadia all of its right to receive cash payments from SBC totaling \$236 million, pursuant to the Termination, Mutual Release and Settlement Agreement, dated June 15, 2005, among Leucadia, WilTel and SBC. The excluded liabilities include all of WilTel's long-term debt obligations, WilTel's obligations under its defined benefit pension plan, certain other employee related liabilities and other claims. The agreement required Leucadia to pay in full all of WilTel's obligations under its credit agreement and for Leucadia to release WilTel from any obligation under the outstanding mortgage note secured by its headquarters building. Level 3 entered into an agreement with Leucadia to lease a portion of the former WilTel headquarters building in Tulsa.

ICG: On April 1, 2004, the Company acquired the wholesale dial access customer contracts of ICG Communications, Inc. ("ICG"). The Company agreed to pay approximately \$35 million in cash to acquire the contracts and related equipment, which provide dial-up Internet access to various large customers and other leading ISPs. The terms of the agreement required Level 3 to pay \$25 million at closing and additional payments of \$5 million on both July 1, 2004 and October 1, 2004. The purchase price was subject to post-closing adjustments, but those adjustments were not material. Level 3 migrated the traffic from the customer contracts acquired from ICG onto its own network infrastructure and the migration was substantially complete by the end of 2004.

Sprint : On October 1, 2004, the Company acquired the wholesale dial Internet access business of Sprint Communications Company, L.P. ("Sprint"). Level 3 paid \$34 million in cash to acquire the business, which provides dial-up Internet access to leading Internet service providers ("ISPs") throughout the United States and agreed to provide discounted services to Sprint that were valued at \$5 million, which was accounted for as part of the purchase price. Level 3 and Sprint entered into a transition services agreement for the migration of customers onto the Level 3 network, which Level 3 completed in the third quarter of 2005. During the migration period, until such time as a customer contract was assumed or assigned,

amounts received for services provided by Sprint were accounted for as a reduction in purchase price as opposed to revenue. The net amount received prior to the assumption or assignment of these contracts totaled \$5 million through December 31, 2005 and therefore reduced the purchase price to \$29 million. With the completion of the migration activities, Level 3 recognizes as revenue, amounts received from all customer contracts acquired in this transaction. The results of operations attributable to the Sprint assets acquired and liabilities assumed are included in the consolidated financial statements from the date of assumption or assignment of contracts.

Purchase Price Allocation

Under business combination accounting, the total final purchase price for each of the acquired companies was allocated to the net tangible and identifiable intangible assets based on their estimated fair values as of the acquisition dates. The allocation of the purchase price was based upon valuations performed for each acquired company. The valuations for the WilTel and the Progress Telecom acquisitions have been finalized. The valuations for the ICG Communications, TelCove and Looking Glass acquisitions are in the process of being finalized.

The valuations for the WilTel and Looking Glass acquisitions indicated that the fair value of the assets acquired exceeded the total of the purchase price paid and the liabilities assumed in the transactions. As a result, the excess value or negative goodwill was applied against the fair value of the long-lived assets in 2006. The valuations for the Progress, ICG Communications and TelCove acquisitions indicated that the fair value of the assets acquired was less than the total of the purchase price paid and the liabilities assumed in the transactions. As a result, the excess purchase price was assigned to goodwill for each acquisition in 2006.

Tangible and Intangible Long-Lived Assets

In performing the purchase price allocation for each acquired company, the Company considered, among other factors, the intention for future use of acquired assets, analyses of historical financial performance and estimates of future performance of each acquired company's products. The fair value of assets was based, in part, on a valuation using either a cost, income or in some cases market valuation approach and estimates and assumptions provided by management. The tangible assets primarily include the real and personal property used to provide communications and video services in the case of WilTel. In addition, tangible assets include the fair value of software purchased or developed by each company if applicable. Intangible assets consist primarily of customer relationships and the Vyvx trademark. Management has established an indefinite life on the Vyvx trademark and lives ranging from 6 to 15 years for the customer relationships.

Deferred Revenue

The fair value of deferred revenue included in the final purchase price allocation for each acquired company was determined based on monthly amounts billed in advance for which services would be provided to customers in the period immediately following acquisition. Level 3 did not record deferred revenue for long-term contracts in which the acquired company had already received consideration from the customer as Level 3 does not expect to incur any direct and incremental costs associated with these contracts.

Current and Noncurrent Obligations

The fair value of each acquired company's current liabilities was determined based on the expected cash flows for the twelve months following the date of acquisition. Level 3 did not present value the cash flows as it does not expect the present values to be significantly different than the gross cash flows.

The noncurrent obligations assumed in each acquisition, if applicable, have been recorded at their present value using an appropriate interest rate. The Company has identified certain acquired facilities that it does not expect to utilize for the combined business. The Company has also revalued the asset retirement obligations of each acquired company using Level 3's weighted average cost of capital rather than the acquired company's weighted average cost of capital.

The unaudited financial information in the table below summarizes the combined results of operations of Level 3 and the acquired businesses, on a pro forma basis, as though the companies acquired in 2005 and 2006 had been combined as of the beginning of each of the periods presented. The pro forma financial information is presented for informational purposes only and is not indicative of the results of operations that would have been achieved if the acquisitions had taken place at the beginning of each of the periods presented. The pro forma financial information for all periods presented includes the preliminary business combination accounting effect on historical revenues of the acquired companies, adjustments to depreciation on acquired property, amortization charges from acquired intangible assets, restructuring costs and acquisition costs reflected in the historical statements of operations for periods prior to Level 3's acquisition.

	Unaudited Pro Forma Years ended December 31,	
	2006	2005
	(dollars in millions, except per share data)	
Revenue	\$ 3,676	\$ 3,939
Loss from Continuing Operations	(815)	(661)
Income from Discontinued Operations	46	69
Net Loss	(769)	(592)
Per share:		
Loss from continuing operations	\$ (0.70)	\$ (0.64)
Net loss	\$ (0.66)	\$ (0.58)
Pro Forma Weighted Shares Outstanding (in thousands)	1,157,692	1,028,639

Included in the actual results and pro forma financial information for the year ended December 31, 2006 are certain amounts which affect the comparability of the results, including net losses of \$83 million as a result of the early extinguishments of certain long-term debt, \$11 million of termination revenue, a gain of approximately \$33 million from the sale of Software Spectrum, a workforce reduction charge of \$5 million, and non-cash impairment charges of \$8 million that primarily resulted from the decision to terminate certain information technology projects in the Communications business.

Included in the actual results and pro forma financial information for the year ended December 31, 2005 are certain amounts which affect the comparability of the results, including termination revenue of \$133 million, a gain on the sale of (i)Structure of \$49 million, a workforce reduction charge of \$15 million, and non-cash impairment charges of \$9 million that primarily resulted from the decision to terminate projects for certain voice products in the Communications business.

The fair value of the assets acquired and the liabilities assumed in the ICG Communications, TelCove and Looking Glass transactions are based upon preliminary valuations as of their respective acquisition dates after reflecting other contractual purchase price adjustments and are subject to change due to further analysis of the assets acquired and liabilities assumed as well as integration plans. The fair value of assets acquired and liabilities assumed in the WiTel and Progress Telecom transactions are based upon a final valuation after reflecting other contractual purchase price adjustments. The fair values of the assets acquired and the liabilities assumed for the companies Level 3 acquired are as follows.

	Looking Glass	TelCove	ICG Communications (dollars in millions)	Progress Telecom	WiTel	Sprint	ICG Managed Modem
Assets:							
Cash and cash equivalents	\$ 3	\$ 3	\$ 6	\$ —	\$ 128	\$ —	\$ —
Accounts receivable	8	23	7	3	257	—	—
Other current assets	2	5	2	2	22	3	2
Property, plant and equipment, net	183	796	10	77	629	—	—
Goodwill	—	179	127	32	—	—	—
Identifiable intangible assets	9	273	49	36	152	31	37
Other assets	1	—	4	—	26	—	—
Total Assets	206	1,279	205	150	1,214	34	39
Liabilities:							
Accounts payable	5	20	6	1	204	—	—
Accrued payroll	1	6	2	1	29	—	—
Other current liabilities	9	20	10	7	61	—	4
Current portion of capital leases	—	3	—	1	—	—	—
Capital leases	—	10	3	8	—	—	—
Deferred revenue— Acquired Company	1	—	4	2	41	—	—
Deferred revenue— Level 3	(2)	(3)	(1)	(4)	(2)	5	—
Other liabilities	28	7	3	—	98	—	—
Total Liabilities	42	63	27	16	431	5	4
Purchase Price	\$ 164	\$ 1,216	\$ 178	\$ 134	\$ 783	\$ 29	\$ 35

(3) Discontinued Operations

The Company sold the two businesses, Software Spectrum and (i)Structure, that comprised Level 3's information services segment and are presented as discontinued operations.

Software Spectrum

On September 7, 2006, Level 3 sold Software Spectrum, Inc. to Insight, a leading provider of information technology products and services. In connection with the transaction, Level 3 received total proceeds of \$353 million in cash, consisting of a base purchase price of \$287 million and a working capital adjustment of approximately \$66 million. The purchase price was subject to working capital and certain other post-closing adjustments. During the fourth quarter of 2006, the Company paid \$2 million to Insight as the final working capital adjustment. Level 3 recognized a \$33 million gain on the transaction in the third quarter of 2006 after transaction costs.

The following is the summarized results of operations of the Software Spectrum business for the period from January 1, 2006 through September 7, 2006 and for the years ended December 31, 2005 and 2004:

	January 1, Through September 7, 2006	Twelve Months Ended	
		2005	2004
		(dollars in millions)	
Revenues	\$ 1,400	\$ 1,894	\$ 1,861
Costs and Expenses:			
Cost of revenue	1,269	1,717	1,705
Depreciation and amortization	8	10	11
Selling, general and administrative	111	143	125
Restructuring and impairment charges	1	—	2
Total costs and expenses	1,389	1,870	1,843
Income from Operations	11	24	18
Other Income (Expense)	5	(1)	7
Income from Operations Before Income Taxes	16	23	25
Income Tax Expense	(3)	(3)	(5)
Income from Discontinued Operations	\$ 13	\$ 20	\$ 20

The following is summarized financial information for the Software Spectrum business as of December 31, 2005:

	December 31, 2005
	(dollars in millions)
Assets	
Current Assets:	
Cash and cash equivalents	\$ 73
Receivables	431
Other	93
Total Current Assets	597
Property, Plant and Equipment, net	6
Goodwill and Other Intangible Assets, net	242
Other	16
Total Assets	861
Current Liabilities:	
Accounts payable	420
Accrued payroll and employee benefits	17
Deferred revenue	67
Other	35
Total Current Liabilities	539
Deferred Revenue	11
Other Noncurrent Liabilities	12
Total Liabilities	562
Net Assets	\$ 299

(i)Structure

On November 30, 2005, Level 3 sold (i)Structure to Infocrossing for proceeds of \$85 million which consisted of \$82 million in cash and \$3 million of Infocrossing, Inc. common stock. The cash purchase price is subject to post-closing adjustments based on actual working capital as of the closing date. The Company and Infocrossing are in the process of completing the working capital adjustments through arbitration. Level 3 recognized a \$49 million gain on the transaction in the fourth quarter of 2005.

The following is the summarized results of operations of the (i)Structure business for the eleven months ended November 30, 2005 and the year ended December 31, 2004:

	January 1, Through November 30, 2005	Twelve Months Ended 2004
	(dollars in millions, except per share data)	
Revenues	\$ 64	\$ 75
Costs and Expenses:		
Cost of revenue	47	53
Depreciation and amortization	8	13
Selling, general and administrative	9	9
Total costs and expenses	64	75
Income from Discontinued Operations	—	—
Gain on Sale of Discontinued Operations	49	—
Income from Discontinued Operations	\$ 49	\$ —

(4) Termination Revenue

On March 1, 2005, Level 3 entered into an agreement with 360networks in which both parties agreed to terminate a 20-year IRU agreement. Under the new agreement, 360networks returned the dark fiber originally provided by Level 3. Under the original IRU agreement, signed in 2000, the cash received by Level 3 was deferred and amortized to revenue over the 20-year term of the agreement. As a result of this transaction, Level 3 recognized the unamortized deferred revenue of approximately \$86 million as non-cash termination revenue in the first quarter of 2005.

On February 22, 2005, France Telecom and Level 3 finalized an agreement to terminate a dark fiber agreement signed in 2000. Under the terms of the agreement, France Telecom returned the fiber to Level 3. Under the original IRU agreement, the cash received by Level 3 was deferred and amortized to revenue over the 20-year term of the agreement. As a result of this transaction, Level 3 recognized the unamortized deferred revenue of approximately \$40 million as non-cash termination revenue in the first quarter of 2005.

Level 3 and McLeodUSA Incorporated (“McLeod”) entered into an agreement on November 1, 2004, whereby McLeod returned certain intercity dark fiber provided by Level 3 under a 1999 agreement and provides discounted network services to Level 3 in exchange for cash and other consideration. Cash received under the 1999 agreement was deferred and amortized to revenue over the 20-year term of the agreement. Level 3 had no further service obligations with respect to the fiber and therefore recognized the \$98 million of remaining unamortized deferred revenue for the fiber returned as non-cash termination revenue in 2004. The Company allocated the amounts paid to McLeod to fiber and prepaid network expenses. The value of the fiber returned was determined based on the capital costs that would be avoided in pulling additional fiber in certain segments of the Company’s intercity network where fiber inventory would need to be replenished in the next three years. The prepaid network expense was valued based on

the amount of discounted network expense services the Company expects to realize through purchases of these services on McLeod's network.

(5) Restructuring and Impairment Charges

In 2006, the Company initiated workforce reductions that are expected to affect approximately 1,200 employees in its North American communications business related to the integration of WiTel, Progress Telecom, ICG Communications, TelCove and Looking Glass into Level 3's operations. The accounting treatment for the severance costs is dependent on whether those individuals affected are former employees of the acquired companies or Level 3 employees. The estimated severance costs earned by employees of the acquired companies as of the acquisition date are included as a liability in the balance sheet as of the acquisition date. The Company expects to incur approximately \$30 million of severance and related costs for former WiTel, Progress Telecom, ICG Communications, TelCove and Looking Glass employees. As of December 31, 2006, the Company paid \$19 million of severance and related costs for these employees. Severance costs attributable to Level 3 employees are recorded as a restructuring charge in the statement of operations once the employees are notified that their position will be eliminated and the severance arrangements are communicated to the employee.

As of December 31, 2006, the Company had notified or terminated approximately 797 employees (248 for Level 3 and 549 for acquired businesses) pursuant to these activities. During 2006, the Company recorded approximately \$5 million in restructuring charges for affected Level 3 employees. As of December 31, 2006, the Company had remaining obligations of less than \$1 million for those Level 3 employees terminated or notified. The workforce reduction attributable to the WiTel integration activity was substantially complete by the end of 2006. The workforce reductions attributable to the Progress Telecom, ICG Communications, TelCove and Looking Glass integration activities are expected to be completed in 2007.

In the first quarter of 2005, the Company initiated a workforce reduction of approximately 470 employees in its North American and European communications business and as a result recognized severance and related charges of approximately \$15 million. As of December 31, 2005, the Company had satisfied its remaining obligations associated with the workforce reduction.

During 2005, the Company identified additional communications facilities that it no longer required and would not provide any future economic benefit to the Company. Also during the year, the Company revised its lease impairment analysis to reflect improvements in sublease income for communications facilities impaired in prior periods. In total, the Company reduced its expected lease impairment obligations by \$1 million in 2005.

The communications business recorded lease impairment charges of \$14 million for real property leases in North America and Europe in the fourth quarter of 2004. The charge resulted from ceasing use of certain leased space, the signing of subleases for existing vacant space at lower than estimated rates, and extending the estimated sublease dates for other vacant properties due to market conditions.

A summary of the restructuring charges and related activity follows:

	Severance and Related		Facilities Related
	Number of Employees	Amount (in millions)	Amount (in millions)
Balance December 31, 2003	60	\$ 4	\$ 6
2004 Charges	80	—	14
2004 Payments	(140)	(4)	(4)
Balance December 31, 2004	—	—	16
2005 Charges(Benefit)	472	15	(1)
2005 Payments	(472)	(15)	(3)
Balance December 31, 2005	—	\$ —	\$ 12
2006 Charges	248	5	—
2006 Payments	(242)	(5)	(2)
Balance December 31, 2006	6	\$ —	\$ 10

The Company paid approximately \$2 million, \$3 million and \$4 million of facilities related costs in 2006, 2005 and 2004, respectively. The remaining lease termination obligations of \$10 million are expected to be paid over the terms of the impaired leases, which extend to 2015, if the Company is unable to negotiate a buyout of the leases.

Impairments

The Company at least annually, or as events or circumstances change that could affect the recoverability of the carrying value of its communications assets, conducts a comprehensive review of the carrying value of its communications assets to determine if the carrying amount of the communications assets are recoverable in accordance with SFAS No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets” (“SFAS No. 144”). For purposes of this review, Level 3 has historically separately evaluated colocation facilities, certain additional conduits and its communication network (including network equipment, fiber, conduits and customer premise equipment) as these were the lowest levels with separately identifiable cash flows for grouping of assets. Beginning in 2006, the Company stopped evaluating colocation assets separately and began including them in the communications network asset group due to changes in the nature of the cash flows from the delivery of colocation services. The majority of the Company’s colocation customers now purchase other services in conjunction with their colocation services thereby reducing the independence of colocation services cash flows from other services. In addition, the percentage of colocation space used to support the network asset has increased over time. The impairment analysis is based on a long-term cash flow forecast to assess the recovery of the communications assets over the estimated useful life of the primary asset. The Company concluded that the assets were not impaired as of December 31, 2006. Management’s estimate of the future cash flows attributable to its long-lived assets and the fair value of its businesses involve significant uncertainty. Those estimates are based on management’s assumptions of future results, growth trends and industry conditions. The impairment analysis of long-lived assets also requires management to make certain subjective assumptions and estimates regarding the expected future use of certain additional conduits included in the network asset group and the expected future use of certain empty conduit evaluated for impairment separately from the network asset group. Management will continue to assess the Company’s assets for impairment as events occur or as industry conditions warrant.

The Company recognized \$8 million of non-cash impairment charges in 2006. Level 3 recognized \$4 million of non-cash impairment charges as a result of the decision to terminate projects for certain voice services and certain information technology projects in the communications business which had been previously capitalized. These projects have identifiable costs which Level 3 can separately evaluate for

impairment. The costs incurred for these projects, including capitalized labor, were impaired as the carrying value of these projects were no longer expected to provide future benefit to the Company. In addition, Level 3 recognized \$4 million of non-cash impairment charges primarily related to excess land of the communications business held for sale in Germany. This charge resulted from the difference between the recorded carrying value and the estimated market value of the land.

The Company recognized \$9 million of non-cash impairment charges in 2005 that primarily resulted from the decision to terminate projects for certain voice services and certain information technology projects in the communications business which had been previously capitalized. These projects have identifiable costs which Level 3 can separately evaluate for impairment. The costs incurred for these projects, including capitalized labor, were impaired as the carrying value of these projects were no longer expected to provide future benefit to the Company. The Company did not incur asset impairment expenses in 2004.

(6) Loss Per Share

The Company had a loss from continuing operations for the three years ended December 31, 2006. Therefore, the effect of the approximately 481 million, 418 million and 171 million shares issuable pursuant to the five, four and three series of convertible notes outstanding at December 31, 2006, 2005 and 2004, respectively, have not been included in the computation of diluted loss per share because their inclusion would have been anti-dilutive to the computation. In addition, the effect of the approximately 54 million, 59 million and 49 million stock options, outperform stock options, restricted stock units and warrants outstanding at December 31, 2006, 2005 and 2004, 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 loss per share calculations for the Level 3 common stock (dollars in million, except per share data):

	Year Ended December 31,		
	2006	2005	2004
Loss from Continuing Operations	\$ (790)	\$ (707)	\$ (478)
Income from Discontinued Operations (2006 and 2005 include gain on sale)	46	69	20
Net Loss	<u>\$ (744)</u>	<u>\$ (638)</u>	<u>\$ (458)</u>
Total Number of Weighted Average Shares Outstanding used to Compute Basic and Diluted Earnings Per Share (in thousands)	1,003,255	699,589	683,846
Earnings (Loss) Per Share of Level 3 Common Stock (Basic and Diluted):			
Loss from Continuing Operations	\$ (0.79)	\$ (1.01)	\$ (0.70)
Income from Discontinued Operations	0.05	0.10	0.03
Net Loss	<u>\$ (0.74)</u>	<u>\$ (0.91)</u>	<u>\$ (0.67)</u>

(7) 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

At December 31, 2006, marketable securities consist entirely of U.S. Treasury securities that were characterized as held to maturity. These securities total \$235 million and are reflected as current assets on the consolidated balance sheet at December 31, 2006.

At December 31, 2005, marketable securities consist of U.S. Treasury securities and the Infocrossing shares received in the (i)Structure transaction which were valued at quoted market prices. For most of 2005, the Company characterized the U.S. Treasury securities as held to maturity. As a result of the acquisition of WilTel and expected cash flow requirements in 2006, the Company designated certain Treasury securities as available for sale in the fourth quarter of 2005. These securities totaled \$173 million, stated at fair value since they were available for sale, and were reflected as current assets on the consolidated balance sheet at December 31, 2005. The Infocrossing shares and U.S. Treasury securities characterized as available for sale were sold in 2006.

Restricted securities consist primarily of cash investments that serve to collateralize outstanding letters of credit and certain performance and operating obligations of the Company.

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.

The net unrealized holding gains and losses for marketable securities classified as available for sale were included in accumulated other comprehensive income (loss) within stockholders' equity (deficit). Securities characterized as held to maturity are stated at cost. The unrealized holding gains and losses for securities characterized as held to maturity are not reflected in the consolidated financial statements.

At December 31, 2006 and 2005 the unrealized holding gains and losses on the marketable securities were as follows:

	<u>Cost</u>	<u>Unrealized Holding Gains</u>	<u>Unrealized Holding Losses</u>	<u>Fair Value</u>
	(dollars in millions)			
2006				
Marketable Securities:				
U.S. Treasury securities—Current	\$ 235	\$ —	\$ (1)	\$ 234
	<u>\$ 235</u>	<u>\$ —</u>	<u>\$ (1)</u>	<u>\$ 234</u>
2005				
Marketable Securities:				
U.S. Treasury securities—Current	\$ 173	\$ —	\$ —	\$ 173
Equity Securities—Current	3	—	—	3
U.S. Treasury securities—Noncurrent	234	—	(2)	232
	<u>\$ 410</u>	<u>\$ —</u>	<u>\$ (2)</u>	<u>\$ 408</u>

The Company recognized \$2 million of realized gains from the sale of marketable equity securities in 2006, \$2 million of realized losses from the sale of marketable debt securities in 2005 and \$23 million of realized gains from the sale of marketable equity securities in 2004. These realized gains and losses are reflected in Other, net on the consolidated statement of operations for all periods presented.

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

Long-Term Debt

The fair value of long-term debt was estimated using the December 31, 2006 and 2005 average of the bid and ask price for the publicly traded debt instruments. The CBRE Commercial Mortgage was not traded in an organized public manner. The fair value of this instrument is assumed to approximate the carrying value at December 31, 2006 as it was secured by underlying assets. The 9% Convertible Senior Discount Notes due 2013 included within Long-Term Debt are not traded in an organized public manner. The fair value of these notes was calculated using a convertible model, which uses the Black-Scholes valuation model to value the equity portion of the security and bond math to value the debt portion of the security (using market yields on other Level 3 traded debt). The 10% Convertible Senior Notes due 2011 included within Long-Term Debt are not traded in an organized public manner. Level 3 has obtained a market value from a third party broker for the 10% Convertible Senior Notes due 2011.

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

	2006		2005	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(dollars in millions)			
Cash and Cash Equivalents (excluding discontinued operations)	\$ 1,681	\$ 1,681	\$ 379	\$ 379
Marketable Securities—Current	235	234	176	176
Marketable Securities—Noncurrent	—	—	234	232
Restricted Securities—Current	46	46	34	34
Restricted Securities—Noncurrent	90	90	75	75
Receivables less allowance for doubtful accounts (Note 8)	326	326	392	392
Investments (Note 12)	14	14	15	15
Accounts Payable	391	391	367	367
Long-term Debt, including current portion (Note 13)	7,362	8,578	6,023	5,266

(8) Receivables

Receivables at December 31, 2006 and 2005 were as follows:

	<u>Communications</u>	<u>Coal</u>	<u>Total</u>
	(dollars in millions)		
2006			
Accounts Receivable—Trade	\$ 337	\$ 6	\$ 343
Allowance for Doubtful Accounts	(17)	—	(17)
Total	<u>\$ 320</u>	<u>\$ 6</u>	<u>\$ 326</u>
2005			
Accounts Receivable—Trade	\$ 400	\$ 9	\$ 409
Allowance for Doubtful Accounts	(17)	—	(17)
Total	<u>\$ 383</u>	<u>\$ 9</u>	<u>\$ 392</u>

The Company recognized bad debt expense in selling, general and administrative expenses of \$1 million, less than \$1 million and \$3 million in 2006, 2005 and 2004, respectively. Level 3 received \$1 million, \$2 million and \$2 million of proceeds for amounts previously deemed uncollectible in 2006, 2005 and 2004, respectively. The Company reduced accounts receivable and the allowance for doubtful accounts by less than \$1 million, less than \$1 million and \$8 million in 2006, 2005 and 2004, respectively, for the write off of previously reserved amounts the Company deemed as uncollectible.

(9) Other Current Assets

At December 31, 2006 and 2005 other current assets consisted of the following:

	<u>2006</u>	<u>2005</u>
	<u>(dollars in</u>	
	<u>millions)</u>	
Prepaid Assets	\$ 52	\$ 55
Debt Issuance Costs, net	18	16
Other	31	21
	<u>\$ 101</u>	<u>\$ 92</u>

Prepaid assets include insurance, software maintenance, rent and right of way costs.

(10) Property, Plant and Equipment, net

Costs associated directly with expansions and improvements to the communications network and customer installations, including employee related costs, have been capitalized. The Company generally capitalizes costs associated with network construction, provisioning of services and software development. Capitalized labor and related costs associated with employees and contract labor working on capital projects were approximately \$72 million, \$51 million and \$66 million for the years ended December 31, 2006, 2005 and 2004, respectively. Included in capitalized labor and related costs was \$2 million of capitalized non-cash compensation costs related to options and warrants granted to employees for each of the years ended December 31, 2006, 2005 and 2004, respectively.

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

The Company reviews its capitalized projects at least annually or when events and circumstances indicate that the assets may be impaired. When previously capitalized software development costs are considered to be impaired, the Company calculates and recognizes an impairment loss in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets."

Included in Land and Mineral Properties are mineral properties related to the coal business with a cost basis of approximately \$5 million for each of the years ended December 31, 2006 and 2005. The remaining Land and Mineral Properties balance of approximately \$209 million and \$205 million for the years ended December 31, 2006 and 2005, respectively, represent owned assets of the communications business, including land improvements. The coal mineral properties include owned and leased assets. The various coal lease agreements require minimum lease payments and provide for royalty or overriding royalty payments based on the tons of coal mined or sold from the properties. Depletion on the mineral properties is provided on a units-of-extraction basis determined in relation to coal committed under sales contracts.

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 and equipment below.

The cost and accumulated depreciation of property, plant and equipment has been reduced for impairments taken in current and prior years.

At December 31, 2006 and 2005, property, plant and equipment were as follows:

	<u>Cost</u>	<u>Accumulated Depreciation</u> (dollars in millions)	<u>Book Value</u>
December 31, 2006			
Land and Mineral Properties	\$ 214	\$ (28)	\$ 186
Facility and Leasehold Improvements:			
Communications	1,692	(482)	1,210
Coal Mining	151	(148)	3
Network Infrastructure	5,430	(1,409)	4,021
Operating Equipment:			
Communications	2,706	(1,799)	907
Coal Mining	71	(64)	7
Furniture, Fixtures and Office Equipment	132	(106)	26
Other	28	(24)	4
Construction-in-Progress	104	—	104
	<u>\$ 10,528</u>	<u>\$ (4,060)</u>	<u>\$ 6,468</u>
December 31, 2005			
Land and Mineral Properties	\$ 210	\$ (26)	\$ 184
Facility and Leasehold Improvements:			
Communications	1,532	(355)	1,177
Coal Mining	153	(149)	4
Network Infrastructure	4,705	(1,126)	3,579
Operating Equipment:			
Communications	2,156	(1,528)	628
Coal Mining	69	(62)	7
Furniture, Fixtures and Office Equipment	111	(96)	15
Other	22	(19)	3
Construction-in-Progress	35	—	35
	<u>\$ 8,993</u>	<u>\$ (3,361)</u>	<u>\$ 5,632</u>

The value of property, plant and equipment related to the ICG Communications, TelCove and Looking Glass acquisitions are based on preliminary valuations. The value of property, plant and equipment related to WilTel and Progress Telecom, is based on a final valuation.

During 2006, Level 3 determined that the period the Company expects to use its existing fiber is longer than the remaining useful life as originally estimated. As a result, the Company extended the depreciable life of its existing fiber from 7 years to 12 years. This change in estimate, effective as of April 1, 2006, was accounted for prospectively, in accordance with SFAS No. 154 and reduced depreciation expense by \$54 million in 2006. In addition, this change in estimate reduced net loss from continuing operations and net loss by \$54 million, or approximately \$0.05 per share for the year ended December 31, 2006.

In addition, during 2006, Level 3 determined that the period the Company expects to use its existing electronic equipment is longer than the remaining useful lives as originally estimated. As a result, the Company extended the depreciable life of its existing transmission equipment from 5 years to 7 years and existing IP equipment from 3 years to 4 years. This change in estimate, effective as of July 1, 2006, was accounted for prospectively, in accordance with SFAS No. 154, and reduced depreciation expense by \$26 million in 2006. In addition, this change in estimate reduced net loss from continuing operations and net loss by \$26 million, or approximately \$0.03 per share for the year ended December 31, 2006.

Depreciation expense was \$652 million in 2006, \$584 million in 2005 and \$613 million in 2004.

(11) Goodwill and Other Intangibles, net

Goodwill and Other Intangibles, net at December 31, 2006 and 2005 were as follows (dollars in millions):

	<u>Goodwill</u>	<u>Other Intangibles</u>
December 31, 2006		
360networks	\$ —	\$ 3
Sprint	—	5
Telverse	—	10
Genuity	—	6
WilTel	—	135
Progress Telecom	32	33
ICG Communications	127	47
TelCove	179	264
Looking Glass	—	8
McLeod	40	—
XCOM	30	—
	<u>\$ 408</u>	<u>\$ 511</u>
December 31, 2005		
360networks	\$ —	\$ 4
Sprint	—	16
ICG	—	4
Telverse	—	16
Genuity	—	30
WilTel	—	151
McLeod	40	—
XCOM	30	—
	<u>\$ 70</u>	<u>\$ 221</u>

The Company segregates identifiable intangible assets acquired in a business combination from goodwill. In accordance with SFAS No. 142, Goodwill is no longer amortized and the carrying amount of the goodwill must be evaluated at least annually for impairment using a fair value based test. An assessment of the carrying value of the goodwill attributable to the communications business indicated that the assets were not impaired as of December 31, 2006.

On December 23, 2005, Level 3 completed the acquisition of WilTel. A final valuation of the assets acquired indicated a value of \$152 million for intangible assets. The intangible assets primarily include customer relationships and the Vyvx trademark. The final valuation placed an indefinite life on the Vyvx trademark and lives ranging from 6 to 11 years for the customer relationships.

On March 20, 2006, Level 3 completed the acquisition of Progress Telecom. A final valuation of the assets acquired in the Progress Telecom acquisition resulted in a value of \$36 million for customer-related intangible assets with an estimated useful life of 8 years. The final purchase price valuation indicated that the purchase price exceeded the fair value of the identifiable assets acquired and liabilities assumed by \$32 million,

On May 31, 2006, Level 3 completed the acquisition of ICG Communications. A preliminary valuation of the assets acquired in the ICG Communications transaction indicated a value of \$49 million for customer-related intangible assets with an estimated useful life of 15 years.

On July 24, 2006, Level 3 completed the acquisition of TelCove. A preliminary valuation of the assets acquired in the TelCove transaction as of the acquisition date, indicates customer-related intangible assets of approximately \$253 million, with lives ranging from 9 to 13 years and other assets of approximately \$20 million with an indefinite life.

On August 2, 2006, Level 3 completed the acquisition of Looking Glass. A preliminary valuation of the assets acquired in the Looking Glass transaction as of the acquisition date, indicates customer-related intangibles of approximately \$9 million with an estimated useful life of 8 years. Based on the valuation, Level 3 adjusted its preliminary estimate of the amount initially allocated to customer intangibles from \$41 million at the end of the third quarter of 2006 to \$9 million. Also, during the fourth quarter of 2006 Level 3 recorded a \$24 million liability for unfavorable leases attributable to Looking Glass.

The preliminary purchase price valuations for ICG Communications and TelCove indicated that the purchase price exceeded the fair value of the identifiable assets acquired and liabilities assumed and resulted in goodwill of \$127 million and \$179 million, respectively. The preliminary valuation of the assets acquired and liabilities assumed in the Looking Glass transaction indicates that the fair value of the identifiable net assets acquired exceeds the consideration paid to the former owners and resulted in negative goodwill of \$24 million which reduced the fair value of long-lived assets acquired in the transaction on a pro-rata basis.

During the first quarter of 2005, Level 3 purchased a customer contract from 360networks for cash and future services valued at \$4 million. The total purchase price was recorded as an intangible asset and will be amortized over the remaining four-year term of the customer contract.

At December 31, 2006 and 2005 identifiable intangible assets were as follows (dollars in millions):

	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Book Value</u>
December 31, 2006			
Customer Contracts:			
Sprint	\$ 31	\$ (26)	\$ 5
ICG	37	(37)	—
Genuity	28	(22)	6
McLeod	49	(49)	—
Customer Relationships:			
Genuity	79	(79)	—
360networks	4	(1)	3
WilTel	120	(17)	103
Progress Telecom	36	(3)	33
ICG Communications	49	(2)	47
Looking Glass	9	(1)	8
TelCove	253	(9)	244
Trademarks:			
WilTel	32	—	32
Technology:			
Telverse	31	(21)	10
Other:	20	—	20
	<u>\$ 778</u>	<u>\$ (267)</u>	<u>\$ 511</u>

	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Book Value</u>
December 31, 2005			
Customer Contracts:			
Sprint	\$ 31	\$ (15)	\$ 16
ICG	37	(33)	4
Genuity	28	(17)	11
McLeod	49	(49)	—
Customer Relationships:			
Genuity	79	(60)	19
360networks	4	—	4
WilTel	120	(1)	119
Trademarks:			
WilTel	32	—	32
Technology:			
Telverse	31	(15)	16
	<u>\$ 411</u>	<u>\$ (190)</u>	<u>\$ 221</u>

Intangible asset amortization expense was \$78 million, \$63 million and \$58 million for the years ended December 31, 2006, 2005 and 2004, respectively.

The amortization expense related to intangible assets currently recorded on the Company's books for each of the five succeeding years is estimated to be the following for the years ended December 31: 2007—\$66 million; 2008—\$52 million; 2009—\$48 million; 2010—\$47 million; 2011—\$47 million and thereafter—\$199 million.

(12) Other Assets, net

At December 31, 2006 and 2005 other assets consisted of the following:

	<u>2006</u>	<u>2005</u>
	<u>(dollars in millions)</u>	
Debt Issuance Costs, net	\$ 75	\$ 54
Investments	14	15
Deposits	17	22
Other	22	20
	<u>\$ 128</u>	<u>\$ 111</u>

In 2005, the Company invested \$10 million in Infinera Corporation, a privately-held communications equipment company. Level 3 is accounting for this investment using the cost method.

See Footnote 13 below for a discussion of debt issuance costs included in other assets, net above.

(13) Long-Term Debt

At December 31, 2006 and 2005, long-term debt was as follows:

	2006	2005
	(dollars in millions)	
Senior Secured Term Loan (8.37% due 2011)	\$ 730	\$ 730
Senior Notes (11.0% due 2008)	78	132
Senior Notes (9.125%)	—	954
Senior Discount Notes (10.5%)	—	144
Senior Euro Notes (10.75% due 2008)	65	59
Senior Discount Notes (12.875% due 2010)	488	488
Senior Euro Notes (11.25% due 2010)	137	123
Senior Notes (11.25% due 2010)	96	96
Senior Notes (11.5% due 2010)	692	—
Fair value adjustment on Senior Notes	(60)	—
Senior Notes (10.75% due 2011)	3	500
Floating Rate Senior Notes (11.8% due 2011)	150	—
Issue discount on Senior Notes	(4)	—
Senior Notes (12.25% due 2013)	550	—
Issue discount on Senior Notes	(2)	—
Senior Notes (9.25% due 2014)	1,250	—
Issue premium on Senior Notes	11	—
Convertible Senior Notes (2.875% due 2010)	374	374
Convertible Senior Notes (5.25% due 2011)	345	345
Convertible Senior Notes (10.0% due 2011)	880	880
Convertible Senior Notes (3.5% due 2012)	335	—
Convertible Senior Discount Notes (9.0% due 2013)	275	252
Convertible Subordinated Notes (6.0% due 2009)	362	362
Convertible Subordinated Notes (6.0% due 2010)	514	514
Commercial Mortgage (6.86% due 2015)	70	70
Capital leases assumed in acquisitions	23	—
	7,362	6,023
Less current portion	(5)	—
	<u>\$ 7,357</u>	<u>\$ 6,023</u>

Debt Exchanges, Amendments and Repurchases

2006 Debt Exchange

On January 13, 2006, the Company completed private exchange offers to exchange a portion of its outstanding 9.125% Senior Notes due 2008, 11% Senior Notes due 2008 and 10.5% Senior Discount Notes due 2008 (together the “2008 Notes”) that were held by eligible holders in a private placement for cash and new 11.5% Senior Notes due 2010. The Company issued \$692 million aggregate principal amount of 11.5% Senior Notes due 2010 as well as paid \$46 million of cash consideration in exchange for the 2008 Notes tendered in the transactions. The Company also paid approximately \$13 million in cash for total accrued interest to the closing date on the 2008 Notes that were accepted for exchange.

Pursuant to the guidance in EITF No. 96-19, “Debtor’s Accounting for a Modification or Exchange of Debt Instruments” (“EITF No. 96-19”), the Company accounted for the exchange of the 9.125% Senior Notes due 2008 and the 11% Senior Notes due 2008 as an extinguishment of debt and recognized a gain of

approximately \$27 million in Other Income in the first quarter of 2006. The gain was determined using the fair value of the new 11.5% Senior Notes due 2010 at the time of issuance. The fair value of the 11.5% Senior Notes due 2010 was approximately \$73 million less than the face amount of the debt. The accretion of the \$73 million discount will be reflected as interest expense in future periods using the effective interest method. The 11.5% Senior Notes due 2010 were recorded at their fair value on the transaction date and will accrete to their face value at maturity. Premiums paid to holders of the 9.125% Senior Notes due 2008 and the 11% Senior Notes due 2010 of \$41 million reduced the gain on extinguishment of debt.

In accordance with EITF No. 96-19, the exchange of the 10.5% Senior Discount Notes due 2008 was accounted for as a modification of the existing debt. The premiums paid to the holders of the 10.5% Senior Discount Notes due 2008 of \$5 million were added to the existing debt issuance costs and will be amortized over the term of the 11.5% Senior Notes due 2010.

The Company incurred approximately \$5 million of third party costs associated with the exchange transaction. The costs were allocated to each tranche of debt based on the amount tendered for exchange. The \$4 million of fees allocated to the 9.125% Senior Notes due 2008 and the 11% Senior Notes due 2008 were capitalized and will be amortized to interest expense over the term of the respective notes. The \$1 million of costs allocated to the 10.5% Senior Discount Notes due 2008 were expensed in the first quarter of 2006.

The principal amount of 2008 Notes tendered is set forth in the table below (dollars in millions).

2008 Notes Exchanged	Aggregate Principal Amount Outstanding Before Exchange Offers	Aggregate Principal Amount Tendered	Aggregate Principal Amount of Old Notes that Remained Outstanding	Total Cash Premium Payment
9.125% Senior Notes due 2008	\$ 954	\$ 556	\$ 398	\$ 36
11% Senior Notes due 2008	132	54	78	5
10.5% Senior Discount Notes due 2008	144	82	62	5

The exchange offers were made only to qualified institutional buyers and institutional accredited investors inside the United States and to certain non-U.S. investors located outside the United States.

The 11.5% Senior Notes are senior unsecured obligations of the Company, ranking equal in right of payment with the old notes not tendered in the exchange offers as well as all other senior unsecured obligations of the Company. The 11.5% Senior Notes due 2010 mature on March 1, 2010, and bear interest at a rate per annum equal to 11.5%. Interest on the notes is payable on March 1 and September 1 of each year, beginning on September 1, 2006. The Company may redeem some or all of the 11.5% Senior Notes due 2010 at any time on or after March 1, 2009, at 100% of their principal amount plus accrued interest.

The Company's exchange offer registration statement for these notes was declared effective by the Securities and Exchange Commission on August 8, 2006 and the exchange offer relating to these notes was subsequently completed.

2006 Debt Tenders and Redemptions

On July 13, 2006, Level 3 redeemed all of its outstanding 9.125% Senior Notes due 2008 and 10.5% Senior Discount Notes due 2008 remaining after the debt exchange completed on January 13, 2006, described above. Aggregate principal, call premium and accrued interest totaled \$470 million.

The 9.125% Senior Notes due 2008 were redeemed at a redemption price equal to 100% of the principal amount of those notes plus accrued and unpaid interest. The aggregate principal amount of

9.125% Senior Notes due 2008 that were redeemed was \$398 million. The 10.5% Senior Discount Notes due 2008 were redeemed at a redemption price equal to 101.75% of the principal amount at maturity of those notes plus accrued and unpaid interest. The aggregate principal amount at maturity of 10.5% Senior Discount Notes due 2008 that were redeemed was \$62 million.

On December 27, 2006, Level 3 Financing, Inc. ("Level 3 Financing") a wholly owned subsidiary of the Company, purchased for cash \$497 million in total principal amount of its 10.75% Senior Notes due 2011, representing approximately 99.3% of the aggregate principal amount outstanding of all 10.75% Senior Notes Due 2011. Holders of the 10.75% Senior Notes due 2011 validly tendered and accepted for purchase by Level 3 Financing received \$1,092.21 per \$1,000 principal amount of the these notes, which included \$1,062.21 as the purchase price and \$30.00 as a consent payment. Level 3 Financing paid in cash approximately \$528 million to purchase the 10.75% Senior Notes due 2011 as well as a \$15 million consent payment and \$11 million for total accrued interest to the closing date of the tender offer. The Company recorded a \$54 million net loss on the early extinguishment of the debt, including unamortized debt issuance costs of \$8 million.

Amendment and Restatement of Credit Facility

On June 27, 2006, Level 3 Financing amended and restated its existing \$730 million senior secured credit facility (see Senior Secured Term Loan due 2011 below) to reduce the interest rate payable under the agreement by 400 basis points, modify the pre-payment provisions and make other specified changes.

The amendment of the credit facility was treated as an extinguishment of the existing debt instrument due to the significant change in lenders of the debt in accordance with EITF No. 96-19. The fair value of the amended and restated credit facility approximated the carrying value of the original credit facility as the interest rate of the amended and restated credit facility approximated current market rates. As part of the transaction, Level 3 Financing paid a prepayment premium of approximately \$42 million to existing debt holders. The prepayment premium along with the unamortized deferred debt issuance costs of \$13 million from the original offering, were recognized as a loss on the extinguishment of debt in the second quarter of 2006. The Company also incurred \$11 million of third party costs to complete this transaction. These costs were reflected as deferred debt issuance costs and will be amortized to interest expense over the term of the debt using the effective interest method.

Debt Instruments

At December 31, 2006, Level 3 was in compliance with the covenants on all outstanding debt issuances.

Senior Secured Term Loan due 2011

On December 1, 2004, Level 3 Communications, Inc., as guarantor, Level 3 Financing, as borrower, and certain lenders entered into a credit agreement ("Credit Agreement") pursuant to which the lenders extended a \$730 million senior secured term loan ("Senior Secured Term Loan") to Level 3 Financing. The term loan matures in 2011 and had a current interest rate of the London Interbank Offering Rate ("LIBOR") plus an applicable margin of 700 basis points. On June 27, 2006, Level 3 Financing amended and restated the Senior Secured Term Loan to reduce the interest rate payable under the agreement by 400 basis points, modify the pre-payment provisions and make other specified changes.

Interest on the note accrues at the three month LIBOR and is payable in cash on March 5, June 5, September 5 and December 5 of each year, in arrears, beginning March 1, 2005. The interest rate was 8.37% at December 31, 2006 and was determined at the commencement of the interest period beginning December 5, 2006.

Level 3 Financing's obligations under this term loan are, subject to certain exceptions, secured by certain assets of the Company; and certain of the Company's material domestic subsidiaries that are engaged in the telecommunications business. The Company and these subsidiaries have also guaranteed the obligations of Level 3 Financing under the Senior Secured Term Loan. Level 3 Communications, LLC and its material domestic subsidiaries have guaranteed and have pledged certain of their assets to secure the obligations under the Senior Secured Term Loan. Certain of the initial subsidiary guarantors have been released from their pledge and guarantee obligations under the Senior Secured Term Loan.

The Credit Agreement includes certain negative covenants which restrict the ability of the Company, Level 3 Financing and any restricted subsidiary to engage in certain activities. The Credit Agreement also contains certain events of default. It does not require the Company or Level 3 Financing to maintain specific financial ratios.

Level 3 used the original net proceeds after transaction costs to fund the purchase of certain of its existing debt securities outstanding at the time.

Debt issuance costs of \$17 million were originally capitalized and were being amortized to interest expense over the term of the Senior Secured Term Loan. As part of the amendment and restatement of the Senior Secured Term Loan, the remaining original debt issuance costs were written off and are included in the loss on the extinguishment of debt. The transaction costs to amend and restate the Senior Secured Term Loan in June 2006 of \$11 million were capitalized and are being amortized to interest expense over the remaining term of the Senior Secured Term Loan. After amortization, debt issuance costs were approximately \$10 million at December 31, 2006.

See Subsequent Events (Note 21) regarding the February 9, 2007 announcement to refinance the Senior Secured Term Loan.

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"). As of December 31, 2006 a total of \$722 million aggregate principal amount of the 11% Senior Notes had been repurchased. 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 to 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 less than \$1 million at December 31, 2006.

See Subsequent Events (Note 21) regarding the February 15, 2007 announcement of the Company's tender offer to purchase the 11% Senior Notes due 2008.

10.75% Senior Euro Notes due 2008

In February 2000, Level 3 Communications, Inc. received €488 million (\$478 million when issued) of net proceeds, after debt issuance costs, from an offering of €500 million aggregate principal amount 10.75% Senior Euro Notes due 2008 ("10.75% Senior Euro Notes"). As of December 31, 2006, a total of €450 million aggregate principal amount of the 10.75% Senior Euro Notes had been repurchased. 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 €12 million were originally capitalized and are being amortized over the term of the 10.75% Senior Euro Notes. As a result of amortization and debt repurchases, the net capitalized debt issuance costs have been reduced to less than €1 million at December 31, 2006.

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 €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 \$65 million in the Company's consolidated financial statements at December 31, 2006. The difference between the carrying value at December 31, 2006 and the value at issuance, after repurchases, is recorded in other comprehensive income.

See Subsequent Events (Note 21) regarding the February 20, 2007 announcement of the Company's tender offer to purchase the 10.75% Senior Euro Notes due 2008.

12.875% Senior Discount Notes due 2010

In February 2000, Level 3 Communications, Inc. sold in a private offering \$675 million aggregate principal amount at maturity 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. As of December 31, 2006, a total of \$187 million aggregate principal amount at maturity of the 12.875% Senior Discount Notes had been repurchased, leaving \$488 million aggregate principal amount outstanding. Interest on the 12.875% Senior Discount Notes accreted at a rate of 12.875% per year, compounded semi-annually, to 100% of their principal amount on March 15, 2005, which is an aggregate principal amount of \$488 million. Cash interest did not accrue on the 12.875% Senior Discount Notes prior to March 15, 2005. Commencing March 15, 2005, interest on the 12.875% Senior Discount Notes accrues at the rate of 12.875% per year and is payable in cash semi-annually in arrears.

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 forth 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
2006	104.292%
2007	102.146%
2008 and thereafter	100.000%

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 to 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 \$2 million at December 31, 2006.

See Subsequent Events (Note 21) regarding the February 15, 2007 announcement of the Company's call notice to redeem the 12.875% Senior Discount Notes due 2010.

11.25% Senior Euro Notes due 2010

In February 2000, Level 3 Communications, Inc. received €293 million (\$285 million when issued) of netproceeds, after debt issuance costs, from an offering of €300 million aggregate principal amount 11.25% Senior Euro Notes due 2010 ("11.25% Senior Euro Notes"). As of December 31, 2006, a total of €196 million aggregate principal amount of the 11.25% Senior Euro Notes had been repurchased. 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
2006	103.750%
2007	101.875%
2008 and thereafter	100.000%

Debt issuance costs of €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 €1 million at December 31, 2006. 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 €300 million 11.25% Senior EuroNotes 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 \$137 million in the Company's financial statements at December 31, 2006. The difference between the carrying value at December 31, 2006 and the value at issuance, after repurchases, is recorded in other comprehensive income.

See Subsequent Events (Note 21) regarding the February 15, 2007 announcement of the Company's call notice to redeem the 11.25% Senior Euro Notes due 2010.

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"). As of December 31, 2006, a total of \$154 million aggregate principal amount of the 11.25% Senior Notes had been repurchased. 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
2006	103.750%
2007	101.875%
2008 and thereafter	100.000%

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 to 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 \$1 million at December 31, 2006.

See Subsequent Events (Note 21) regarding the February 15, 2007 announcement of the Company's call notice to redeem the 11.25% Senior Notes due 2010.

10.75% Senior Notes due 2011

In October 2003, Level 3 Financing received \$486 million of net proceeds from a private placement offering of \$500 million aggregate principal amount of its 10.75% Senior Notes due 2011 ("10.75% Senior Notes"). As of December 31, 2006, a total of \$497 million aggregate principal amount of the 10.75% Senior Notes had been redeemed. Interest on the notes accrues at 10.75% per year and is payable in arrears on April 15 and October 15 each year in cash. These notes are guaranteed by Level 3 Communications, LLC and Level 3 Communications, Inc. (See Note 20).

The 10.75% Senior Notes are subject to redemption at the option of Level 3 Financing, in whole or in part, at any time or from time to time on or after October 15, 2007, plus accrued and unpaid interest thereon to the redemption date, if redeemed during the twelve months beginning October 15, of the years indicated below:

Year	Redemption Price
2007	105.375%
2008	102.688%
2009 and thereafter	100.000%

In connection with the tender offer and related consent solicitation on December 27, 2006, Level 3 Financing entered into a Supplemental Indenture, dated as of October 1, 2003 ("10.75% Note Indenture"), among Level 3, as Guarantor, Level 3 Financing, as issuer, and The Bank of New York, as Trustee, relating to the 10.75% Notes. Pursuant to the Supplemental Indenture, the 10.75% Note Indenture was amended to eliminate substantially all of the covenants, certain repurchase rights and certain events of default and related provisions contained in the 10.75% Note Indenture.

The 10.75% Senior Notes are senior, unsecured obligations of Level 3 Financing, ranking *pari passu* with all existing and future senior unsecured indebtedness of Level 3 Financing.

Debt issuance costs of \$14 million were originally capitalized and are being amortized to interest expense over the term of the 10.75% Senior Notes. As a result of amortization and the repurchase transaction, the capitalized debt issuance costs have been reduced to less than \$1 million at December 31, 2006.

Floating Rate Senior Notes due 2011

On March 14, 2006, Level 3 Communications, Inc., as guarantor and Level 3 Financing, as borrower, entered into an indenture with the Bank of New York, as trustee, and issued \$150 million aggregate principal amount of floating rate senior notes due 2011 ("Floating Rate Senior Notes due 2011") in a private offering. After transaction costs, the Company received net proceeds associated with this offering of \$142 million.

The Floating Rate Senior Notes due 2011 rank equal in right of payment with all other senior unsecured obligations of Level 3 Financing and have an initial interest rate equal to the six month London Interbank Offered Rate ("LIBOR"), plus 6.375%, which will be reset semi-annually. Interest on the notes is payable on March 15 and September 15 of each year, beginning on September 15, 2006. The interest rate was 11.8% at December 31, 2006. The Floating Rate Senior Notes due 2011 were priced at 96.782% of par and will mature on March 15, 2011. The discount of \$4 million is reflected as a reduction in long-term debt and is being amortized as interest expense over the term of the Floating Rate Senior Notes due 2011 using the effective interest method. As of December 31, 2006, these notes are guaranteed by Level 3 Communications, Inc. and Level 3 Communications, LLC (See Note 20).

The Floating Rate Senior Notes due 2011 are subject to redemption at the option of Level 3 Financing in whole or in part, at any time or from time to time, on or after March 15, 2008 at the redemption prices (expressed as a percentage of principal amount) set forth below, plus accrued and unpaid interest thereon to the redemption date, if redeemed during the twelve months beginning March 15, of the years indicated below:

Year	Redemption Price
2008	102.0%
2009	101.0%
2010	100.0%

On March 14, 2006, Level 3, Level 3 Financing and the initial purchasers of the Floating Rate Senior Notes due 2011 entered into a registration rights agreement relating to the Floating Rate Senior Notes due 2011 pursuant to which Level 3 and Level 3 Financing agreed to file an exchange offer registration statement with the Securities and Exchange Commission. The Company's exchange offer registration statement for these notes was declared effective by the Securities and Exchange Commission on August 8, 2006 and the exchange offer relating to these notes was subsequently completed.

Debt issuance costs of \$3 million were capitalized and are being amortized over the term of the Floating Rate Senior Notes due 2011 using the effective interest method. As a result of amortization, the capitalized debt issuance costs have been reduced to approximately \$3 million at December 31, 2006.

See Subsequent Events (Note 21) regarding the February 15, 2007 announcement of Level 3 Financing's tender offer to purchase the Floating Rate Senior Notes due 2011.

12.25% Senior Notes due 2013

On March 14, 2006, Level 3 Communications, Inc., as guarantor and Level 3 Financing, as borrower, entered into an indenture with the Bank of New York, as trustee, and issued \$250 million aggregate principal amount of 12.25% senior notes due 2013 (“12.25% Senior Notes due 2013”) in a private offering.

On April 6, 2006, the Company issued \$300 million aggregate principal amount of 12.25% Senior Notes due 2013 in a private offering. These notes together with the \$250 million aggregate principal amount of 12.25% Senior Notes due 2013 issued on March 14, 2006 will be treated under the same indenture as a single series of notes. The Company received net proceeds of \$538 million associated with the 12.25% Senior Notes due 2013.

The 12.25% Senior Notes due 2013 are senior unsecured obligations of Level 3 Financing, ranking equal in right of payment with all other senior unsecured obligations of Level 3 Financing. As of December 31, 2006, these notes are guaranteed by Level 3 Communications, Inc. and Level 3 Communications, LLC (See Note 20). The notes will mature on March 15, 2013. Interest on the notes accrues at 12.25% per year and is payable on March 15 and September 15 of each year, beginning on September 15, 2006. The \$250 million of 12.25% Senior Notes due 2013 issued on March 14, 2006 were priced at 96.618% of par. The \$300 million of 12.25% Senior Notes due 2013 issued on April 6, 2006 were priced at 102% of par. The resulting net discount of the two issuances of approximately \$2 million is reflected as a reduction in long-term debt and is being amortized as interest expense over the remaining term of the 12.25% Senior Notes due 2013 using the effective interest method.

The 12.25% Senior Notes due 2013 are subject to redemption at the option of Level 3 Financing in whole or in part, at any time or from time to time, on or after March 15, 2010 at the redemption prices (expressed as a percentage of principal amount) set forth below, plus accrued and unpaid interest thereon to the redemption date, if redeemed during the twelve months beginning March 15, of the years indicated below:

Year	Redemption Price
2010	106.125%
2011	103.063%
2012	100.000%

On March 14, 2006, Level 3 Communications, Inc., Level 3 Financing and the initial purchasers of the 12.25% Senior Notes due 2013 entered into a registration rights agreement regarding the 12.25% Senior Notes due 2013 pursuant to which Level 3 Communications, Inc. and Level 3 Financing agreed to file an exchange offer registration statement with the Securities and Exchange Commission. The Company’s exchange offer registration statement for these notes was declared effective by the Securities and Exchange Commission on August 8, 2006 and the exchange offer relating to these notes was subsequently completed.

The debt represented by the 12.25% Senior Notes due 2013 together with the Floating Rate Notes due 2011 constitutes purchase money indebtedness under the indentures of Level 3.

Debt issuance costs of approximately \$11 million were capitalized and are being amortized over the term of the 12.25% Senior Notes due 2013. As a result of amortization, the capitalized debt issuance costs have been reduced to \$10 million at December 31, 2006.

9.25% Senior Notes Due 2014

On October 30, 2006, Level 3 Communications, Inc., as guarantor and Level 3 Financing, Inc. as borrower, received \$588 million of net proceeds after transaction costs, from a private offering of \$600 million aggregate principal amount of its 9.25% Senior Notes due 2014 (“9.25% Senior Notes Due 2014”). On December 13, 2006, Level 3 Communications, Inc., as guarantor and Level 3 Financing, Inc. as borrower, received \$661 million of net proceeds after transaction costs and accrued interest, for a second

offering of \$650 million aggregate principal amount of 9.25% Senior Notes due 2014. These notes together with the \$600 million aggregate principal amount of 9.25% Senior Notes due 2014 issued on October 30, 2006 were issued under the same indenture and will be treated as a single series of notes. The Company received total net proceeds of \$1.239 billion (excluding prepaid interest).

The 9.25% Senior Notes due 2014 are senior unsecured obligations of Level 3 Financing, ranking equal in right of payment with all other senior unsecured obligations of Level 3 Financing. As of December 31, 2006, these notes are guaranteed by Level 3 Communications, Inc. (See Note 20). The notes will mature on November 1, 2014. Interest on the 9.25% Senior Notes Due 2014 accrues at 9.25% interest per year and is payable semi-annually in cash on May 1 and November 1 beginning May 1, 2007. The \$600 million of 9.25% Senior Notes due 2014 issued on October 30, 2006 were priced at par. The \$650 million of 9.25% Senior Notes due 2014 issued on December 13, 2006 were priced at 101.75% of par plus accrued interest from October 30, 2006, representing an effective yield of 8.86% to the purchasers of these senior notes. The resulting premium of the two issuances of approximately \$11 million is reflected as an increase to long-term debt and is being amortized as a reduction to interest expense over the remaining term of the 9.25% Senior Notes due 2014 using the effective interest method.

The debt represented by the 9.25% Senior Notes Due 2014 constitutes purchase money indebtedness under the indentures of Level 3 Communications, Inc. A portion of the proceeds were used to redeem \$497 million of the Company's 10.75% Senior Notes Due 2008 on December 27, 2006. Gross proceeds from this offering that exceed the amount necessary to repurchase or refinance the 10.75% Senior Notes Due 2008 constitutes purchase money indebtedness and will be used solely to fund the cost of construction, installation, acquisition, lease, development or improvement of any assets to be used in the Company's communications business, including the cash purchase price of any past, pending or future acquisitions.

The 9.25% Senior Notes Due 2014 are subject to redemption at the option of Level 3 Financing in whole or in part, at any time or from time to time, on or after November 1, 2010 at the redemption prices (expressed as a percentage of principal amount) set forth below, plus accrued and unpaid interest thereon to the redemption date, if redeemed during the twelve months beginning November 1, of the years indicated below:

Year	Redemption Price
2010	104.625%
2011	102.313%
2012	100.000%

At any time or from time to time on or prior to November 1, 2009, Level 3 Financing may redeem up to 35% of the original aggregate principal amount of the 9.25% Senior Notes Due 2014 at a redemption price equal to 109.250% of the principal amount of those notes so redeemed, plus accrued and unpaid interest thereon (if any) to the redemption date (subject to the right of holders of record on the relevant record date to receive interest due on the relevant interest payment date), with the net cash proceeds contributed to the capital of Level 3 Financing of one or more private placements to persons other than affiliates of Level 3 or underwritten public offerings of common stock of Level 3 resulting, in each case, in gross proceeds of at least \$100 million in the aggregate; provided, however, that at least 65% of the original aggregate principal amount of the 9.25% Senior Notes Due 2014 would remain outstanding immediately after giving effect to such redemption. Any such redemption shall be made within 90 days of such private placement or public offering upon not less than 30 nor more than 60 days' prior notice.

The 9.25% Senior Notes Due 2014 are not currently registered under the Securities Act of 1933 or any state securities laws and, unless so registered, may not be offered or sold except pursuant to an applicable exemption from the registration requirements of the Securities Act of 1933 and applicable state securities laws. On October 30, 2006 and December 28, 2006, Level 3, Level 3 Financing and the initial purchasers of the 9.25% Senior Notes Due 2014 entered into registration rights agreements relating to the 9.25% Senior

Notes Due 2014 pursuant to which Level 3 and Level 3 Financing agreed to file an exchange offer registration statement with the Securities and Exchange Commission. The registration statement has been filed but not yet declared effective.

Under the terms of the registration rights agreements, Level 3 Financing may be required to pay “Special Interest” in the event of a registration default. Special Interest will accrue at a rate of 0.50% per annum on the principal amount during the 90-day period after the occurrence of the registration default and will increase by 0.25% per annum at the end of each subsequent 90-day period. In no event will the rate exceed 1.00% per annum on the principal amount. If the exchange offer is completed on the terms and within the period contemplated by the registration rights agreements, no special interest will be payable. A registration default may occur if the Company fails to file with the Securities and Exchange Commission and have declared effective the exchange offer registration statement by certain dates as specified in the registration rights agreement. The Company believes that the likelihood of having to make Special Interest payments under the terms of the registration rights agreement is remote and, as a result, has not accrued a liability for any obligation under the agreement.

Debt issuance costs of approximately \$23 million were capitalized and are being amortized over the term of the 9.25% senior Notes Due 2014. As a result of amortization, the capitalized debt issuance costs have been reduced to \$22 million at December 31, 2006.

2.875% Convertible Senior Notes due 2010

In July 2003, Level 3 Communications, Inc. completed the offering of \$374 million aggregate principal amount of its 2.875% Convertible Senior Notes due 2010 (“2.875% Convertible Senior Notes”) in an underwritten public offering pursuant to the Company’s shelf registration statement. Interest on the notes accrues at 2.875% per year and is payable semi-annually in arrears in cash on January 15 and July 15, beginning January 15, 2004. The 2.875% Convertible Senior Notes are senior, unsecured obligations of Level 3 Communications, Inc., ranking *pari passu* with all existing and future senior unsecured debt. The 2.875% Convertible Senior Notes contain certain covenants, which among other things, limit additional liens on assets of the Company.

The 2.875% Convertible Senior Notes are convertible into shares of the Company’s common stock at a conversion rate of \$7.18 per share, subject to certain adjustments. On or after July 15, 2007, Level 3, at its option, may redeem for cash all or a portion of the notes. Level 3 may exercise this option only if the current market price for the Level 3 common stock for at least 20 trading days within any 30 consecutive trading day period exceeds prices ranging from 170% of the conversion price on July 15, 2007 decreasing to 150% of the conversion price on or after July 15, 2009. Level 3 would also be obligated to pay the holders of the redeemed notes a cash amount equal to the present value of all remaining scheduled interest payments.

Level 3 used the net proceeds of \$361 million, after transaction costs, for working capital, capital expenditures and other general corporate purposes, including new product development, debt repurchases and acquisitions.

Debt issuance costs of \$13 million were originally capitalized and are being amortized to interest expense over the term of the 2.875% Convertible Senior Notes. As a result of amortization, the capitalized debt issuance costs have been reduced to \$6 million at December 31, 2006.

5.25% Convertible Senior Notes due 2011

On December 2, 2004, Level 3 Communications, Inc. completed the offering of \$345 million aggregate principal amount of its 5.25% Convertible Senior Notes due 2011 (“5.25% Convertible Senior Notes”) in a private offering. Interest on the notes accrues at 5.25% per year and is payable semi-annually in arrears in cash on June 15 and December 15, beginning June 15, 2005. The 5.25% Convertible Senior Notes are senior, unsecured obligations of Level 3 Communications, Inc., ranking *pari passu* with all existing and

future senior unsecured debt of Level 3 Communications, Inc. The 5.25% Convertible Senior Notes contain certain covenants which limit additional liens on assets of the Company.

The 5.25% Convertible Senior Notes are convertible, at the option of the holders, into shares of the Company's common stock at a conversion rate of \$3.98 per share, subject to certain adjustments. Upon conversion, the Company will have the right to deliver cash in lieu of shares of its common stock, or a combination of cash and shares of common stock. In addition, holders of the 5.25% Convertible Senior Notes will have the right to require the Company to repurchase the notes upon the occurrence of a change in control, as defined, at a price of 100% of the principal amount plus accrued interest and a make whole premium.

On or after December 15, 2008, Level 3, at its option, may redeem for cash all or a portion of the notes. The 5.25% Convertible Senior Notes are subject to redemption at the option of Level 3, in whole or in part, at any time or from time to time, on not more than 60 nor less than 30 days' notice, on or after December 15, 2008, plus accrued and unpaid interest thereon to the redemption date, if redeemed during the twelve months beginning December 15, of the years indicated below:

Year	Redemption Price
2008	102.250%
2009	101.500%
2010 and thereafter	100.750%

In connection with the issuance of the notes, Level 3 used approximately \$62 million of the net proceeds of the offering to enter into convertible note hedge and warrant transactions with respect to the Company's common stock to reduce the potential dilution from conversion of the notes. Level 3 used the remainder of the net proceeds from this offering to fund repurchases of its existing debt securities due in 2008.

Under the terms of the convertible note hedge arrangement (the "Convertible Note Hedge") with Merrill Lynch International ("Merrill"), Level 3 paid \$125 million for a forward purchase option contract under which it is entitled to purchase from Merrill a fixed number of shares of Level 3 common stock (at a current price per share of \$3.98). In the event of the conversion of the notes, this forward purchase option contract allows the Company to purchase, at a fixed price equal to the implicit conversion price of shares issued under the convertible notes, a number of shares equal to the shares that Level 3 issues to a note holder upon conversion. Settlement terms of this forward purchase option allow the Company to elect cash or share settlement based on the settlement option it chooses in settling the conversion feature of the notes. The Company accounted for the Convertible Note Hedge pursuant to the guidance in EITF No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in a Company's Own Stock" ("EITF No. 00-19"). Accordingly, the \$125 million purchase price of the forward stock purchase option contract was recorded as a reduction to consolidated stockholders' equity.

Level 3 also sold to Merrill a warrant (the "Warrant") to purchase shares of Level 3 common stock. The Warrant is currently exercisable for 86,596,380 shares of Level 3 common stock at a current exercise price of \$6.00 per share. Level 3 received \$63 million cash from Merrill in return for the sale of this forward share purchase option contract. Merrill cannot exercise the Warrant unless and until a conversion event occurs. Level 3 has the option of settling the Warrant in cash or shares of Level 3 common stock. The Company accounted for the sale of the Warrant as the sale of a permanent equity instrument pursuant to the guidance in EITF No. 00-19. Accordingly, the \$63 million sales price of the forward stock purchase option contract was recorded as an increase to consolidated stockholders' equity.

The Convertible Note Hedge and the Warrant economically allow Level 3 to acquire sufficient shares of common stock from Merrill to meet its obligation to deliver common stock upon conversion by the holder, unless the common stock price exceeds \$6.00. When the fair value of the Level 3 common stock

exceeds such price, the contracts have an offsetting economic impact and, accordingly, will no longer be effective as a hedge of the dilutive impact of possible conversion.

Debt issuance costs of \$11 million were originally capitalized and are being amortized to interest expense over the term of the 5.25% Convertible Senior Notes. As a result of amortization, debt issuance costs were \$8 million at December 31, 2006.

10% Convertible Senior Notes due 2011

In April 2005, Level 3 Communications, Inc. received \$877 million of net proceeds, after giving effect to offering expenses, from an offering of \$880 million aggregate principal amount of its 10% Convertible Senior Notes due 2011 ("10% Convertible Senior Notes") to institutional investors. Interest on the notes accrues at 10% per year and will be payable semi-annually on May 1 and November 1 beginning on November 1, 2005. The 10% Convertible Senior Notes are unsecured unsubordinated obligations of Level 3 Communications, Inc., ranking *pari passu* with all existing and future unsecured unsubordinated debt of Level 3 Communications, Inc. The 10% Convertible Senior Notes contain certain covenants which limit additional liens on assets of the Company.

The 10% Convertible Senior Notes will be convertible by holders at any time after January 1, 2007 (or sooner if certain corporate events occur) into shares of Level 3 common stock at a conversion price of \$3.60 per share (subject to adjustment in certain events). This is equivalent to a conversion rate of approximately 277.77 shares per \$1,000 principal amount of notes. In addition, holders of the 10% Convertible Senior Notes will have the right to require the Company to repurchase the notes upon the occurrence of a change in control, as defined, at a price of 100% of the principal amount of the notes plus accrued interest and a make whole premium.

On or after May 1, 2009, Level 3, at its option, may redeem for cash all or a portion of the notes. The 10% Convertible Senior Notes are subject to redemption at the option of Level 3, in whole or in part, at any time or from time to time, on not more than sixty nor less than thirty days' notice, on or after May 1, 2009, 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
2009	103.330%
2010 and thereafter	101.670%

Debt issuance costs of \$3 million were originally capitalized and are being amortized to interest expense over the term of the 10% Convertible Senior Notes. As a result of amortization, the capitalized debt issuance costs have been reduced to \$1 million at December 31, 2006.

See Subsequent Events (Note 21) regarding the January 2007 debt for equity exchange of the Company's 10% Convertible Senior Notes due 2011.

3.5% Convertible Senior Notes due 2012

On June 13, 2006 Level 3 Communications, Inc. received \$326 million of net proceeds, after giving effect to offering expenses, from a public offering of \$335 million aggregate principal amount of its 3.5% Convertible Senior Notes due 2012 ("3.5% Convertible Senior Notes"). The 3.5% Convertible Senior Notes were priced at 100% of the principal amount. The notes are senior unsecured obligations of the Company, ranking equal in right of payment with all the Company's existing and future unsubordinated indebtedness. The 3.5% Convertible Senior Notes will mature on June 15, 2012. Interest on the notes will be payable semi-annually in arrears on June 15 and December 15 of each year, beginning on December 15, 2006.

At any time before the close of business on June 15, 2012, the 3.5% Convertible Senior Notes are convertible by holders into shares of Level 3's common stock at a conversion price of \$5.46 per share (subject to adjustment in certain events). This is equivalent to a conversion rate of approximately 183.1502 shares of common stock per \$1,000 principal amount of these notes. Upon conversion, the Company will have the right to deliver cash in lieu of shares of its common stock, or a combination of cash and shares of common stock. In addition, holders of the 3.5% Convertible Senior Notes will have the right to require the Company to repurchase the notes upon the occurrence of a change in control, as defined, at a price of 100% of the principal amount of the notes plus accrued interest. In addition, if a holder elects to convert its notes in connection with certain changes in control, Level 3 could be required to pay a make whole premium by increasing the number of shares deliverable upon conversion of the notes.

The 3.5% Convertible Senior Notes are subject to redemption at the option of Level 3, in whole or in part, at any time or from time to time, on not more than 60 nor less than 30 days' notice, on or after June 15, 2010, plus accrued and unpaid interest thereon (if any) to the redemption date, if redeemed during the twelve months beginning June 15, of the years indicated below:

Year	Redemption Price
2010	101.17%
2011	100.58%

Level 3 used a portion of the net proceeds from this offering and its common stock offering completed in the second quarter of 2006 to redeem certain debt securities maturing in 2008. The remaining proceeds were used for acquisitions and for general corporate purposes, including working capital and capital expenditures.

Debt issuance costs of \$9 million were originally capitalized and are being amortized to interest expense over the term of the 3.5% Convertible Senior Notes. As a result of amortization, the capitalized debt issuance costs have been reduced to approximately \$9 million at December 31, 2006.

9% Convertible Senior Discount Notes due 2013

In October 2003, Level 3 completed the exchange of approximately \$352 million (book value) of debt and accrued interest outstanding, as of October 24, 2003, for approximately 20 million shares of Level 3 common stock and \$208 million (book value) of a new issue of 9% Convertible Senior Discount Notes.

Level 3 Communications, Inc. issued \$295 million aggregate principal amount at maturity of 9% Convertible Senior Discount Notes. Interest on the 9% Convertible Senior Discount Notes accretes at a rate of 9% per annum, compounded semiannually, to an aggregate principal amount of \$295 million by October 15, 2007. Cash interest will not accrue on the 9% Convertible Senior Discount Notes prior to October 15, 2007; however, Level 3 Communications, Inc. may elect to commence the accrual of cash interest on all outstanding 9% Convertible Senior Discount Notes on or after October 15, 2004, in which case the outstanding principal amount at maturity of each 9% Convertible Senior Discount Note will, on the elected commencement date, be reduced to the accreted value of the 9% Convertible Senior Discount Note as of that date and cash interest shall be payable on that Note on April 15 and October 15 thereafter. Commencing October 15, 2007, interest on the 9% Convertible Senior Discount Notes will accrue at the rate of 9% per annum and will be payable in cash semiannually in arrears. Accrued interest expense for the year ended December 31, 2006 on the 9% Convertible Senior Discount Notes of less than \$1 million was added to long-term debt.

The 9% Convertible Senior Discount Notes are convertible into shares of the Company's common stock at a conversion rate of \$9.99 per share, subject to certain adjustments. The total number of shares issuable upon conversion will range from approximately 25 million to 30 million shares depending upon the total accretion prior to conversion. On or after October 15, 2008, Level 3, at its option, may redeem for

cash all or a portion of the notes. Level 3 may exercise this option only if the current market price for at least 20 trading days within any 30 consecutive trading day period exceeds 140% of the conversion price on October 15, 2008. This amount will be decreased to 130% and 120% on October 15, 2008 and 2009, respectively, if the initial holders sell greater than 33.33% of the notes. Level 3 is also obligated to pay the holders of the redeemed notes a cash amount equal to the present value of all remaining scheduled interest payments.

The 9% Convertible Senior Discount Notes will be subject to conversion into common stock at the option of the holder, in whole or in part, at any time or from time to time after 180 days after the issue date at the following conversion prices (expressed as percentages of accreted value) plus accrued and unpaid interest thereon to the conversion date, of the time periods indicated below:

<u>Year</u>	<u>Redemption Price</u>
October 15, 2006 - April 14, 2007	91.656%
April 15, 2007 - October 14, 2007	95.780%
October 15, 2007 and thereafter	100.090%

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.

6% Convertible Subordinated Notes due 2009

In September 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 previously redeemed, repurchased or 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. As of December 31, 2006, less than \$1 million of debt had been converted into shares of common stock. As of December 31, 2006, a total of \$461 million aggregate principal amount of the Subordinated Notes 2009 had been repurchased or exchanged for common stock.

Debt issuance costs of \$25 million were originally capitalized and are being amortized to 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 \$3 million at December 31, 2006.

6% Convertible Subordinated Notes due 2010

In February 2000, Level 3 Communications, Inc. 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.

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. As of December 31, 2006, no debt had been converted into shares of common stock. As of December 31, 2006, a total of \$350 million aggregate principal amount of the Subordinated Notes 2010 had been repurchased or exchanged for common stock.

Debt issuance costs of \$27 million were originally capitalized and are being amortized to 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 \$5 million at December 31, 2006.

Commercial Mortgage

In the third quarter of 2005, the Company completed a refinancing of the mortgage on its corporate headquarters. On September 27, 2005, HQ Realty, Inc. entered into a \$70 million loan at an initial fixed rate of 6.86% through 2010, the anticipated repayment date as defined in the loan agreement ("CBRE Commercial Mortgage"). After 2010 through maturity in 2015, the interest rate will adjust to the greater of 9.86% or the five year U.S. Treasury rate plus 300 basis points. HQ Realty, Inc. received \$66 million of net proceeds after transaction costs and has deposited \$4 million into restricted cash accounts for future facility improvements and property taxes. HQ Realty, Inc. was required to make interest only payments in the first year and began making monthly principal payments in the second year based on a 30-year amortization schedule.

Debt issuance costs of \$1 million were capitalized and are being amortized as interest expense over the term of the CBRE Commercial Mortgage. As a result of amortization, the capitalized debt issuance costs have been reduced to \$1 million at December 31, 2006.

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 and its subsidiaries other than HQ Realty, Inc. are not available to satisfy the obligations of HQ Realty, Inc.

Capital Leases

As part of the Progress Telecom transaction completed on March 20, 2006, the Company assumed certain capital lease obligations of Progress Telecom for IRU dark fiber facilities of \$9 million. The capital leases mature at various dates through 2021. As of December 31, 2006 the capital lease obligation is \$8 million.

As part of the ICG Communications transaction on May 31, 2006, the Company assumed certain capital lease obligations of ICG Communications for IRU dark fiber facilities of \$3 million. The capital leases mature at various dates through 2018. As of December 31, 2006 the capital lease obligation is approximately \$3 million.

As part of the TelCove transaction completed on July 24, 2006, the Company assumed certain capital lease obligations of TelCove primarily for IRU dark fiber facilities of \$13 million. The capital leases mature at various dates through December 2030. As of December 31, 2006 the capital lease obligation is approximately \$12 million.

Future Debt Maturities:

The Company's contractual obligations as of December 31, 2006 related to debt, including capital leases and excluding issue discounts and fair value adjustments will require estimated cash payments during each of the five succeeding years as follows: 2007—\$5 million; 2008—\$148 million; 2009—\$365 million; 2010—\$2,369 million, 2011—\$2,110 million and \$2,420 million thereafter.

(14) Asset Retirement Obligations

Asset retirement obligation accretion expense of \$24 million, \$13 million and \$11 million was recorded during the years ended December 31, 2006, 2005 and 2004, respectively; resulting in total asset retirement obligations, including reclamation costs for the coal business, of \$202 million and \$181 million at December 31, 2006 and 2005, respectively. The total asset retirement obligation as of December 31, 2006 includes \$46 million of asset retirement obligation related to WilTel, ICG Communications and Looking Glass. The total asset retirement obligation as of December 31, 2005 includes WilTel's asset retirement obligation of \$35 million.

Expense of \$21 million related to the communications business was recorded in selling, general and administrative expenses on the consolidated statement of operations for the year ended December 31, 2006. In addition, expense of \$3 million related to the Company's coal mining business was recorded in cost of revenue on the consolidated statement of operations for the year ended December 31, 2006. This was partially offset by less than \$1 million of gains recognized on settlement of obligations attributable to the use of internal resources rather than third parties to perform reclamation work. In addition, the coal mining business incurred \$2 million of additional reclamation liabilities as a result of expanded mining activities and incurred \$3 million of costs for work performed to remediate previously mined properties.

Level 3 recorded a reduction in the 2006 depreciation expense totaling approximately \$5 million as a result of a change in the estimated future asset retirement obligation costs associated with its 50% interest in the Decker coal mine. In accordance with SFAS No. 143, Level 3 recorded the full impact of the change in estimate in the current period.

Expense of \$10 million related to the communications business was recorded in selling, general and administrative expenses on the consolidated statement of operations for the year ended December 31, 2005. In addition, expense of \$3 million related to the Company's coal mining business was recorded in cost of revenue on the consolidated statement of operations for the year ended December 31, 2005. In addition, the coal mining business incurred \$3 million of additional reclamation liabilities as a result of expanded mining activities and incurred \$2 million of costs for work performed to remediate previously mined properties.

Expense of \$7 million related to the communications business was recorded in selling, general and administrative expenses on the consolidated statement of operations for the year ended December 31, 2004. Expense of \$4 million related to the Company's coal mining business was recorded in cost of revenue on the consolidated statement of operations for the year ended December 31, 2004. In addition, the coal mining business incurred \$4 million of additional reclamation liabilities as a result of expanded mining activities and incurred \$1 million of costs for work performed to remediate previously mined properties.

The Company had noncurrent restricted cash of approximately \$59 million and \$56 million set aside to fund the reclamation liabilities at December 31, 2006 and 2005, respectively.

(15) Employee Benefit Plans

The Company adopted the recognition provisions of SFAS No. 123 in 1998. 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 was amortized over the vesting periods of the options.

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 may not be settled in cash, but rather, are generally settled through issuance of common stock.

Beginning January 1, 2006, the Company adopted SFAS No. 123R. SFAS No. 123R requires that estimated forfeitures be factored in the amount of expense recognized for awards that are not fully vested. The Company has historically recorded the effect of forfeitures of equity awards as they occur. The effect of applying the change from the original provisions of SFAS No. 123 on the Company's results of operations, basic and diluted earnings per share and cash flows for the year ended December 31, 2006 was not material.

The adoption of SFAS No. 123 has resulted in material non-cash charges to operations since its adoption in 1998, and the adoption of SFAS No. 123R on January 1, 2006 will continue to result in material non-cash charges to operations in the future. The amount of the non-cash charges will be dependent upon a number of factors, including the number of grants, the fair value of each grant estimated at the time of its award and the number of grants that ultimately vest.

The Company recognized in net loss from continuing operations a total of \$84 million, \$51 million and \$43 million of non-cash compensation in 2006, 2005 and 2004, respectively. Included in discontinued operations is non-cash compensation expense of \$2 million, \$6 million and \$3 million in 2006, 2005 and 2004, respectively. During the second quarter of 2006, the October 2005 and January 2006 grants were revalued using May 15, 2006 as the grant date, in accordance with SFAS No. 123R, which resulted in an additional \$6 million increase in non-cash compensation expense. As stated in the Company's proxy materials for its 2006 Annual Meeting of Stockholders, over the course of the years since April 1, 1998, the compensation committee of the Company's Board of Directors had administered the 1995 Stock Plan under the belief that the action of the Company's Board of Directors to amend and restate the plan effective April 1, 1998 had the effect of extending the original term of the Plan to April 1, 2008. After a further review of the terms of the plan, however, the compensation committee determined that an ambiguity could have existed that may have resulted in an interpretation that the expiration date of the plan was September 25, 2005. To remove any ambiguity, the Board of Directors sought the approval of the Company's stockholders to amend the plan to extend the term of the plan by five years to September 25, 2010. This approval was obtained at the 2006 Annual Meeting of Stockholders held on May 15, 2006. In addition, the Company capitalized \$2 million a year in 2006, 2005 and 2004, respectively, of non-cash compensation for those employees and contractors directly involved in the construction of the network, installation of customers or development of the business support systems.

SFAS No. 123R requires the benefit of tax deductions in excess of recognized compensation expense be reported as a financing cash flow if the tax benefits are expected to be realizable. As the Company is currently in a net operating loss position and does not expect to generate net income in the near term, Level 3's management does not expect to realize tax benefits from share-based compensation for the foreseeable future.

The following table summarizes non-cash compensation expense and capitalized non-cash compensation for each of the three years ended December 31, 2006.

	2006	2005	2004
	(dollars in millions)		
OSO	\$ 38	\$ 18	\$ 16
C-OSO	—	—	1
Restricted Stock	20	19	4
Shareworks Match Plan	—	(2)	4
401(k) Match Expense	18	15	18
401(k) Discretionary Grant Plan	12	9	5
	88	59	48
Capitalized Noncash Compensation	(2)	(2)	(2)
	86	57	46
Discontinued Operations	(2)	(6)	(3)
	<u>\$ 84</u>	<u>\$ 51</u>	<u>\$ 43</u>

Non-qualified Stock Options and Warrants

The Company has not granted non-qualified stock options (“NQSOs”) since 2000. As of December 31, 2006, all NQSOs previously granted were fully vested and the compensation expense had been fully recognized in the consolidated statements of operations. At December 31, 2006, there were approximately 4.9 million NQSOs outstanding with exercise prices ranging from \$1.76 to \$8.00. The weighted average exercise price of the NQSOs outstanding was \$5.79 at December 31, 2006.

Transactions involving NQSOs granted are summarized as follows:

	Units	Exercise Price Per Unit	Weighted Average Exercise Price	Aggregate Intrinsic Value (in millions)
Balance December 31, 2003	8,921,364	\$0.12 - \$84.75	\$ 5.95	
Options granted	—	—	—	
Options cancelled	(361,500)	5.43 - 84.75	8.23	
Options exercised	—	—	—	
Balance December 31, 2004	8,559,864	0.12 - 21.69	5.85	Less than \$1.0
Options granted	—	—	—	
Options cancelled	(606,150)	5.43 - 8.00	6.00	
Options exercised	(61,168)	0.12 - 0.12	0.12	
Options expired	(1,746,500)	4.04 - 21.69	6.36	
Balance December 31, 2005	6,146,046	1.76 - 8.00	5.75	Less than \$1.0
Options granted	—	—	—	
Options cancelled	(553,248)	1.76 - 8.00	6.29	
Options exercised	(689,250)	4.95 - 5.43	4.97	
Options expired	—	—	—	
Balance December 31, 2006	<u>4,903,548</u>	<u>\$1.76 - \$8.00</u>	<u>\$ 5.79</u>	<u>\$ 1.0</u>
Options exercisable:				
December 31, 2004	8,559,864	\$0.12 - \$21.69	\$ 5.85	
December 31, 2005	6,146,046	1.76 - 8.00	5.75	
December 31, 2006	4,903,548	\$1.76 - \$8.00	\$ 5.79	

Range of Exercise Prices	Number Outstanding as of December 31, 2006	Options Outstanding and Exercisable Weighted Average Remaining Life (years)	Weighted Average Exercise Price
\$1.76 – \$1.76	2,348	1.28	\$ 1.76
5.43 – 5.43	3,654,825	0.78	5.43
\$6.20 – \$8.00	1,246,375	1.06	6.89
	<u>4,903,548</u>	0.85	\$ 5.79

At December 31, 2006, there were approximately 14.6 million warrants outstanding ranging in exercise price from \$4.00 to \$29.00. As of December 31, 2006, all of the warrants previously granted were fully vested and the compensation expense had been fully recognized in the consolidated statements of operations. Of these warrants, all were exercisable at December 31, 2006, with a weighted average exercise price of \$7.79 per warrant.

During the second quarter of 2004, the Company issued approximately 374,000 warrants to a consultant as payment for future consulting financial advisory services. The warrants allow the consultant to purchase common stock at \$4.00 per share. The warrants vested equally in quarterly installments over twelve months. The warrants expire on April 1, 2011. The Company recorded less than \$1 million of expense during 2004 for these warrants. As of December 31, 2004, these warrants were fully expensed.

Outperform Stock Options

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 Company’s common stock price outperforms the S&P 500 Index during the life of the grant. 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 500 Index for grants awarded before September 30, 2005), the value received for awards under the OSO plan is based on a formula involving a multiplier related to the level by which the Company’s common stock outperforms the S&P 500 Index. To the extent that Level 3’s common stock outperforms the S&P 500 Index, the value of OSO units to a holder may exceed the value of nonqualified stock options.

In August 2002, the Company modified the OSO program as follows:

- OSO targets are communicated in terms of number of OSO units rather than a theoretical dollar value.
- The success multiplier was reduced from eight to four.
- Awards will vest over 2 years and have a 4-year life. Fifty percent of the award will vest at the end of the first year after grant, with the remaining 50% vesting over the second year (12.5% per quarter).

The initial strike price, as determined on the day prior to the OSO grant date, is adjusted over time (the “Adjusted Strike Price”), until the exercise date. The adjustment is an amount equal to the percentage appreciation or depreciation in the value of the S&P 500 Index from the date of grant to the date of exercise. The value of the OSO increases for increasing levels of outperformance. OSO units outstanding

at December 31, 2006 have a multiplier range from zero to four depending upon the performance of Level 3 common stock relative to the S&P 500 Index as shown in the following table.

If Level 3 Stock Outperforms the S&P 500 Index by:	Then the Pre-multiplier Gain Is Multiplied by a Success Multiplier of:
0% or Less	0.00
More than 0% but Less than 11%	Outperformance percentage multiplied by 4/11
11% or More	4.00

The Pre-multiplier gain is the Level 3 common stock price minus the Adjusted Strike Price on the date of exercise.

Upon exercise of an OSO, the Company shall deliver or pay to the grantee the difference between the Fair Market Value of a share of Level 3 common stock as of the day prior to the exercise date, less the Adjusted Strike Price, the "Exercise Consideration". The Exercise Consideration may be paid in cash, Level 3 common stock or any combination of cash or Level 3 common stock at the Company's discretion. The number of shares of Level 3 common stock to be delivered by the Company to the grantee is determined by dividing the Exercise Consideration to be paid in Level 3 common stock by the Fair Market Value of a share of Level 3 common stock as of the date prior to the exercise date. Fair Market Value is defined in the OSO agreement, but is currently the closing price per share of Level 3 common stock on the NASDAQ exchange. Exercise of the OSO units does not require any cash outlay by the employee.

OSO awards are granted quarterly to eligible participants. Awards outstanding at December 31, 2006 have a 4-year life and vest 50% at the end of the first year after the grant, with the remaining 50% vesting over the second year (12.5% per quarter).

The fair value of the OSO units granted is calculated by applying a modified Black-Scholes model with the assumptions identified below. The Company utilized a modified Black-Scholes model due to the additional variables required to calculate the impact of the success multiplier of the OSO program. Beginning January 1, 2006, as a result of the adoption of SFAS No. 123R, the Company also considers the estimated forfeiture rate to measure the value of outperform stock options granted to employees. The Company believes that given the relative short life of the options and the other variables used in the model, the modified Black-Scholes model provides a reasonable estimate of the fair value of the OSO units at the time of grant.

	Year Ended December 31,		
	2006	2005	2004
S&P 500 Expected Dividend Yield Rate	1.78%	1.99%	1.54%
Expected Life	3.4 years	2 years	2 years
S&P 500 Expected Volatility Rate	12%	13%	15%
Level 3 Common Stock Expected Volatility Rate	55%	55%	56%
Expected S&P 500 Correlation Factor	.28	.30	.19
Calculated Theoretical Value	153%	116%	120%
Estimated Forfeiture Rate	10.19%	—	—

The fair value of each OSO grant equals the calculated theoretical value multiplied by the Level 3 common stock price on the grant date.

The expected life data was stratified based on levels of responsibility within the Company. The theoretical value used in 2006 was determined using the weighted average exercise behavior for these groups of employees. Upon adoption of SFAS No. 123R, the Company updated its calculation of the Expected Life. Volatility assumptions were derived using historical data as well as current market data.

As part of a comprehensive review of its long-term compensation program, the Company temporarily suspended awards of OSO units in April 2005. During the second quarter of 2005, the Company granted participants in the plan restricted stock units, discussed below.

Beginning in the third quarter 2005, the Company issued both restricted stock units and OSO units as part of its long-term compensation program. In the third quarter of 2005, the Company made a grant for 2005 of restricted stock units that vest ratably over four years.

The fair value under SFAS No. 123 and SFAS No. 123R for the approximately 8 million, 6 million and 5 million OSO units awarded to participants during the year ended December 31, 2006, 2005 and 2004, respectively, was approximately \$50 million, \$18 million and \$22 million, respectively. As of December 31, 2006, the Company had not reflected \$26 million of unamortized compensation expense in its financial statements for previously granted OSO units. The weighted average period over which this cost will be recognized is 1.48 years.

Transactions involving OSO units awarded are summarized in the table below. The Option Price Per Unit identified in the table below represents the initial strike price, as determined on the day prior to the OSO grant date for those grants.

	Units	Initial Strike Price Per Unit	Weighted Average Initial Strike Price	Aggregate Intrinsic Value (in millions)	Weighted Average Remaining Contractual Term
Balance December 31, 2003	21,483,414	\$ 2.45 - \$113.87	\$ 15.36		
Options granted	5,394,056	2.59 - 5.70	3.36		
Options cancelled	(211,876)	2.45 - 113.87	4.80		
Options expired	(4,873,816)	3.02 - 113.87	41.94		
Options exercised	(430,256)	2.45 - 5.58	3.64		
Balance December 31, 2004	21,361,522	2.45 - 25.31	6.61	\$ 5.3	1.59 years
Options granted	5,859,066	2.03 - 3.39	2.61		
Options cancelled	(1,048,494)	2.03 - 25.31	3.00		
Options expired	(11,841,490)	2.59 - 25.31	8.91		
Options exercised	(84,628)	2.45 - 3.02	2.86		
Balance December 31, 2005	14,245,976	2.03 - 6.66	3.34	\$ 9.3	2.34 years
Options granted	8,092,915	2.87 - 5.39	4.49		
Options cancelled	(1,101,849)	2.03 - 6.66	3.71		
Options expired	(3,010,367)	2.03 - 6.66	3.62		
Options exercised	(2,941,180)	2.03 - 4.44	2.97		
Balance December 31, 2006	<u>15,285,495</u>	<u>\$ 2.03 - \$6.66</u>	\$ 3.93	\$ 82.7	2.54 years
Options exercisable ("vested"):					
December 31, 2004	15,507,847	\$ 2.45 - \$25.31	\$ 7.75		
December 31, 2005	8,453,296	2.59 - 6.66	3.88		
December 31, 2006	7,903,200	\$ 2.03 - \$6.66	\$ 3.48	\$ 52.5	1.78 years

Range of Exercise Prices	OSO units Outstanding at December 31, 2006			OSO units Exercisable at December 31, 2006	
	Number Outstanding	Weighted Average Remaining Life (years)	Weighted Average Initial Strike Price	Number Exercisable	Weighted Average Initial Strike Price
\$2.03 - \$3.02	5,422,623	2.61	\$ 2.46	3,673,073	\$ 2.43
3.39 - 4.90	4,744,598	2.22	4.02	2,897,904	3.76
5.16 - 6.66	5,118,274	2.76	5.41	1,332,223	5.75
	<u>15,285,495</u>	2.54	\$ 3.93	<u>7,903,200</u>	\$ 3.48

In the table above, the weighted average initial strike price represents the values used to calculate the theoretical value of OSO units on the grant date and the intrinsic value represents the value of OSO units that have outperformed the S&P 500 Index as of December 31, 2006.

The total realized value of OSO units exercised for the years ended December 31, 2006, 2005 and 2004 were \$20 million, \$6 million and \$10 million, respectively. For the twelve months ended December 31, 2006, 2005 and 2004, respectively, the Company issued 3.8 million, 2.7 million and 2.1 million shares of Level 3 common stock upon the exercise of OSO units. The number of shares of Level 3 stock issued upon exercise of an OSO unit varies based upon the relative performance of Level 3's stock price and the S&P 500 Index between the initial grant date and exercise date of the OSO unit.

At December 31, 2006, based on the Level 3 common stock price and post-multiplier values, the Company was obligated to issue 9.4 million shares for vested and exercisable OSOs as the percentage increase in the S&P 500 Index exceeded the percentage increase in the Level 3 stock price for all grants.

In July 2000, the Company adopted a convertible outperform stock option program ("C-OSO") as an extension of the existing OSO plan. The program was a component of the Company's ongoing employee retention efforts and offered similar features to those of an OSO, but provided 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 vested 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 vested in equal quarterly installments over three years. Each award was immediately exercisable upon vesting. Awards expired four years from the date of the grant.

As of December 31, 2005, the Company had fully amortized the compensation expense in its financial statements for C-OSO units awarded in 2000 and 2001. The final series of C-OSO units granted to employees expired in 2005. There are no C-OSO units outstanding at December 31, 2005.

Transactions involving C-OSO units are summarized below:

	Units	Option Price Per Unit	Weighted Average Option Price
Balance December 31, 2003	4,064,682	\$ 3.82 - \$ 87.23	\$ 15.38
Options cancelled	(24,029)	3.82 - 87.23	3.82
Options expired	(101,096)	3.82 - 87.23	33.38
Options exercised	(1,162,778)	3.82 - 87.23	41.67
Balance December 31, 2004	2,776,779	3.82 - 3.82	3.82
Options cancelled	—	—	—
Options expired	(137,980)	3.82 - 3.82	3.82
Options exercised	(2,638,799)	3.82 - 3.82	3.82
Balance December 31, 2005	—	\$ —	\$ —
Options exercisable:			
December 31, 2004	2,776,779	\$ 3.82 - 3.82	\$ 3.82
December 31, 2005	—	—	—

Restricted Stock and Units

In 2006, 2005 and 2004, approximately 5.9 million, 24.6 million and 0.8 million restricted stock shares or restricted stock units, respectively, were awarded to employees and non-employee members of the Board of Directors. The restricted stock units and shares were granted to the recipients at no cost. Restrictions on transfer lapse over one to four year periods. The fair value of restricted stock units and shares awarded in 2006 of \$27 million was calculated using the value of the Level 3 common stock on the grant date and is being amortized over the restriction lapse periods of the awards. The fair value of restricted stock units and shares awarded in 2005 and 2004 of \$50 million and \$2 million, respectively, was calculated using the value of the Level 3 common stock the day prior to the award and is being amortized over the restriction lapse periods of the awards. As of December 31, 2006, the total compensation cost related to nonvested restricted stock or restricted stock units not yet recognized was \$29 million, and the weighted average period over which this cost will be recognized is 2.9 years.

The changes in restricted stock and restricted stock units are shown in the following table:

	Number	Weighted Average Grant Date Fair Value
Nonvested at December 31, 2003	787,358	\$ 5.35
Stock and units granted	696,947	3.52
Lapse of restrictions	(472,020)	5.42
Stock and units forfeited	(32,128)	4.15
Nonvested at December 31, 2004	980,157	4.05
Stock and units granted	24,627,233	2.03
Lapse of restrictions	(719,716)	3.80
Stock and units forfeited	(1,510,831)	2.12
Nonvested at December 31, 2005	23,376,843	2.06
Stock and units granted	5,874,765	4.65
Lapse of restrictions	(7,225,744)	2.13
Stock and units forfeited	(2,575,137)	2.45
Nonvested at December 31, 2006	19,450,727	\$ 2.76

The Weighted Average Grant Date Fair Value of restricted stock and restricted stock units granted during the years ended December 31, 2006, 2005 and 2004 were \$4.65, \$2.03 and \$3.52, respectively. The

total fair value of restricted stock and restricted stock units vested during the years ended December 31, 2006, 2005 and 2004 was \$15 million, \$2 million and \$2 million, respectively.

Shareworks and 401(k) Plans

The Company had two plans under its Shareworks program: the Match Plan and the Grant Plan. In December 2002, in order to provide employees opportunities to diversify their investments in Company-sponsored savings and retirement plans, the Company decided to enhance the 401(k) plan by introducing a Company match on employee contributions. At the same time the Company determined that, effective January 1, 2003, the Shareworks Match Plan would be discontinued and the Shareworks Grant Plan would be rolled into the 401(k) plan.

Match Plan—The Match Plan was suspended on January 1, 2003. Prior to this date, the Match Plan allowed eligible employees to defer between 1% and 7% of their eligible compensation to purchase Level 3 common stock at the average stock price for the quarter. Full time employees of the communications business and certain information services businesses were considered eligible on the first day of the calendar quarter after their hire. The Company matched the shares purchased by the employee on a one-for-one basis. Stock purchased with payroll deductions was fully vested. Stock purchased with the Company's matching contributions vested three years after the end of the quarter in which it was made. Effective January 1, 2003, past contributions to the Match Plan continued to vest, however, there will be no further contributions to the Plan by employees or the Company.

The Company's quarterly matching contribution was amortized to compensation expense over the vesting period of 36 months.

As of December 31, 2005 the Company had fully amortized to compensation expense the value of the matching contributions and all matching contributions were fully vested. During the second quarter of 2005, the Company reversed \$3 million of non-cash expense in Europe attributable to the discontinuance of certain equity compensation programs.

401(k) Plan—The Company and its subsidiaries offer their 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 ("401(k) Plan"). Each employee is eligible to contribute, on a tax deferred basis, a portion of annual earnings generally not to exceed \$15,000 in 2006. The Company matches 100% of employee contributions up to 7% of eligible earnings or applicable regulatory limits for employees of the communications businesses.

The Company's matching contributions are made with Level 3 common stock based on the closing stock price on each pay date. Employees are able to diversify the Company's matching contribution as soon as it is made, even if they are not fully vested. The Company's matching contributions will vest ratably over the first three years of service or over such shorter period until the employee has completed three years of service at such time the employee is then 100% vested in all Company matching contributions. The Company made 401(k) Plan matching contributions of \$18 million, \$14 million and \$18 million for the year ended December 31, 2006, 2005 and 2004, respectively. The Company's matching contributions were recorded as selling, general and administrative expenses.

The Company made a discretionary contribution to the 401(k) plan in Level 3 common stock for the years ended December 31, 2006, 2005 and 2004 equal to three percent, three percent and two percent of eligible employees' earnings each year, respectively. The 2006 deposit is expected to be made into the employees' 401(k) accounts during the first quarter of 2007. The 2005 and 2004 deposits were made into the employees' 401(k) accounts during the first quarter of the subsequent year. Level 3 recorded an expense of \$11 million, \$8 million and \$7 million attributable for the discretionary contribution in 2006, 2005 and 2004, respectively.

The WilTel Communications employees began contributing to the Level 3 plan on June 17, 2006. On July 3, 2006, the WilTel Communications plan assets were merged into the Level 3 plan. Prior to June 17, 2006, employees of WilTel Communications that participated in the WilTel 401(k) Plan received an employer matching cash contribution of 100% of employee contributions up to 6% of eligible earnings or regulatory limits. The Company made matching cash contributions of \$3 million for the period from January 1 through June 16, 2006.

The Progress Telecom employees began contributing to the Level 3 plan on March 20, 2006. The Progress Telecom plan assets were merged into the Level 3 plan on August 7, 2006.

The ICG Communications employees began contributing to the Level 3 plan on July 1, 2006. There were no matching cash contributions for ICG Communications for the period of May 31, 2006, the date of acquisition, through July 1, 2006. The ICG Communications plan assets were merged into the Level 3 plan on September 1, 2006.

The TelCove and Looking Glass employees began contributing to the Level 3 plan on August 4, 2006 and September 9, 2006, respectively. The matching cash contributions made to the TelCove and Looking Glass plans for the period from the respective acquisition dates to the dates employees began contributing to the Level 3 plan was less than \$1 million each for TelCove and Looking Glass, respectively. The Looking Glass plan assets were merged into the Level 3 plan on November 1, 2006. The Company merged the TelCove plan assets into the Level 3 plan on January 2, 2007.

(16) Income Taxes

An analysis of the income tax provision attributable to loss from continuing operations before income taxes for each of the three years ended December 31, 2006 follows:

	2006	2005	2004
	(dollars in millions)		
Current:			
United States Federal	\$ —	\$ (4)	\$ —
State	—	—	(1)
Foreign	(2)	(1)	—
	(2)	(5)	(1)
Deferred, net of changes in valuation allowances:			
United States Federal	—	—	—
State	—	—	—
Foreign	—	—	—
	—	—	—
Income Tax Provision	<u>\$ (2)</u>	<u>\$ (5)</u>	<u>\$ (1)</u>

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

	2006	2005	2004
	(dollars in millions)		
United States	\$ (710)	\$ (717)	\$ (300)
Foreign	(78)	15	(177)
	<u>\$ (788)</u>	<u>\$ (702)</u>	<u>\$ (477)</u>

A reconciliation of the actual income tax provision and the tax computed by applying the U.S. federal rate (35%) to the loss from continuing operations before income taxes for each of the three years ended December 31, 2006 follows:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
	(dollars in millions)		
Computed Tax Benefit at Statutory Rate	\$ 276	\$ 246	\$ 167
State Income Tax Benefit	26	23	16
Stock Option Plan Exercises	3	(3)	(19)
Taxes on Extinguishments of Debt	(3)	—	(1)
Other	—	(11)	33
Change in Valuation Allowance	(304)	(260)	(197)
Income Tax Provision	<u>\$ (2)</u>	<u>\$ (5)</u>	<u>\$ (1)</u>

The components of the net deferred tax assets (liabilities) for the years ended December 31, 2006 and 2005 were as follows:

	<u>2006</u>	<u>2005</u>
	(dollars in millions)	
Deferred Tax Assets:		
Fixed assets	\$ 630	\$ 790
Accrued payroll and related benefits	309	299
Investment in securities	24	27
Investment in joint ventures	89	82
Unutilized tax net operating losses	2,673	2,249
Other assets or liabilities	30	38
Total Deferred Tax Assets	<u>3,755</u>	<u>3,485</u>
Deferred Tax Liabilities:		
Accrued liabilities and deferred revenue	(158)	(105)
Intangible assets from acquisitions	(72)	—
Total Deferred Tax Liabilities	<u>(230)</u>	<u>(105)</u>
Net Deferred Tax Assets before valuation allowance	3,525	3,380
Valuation Allowance Components:		
Net Deferred Tax Assets	(3,450)	(3,305)
Stockholders' Equity (primarily tax benefit from option exercises)	(75)	(75)
Net Non-Current Deferred Tax Assets after Valuation Allowance	<u>\$ —</u>	<u>\$ —</u>

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. 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. The change in valuation allowance of \$304 million in the reconciliation of the computed tax benefit at statutory rate to the actual income tax provision excludes the reduction of valuation allowance associated with net deferred tax liabilities of businesses acquired during 2006 and the NOL utilized to offset the taxable gain on sale of Software Spectrum. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. The Company considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment.

For federal income tax reporting purposes, the Company has approximately \$7.0 billion of net operating loss carryforwards at December 31, 2006, net of previous carrybacks, available to offset future federal taxable income.

The net operating loss carryforwards expire through 2026 and are subject to examination by the tax authorities. The U.S. net operating loss carryforwards expire as follows (dollars in millions):

Expiring December 31	Amount
2018	\$ 3
2019	2
2020	660
2021	978
2022	1,329
2023	1,001
2024	974
2025	1,346
2026	741
	<u>\$ 7,034</u>

In addition, the Company has approximately \$52 million of net operating loss carryforwards for foreign locations at December 31, 2006, the majority of which have no expiration period.

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. If certain transactions occur with respect to Level 3's capital stock that result in a cumulative ownership change of more than 50 percentage points by 5-percent stockholders over a three-year period as determined under rules prescribed by the U.S. Internal Revenue Code and applicable regulations, annual limitations would be imposed with respect to our ability to utilize our net operating loss carryforwards and certain current deductions against any taxable income it achieves in future periods.

As of December 31, 2006, the Company has no plans to repatriate undistributed earnings of foreign subsidiaries as any earnings are deemed necessary to fund ongoing European operations and planned expansion. Undistributed earnings of foreign subsidiaries that are permanently invested, and for which no deferred taxes have been provided, amounted to zero and \$15 million as of December 31, 2006 and 2005, respectively.

(17) Stockholders' Equity

During 2006, Level 3 completed the sale of 125 million shares of its common stock, par value \$0.01 per share, at \$4.55 per share in an underwritten public offering. Level 3 received proceeds of \$543 million net of \$26 million in transaction costs.

During 2004, the Company's stockholders approved a proposal at the Company's 2004 annual meeting for the reservation of an additional 80 million shares of common stock under the Company's 1995 Stock Plan.

The Level 3 1995 Stock Plan permits option holders to tender shares to the Company to cover income taxes due on option exercises.

Issuances of common stock, for option exercises, equity offerings and acquisitions for the three years ended December 31, 2006 are shown below.

	Outstanding Common Shares
December 31, 2003	677,828,634
Option, Shareworks and 401(k) Activity	8,668,087
December 31, 2004	686,496,721
Option, Shareworks and 401(k) Activity	16,271,097
WilTel Communications Group, LLC Acquisition	115,000,000
December 31, 2005	817,767,818
Equity Offering	125,000,000
Option, Shareworks and 401(k) Activity	18,737,450
2006 Acquisitions	216,917,837
December 31, 2006	<u>1,178,423,105</u>

(18) 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 separate strategic business units that offer different products and serve different markets. The Company’s current reportable segments include: communications and coal mining (See Note 1). Other primarily includes corporate assets and overhead not attributable to a specific segment. In the third quarter of 2006, the Company exited the information services business as a result of the sale of Software Spectrum. Segment information has been revised due to reclassification of the information services businesses as discontinued operations in the consolidated financial statements (See Note 3).

Adjusted OIBDA, as defined by the Company, consists of operating income (loss) before (1) depreciation and amortization expense, (2) stock-based compensation expense included within selling, general and administrative expenses on the consolidated statements of operations and (3) any non-cash impairment costs included within restructuring and impairment expenses all as reported on the consolidated statements of operations. The Company excludes stock-based compensation due to the recording of non-cash compensation expense under the provisions of SFAS No. 123R. Adjusted OIBDA is an important part of the Company’s internal reporting and is an indicator of profitability and operating performance used by the chief operating decision maker or decision making group to evaluate performance and allocate resources. It is a commonly used indicator in the capital-intensive communications industry to analyze companies on the basis of operating performance over time. Adjusted OIBDA is not intended to represent net income or cash flow for the periods presented, is not calculated consistently with the commonly used metric “EBITDA”, and is not recognized under generally accepted accounting principles (“GAAP”) but is used by management to assess segment results and allocate resources.

The data presented in the following tables includes information for the twelve months ended December 31, 2006, 2005 and 2004 for all statement of operations and cash flow information presented, and as of December 31, 2006 and 2005 for all balance sheet information presented. Information related to the acquired businesses is included from their respective acquisition dates. 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 to the 2006 presentation.

	<u>Communications</u>	<u>Coal Mining</u>	<u>Other</u>	<u>Total</u>
	(dollars in millions)			
2006				
Revenue:				
North America	\$ 3,121	\$ 67	\$ —	\$ 3,188
Europe	190	—	—	190
Asia	—	—	—	—
	<u>\$ 3,311</u>	<u>\$ 67</u>	<u>\$ —</u>	<u>\$ 3,378</u>
Adjusted OIBDA:				
North America	\$ 636	\$ 8	\$ (3)	
Europe	41	—	—	
Asia	—	—	—	
	<u>\$ 677</u>	<u>\$ 8</u>	<u>\$ (3)</u>	
Net Capital Expenditures:				
North America	\$ 346	\$ 1	\$ —	\$ 347
Europe	45	—	—	45
Asia	—	—	—	—
	<u>\$ 391</u>	<u>\$ 1</u>	<u>\$ —</u>	<u>\$ 392</u>
Depreciation and Amortization:				
North America	\$ 661	\$ 1	\$ —	\$ 662
Europe	68	—	—	68
Asia	—	—	—	—
	<u>\$ 729</u>	<u>\$ 1</u>	<u>\$ —</u>	<u>\$ 730</u>
	<u>Communications</u>	<u>Coal Mining</u>	<u>Other</u>	<u>Total</u>
	(dollars in millions)			
2005				
Revenue:				
North America	\$ 1,496	\$ 74	\$ —	\$ 1,570
Europe	149	—	—	149
Asia	—	—	—	—
	<u>\$ 1,645</u>	<u>\$ 74</u>	<u>\$ —</u>	<u>\$ 1,719</u>
Adjusted OIBDA:				
North America	\$ 437	\$ 16	\$ (3)	
Europe	21	—	—	
Asia	—	—	—	
	<u>\$ 458</u>	<u>\$ 16</u>	<u>\$ (3)</u>	
Net Capital Expenditures:				
North America	\$ 271	\$ 2	\$ —	\$ 273
Europe	27	—	—	27
Asia	—	—	—	—
	<u>\$ 298</u>	<u>\$ 2</u>	<u>\$ —</u>	<u>\$ 300</u>
Depreciation and Amortization:				
North America	\$ 560	\$ 5	\$ —	\$ 565
Europe	82	—	—	82
Asia	—	—	—	—
	<u>\$ 642</u>	<u>\$ 5</u>	<u>\$ —</u>	<u>\$ 647</u>

	<u>Communications</u>	<u>Coal Mining</u>	<u>Other</u>	<u>Total</u>
	(dollars in millions)			
2004				
Revenue:				
North America	\$ 1,546	\$ 91	\$ —	\$ 1,637
Europe	139	—	—	139
Asia	—	—	—	—
	<u>\$ 1,685</u>	<u>\$ 91</u>	<u>\$ —</u>	<u>\$ 1,776</u>
Adjusted OIBDA:				
North America	\$ 459	\$ 18	\$ (1)	
Europe	4	—	—	
Asia	—	—	—	
	<u>\$ 463</u>	<u>\$ 18</u>	<u>\$ (1)</u>	
Net Capital Expenditures:				
North America	\$ 240	\$ 2	\$ —	\$ 242
Europe	30	—	—	30
Asia	—	—	—	—
	<u>\$ 270</u>	<u>\$ 2</u>	<u>\$ —</u>	<u>\$ 272</u>
Depreciation and Amortization:				
North America	\$ 571	\$ 6	\$ —	\$ 577
Europe	94	—	—	94
Asia	—	—	—	—
	<u>\$ 665</u>	<u>\$ 6</u>	<u>\$ —</u>	<u>\$ 671</u>

	<u>Communications</u>	<u>Discontinued Information Services</u>	<u>Coal Mining</u>	<u>Other</u>	<u>Total</u>
	(dollars in millions)				
Identifiable Assets					
<i>December 31, 2006</i>					
North America	\$ 7,193	\$ —	\$ 98	\$ 1,897	\$ 9,188
Europe	777	—	—	29	806
Asia	—	—	—	—	—
	<u>\$ 7,970</u>	<u>\$ —</u>	<u>\$ 98</u>	<u>\$ 1,926</u>	<u>\$ 9,994</u>
<i>December 31, 2005</i>					
North America	\$ 5,782	\$ 631	\$ 90	\$ 810	\$ 7,313
Europe	716	206	—	18	940
Asia	—	24	—	—	24
	<u>\$ 6,498</u>	<u>\$ 861</u>	<u>\$ 90</u>	<u>\$ 828</u>	<u>\$ 8,277</u>

	<u>Communications</u>	<u>Discontinued Information Services</u>	<u>Coal Mining</u> (dollars in millions)	<u>Other</u>	<u>Total</u>
Long-Lived Assets (excluding Goodwill)					
<i>December 31, 2006</i>					
North America	\$ 6,362	\$ —	\$ 88	\$ —	\$ 6,450
Europe	747	—	—	—	747
Asia	—	—	—	—	—
	<u>\$ 7,109</u>	<u>\$ —</u>	<u>\$ 88</u>	<u>\$ —</u>	<u>\$ 7,197</u>
<i>December 31, 2005</i>					
North America	\$ 5,502	\$ 68	\$ 75	\$ —	\$ 5,645
Europe	696	1	—	—	697
Asia	—	1	—	—	1
	<u>\$ 6,198</u>	<u>\$ 70</u>	<u>\$ 75</u>	<u>\$ —</u>	<u>\$ 6,343</u>
Goodwill(1)					
<i>December 31, 2006</i>					
North America	\$ 408	\$ —	\$ —	\$ —	\$ 408
Europe	—	—	—	—	—
Asia	—	—	—	—	—
	<u>\$ 408</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 408</u>
<i>December 31, 2005</i>					
North America	\$ 70	\$ 194	\$ —	\$ —	\$ 264
Europe	—	—	—	—	—
Asia	—	—	—	—	—
	<u>\$ 70</u>	<u>\$ 194</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 264</u>

- (1) The December 31, 2005 Discontinued Information Services presented in the table above includes \$194 million of goodwill related to Software Spectrum. This goodwill is included in the Consolidated Balance Sheet in Noncurrent Assets of Discontinued Operations.

Communications revenue is grouped into three categories: 1) Core Communications Services (including transport and infrastructure services, wholesale IP and data services, voice services and Vyvx services) 2) Other Communications Services (including managed modem and its related reciprocal compensation, DSL aggregation, and legacy managed IP services), and 3) SBC Contract Services. This revenue reporting structure reflects how the Company's management currently invests and manages cash flows in the communications business.

	Services			
	Core	Other	SBC Contact Services	Total
	(dollars in millions)			
Communications Revenue				
2006				
North America	\$ 1,787	\$ 441	\$ 893	\$ 3,121
Europe	186	4	—	190
Asia	—	—	—	—
	<u>\$ 1,973</u>	<u>\$ 445</u>	<u>\$ 893</u>	<u>\$ 3,311</u>
2005				
North America	\$ 818	\$ 653	\$ 25	\$ 1,496
Europe	144	5	—	149
Asia	—	—	—	—
	<u>\$ 962</u>	<u>\$ 658</u>	<u>\$ 25</u>	<u>\$ 1,645</u>
2004				
North America	\$ 664	\$ 882	\$ —	\$ 1,546
Europe	129	10	—	139
Asia	—	—	—	—
	<u>\$ 793</u>	<u>\$ 892</u>	<u>\$ —</u>	<u>\$ 1,685</u>

Transport and Infrastructure includes \$2 million, \$130 million and \$107 million of termination revenue for the years ended December 31, 2006, 2005 and 2004, respectively. Wholesale IP and data includes \$7 million, \$1 million and \$5 million of termination revenue for the years ended December 31, 2006, 2005 and 2004, respectively. SBC Contract Services includes \$2 million of termination revenue for the year ended December 31 2006. No termination revenue was recorded for SBC in 2005 and 2004.

The majority of North American revenue consists of services delivered within the United States. The majority of European revenue consists of services delivered within the United Kingdom but also includes France and Germany. Transoceanic revenue is allocated to Europe.

The following information provides a reconciliation of Net Income (Loss) to Adjusted OIBDA by operating segment, as defined by the Company, for the years ended December 31, 2006, 2005 and 2004:

2006

	<u>Communications</u>	<u>Discontinued Information Services</u>	<u>Coal Mining</u>	<u>Other</u>
	(dollars in millions)			
Net Income (Loss)	\$ (800)	\$ 46	\$ 7	\$ 3
Income from Discontinued Operations	—	(46)	—	—
Income Tax Provision (Benefit)	4	—	—	(2)
Total Other (Income) Expense	652	—	—	(4)
Operating Income (Loss)	(144)	—	7	(3)
Non-Cash Impairment Charge	8	—	—	—
Depreciation and Amortization Expense	729	—	1	—
Non-Cash Compensation Expense	84	—	—	—
Adjusted OIBDA	<u>\$ 677</u>	<u>\$ —</u>	<u>\$ 8</u>	<u>\$ (3)</u>

2005

	<u>Communications</u>	<u>Discontinued Information Services</u>	<u>Coal Mining</u>	<u>Other</u>
	(dollars in millions)			
Net Income (Loss)	\$ (720)	\$ 69	\$ 16	\$ (3)
Income from Discontinued Operations	—	(69)	—	—
Income Tax Provision	2	—	2	1
Total Other (Income) Expense	474	—	(7)	(1)
Operating Income (Loss)	(244)	—	11	(3)
Non-Cash Impairment Charge	9	—	—	—
Depreciation and Amortization Expense	642	—	5	—
Non-Cash Compensation Expense	51	—	—	—
Adjusted OIBDA	<u>\$ 458</u>	<u>\$ —</u>	<u>\$ 16</u>	<u>\$ (3)</u>

2004

	<u>Communications</u>	<u>Discontinued Information Services</u>	<u>Coal Mining</u>	<u>Other</u>
	(dollars in millions)			
Net Income (Loss)	\$ (509)	\$ 20	\$ 11	\$ 20
Income from Discontinued Operations	—	(20)	—	—
Income Tax Provision	—	—	1	—
Total Other (Income) Expense	264	—	—	(21)
Operating Income (Loss)	(245)	—	12	(1)
Depreciation and Amortization Expense	665	—	6	—
Non-Cash Compensation Expense	43	—	—	—
Adjusted OIBDA	<u>\$ 463</u>	<u>\$ —</u>	<u>\$ 18</u>	<u>\$ (1)</u>

(19) Commitments, Contingencies and Other Items

Right of Way Litigation

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

It is still too early for the Company to reach a conclusion as to the ultimate outcome of these actions. However, management believes that the Company and its subsidiaries have substantial defenses to the claims asserted in all of these actions (and any similar claims which may be named in the future), and intends to defend them vigorously if a satisfactory form of settlement is not approved.

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

Operating Leases

The Company is leasing rights-of-way, facilities and other assets under various operating leases which, in addition to rental payments, may 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 rights-of-way agreements have various expiration dates through 2049. Payments under these right-of-way agreements were \$62 million in 2006, \$30 million in 2005 and \$31 million in 2004.

The Company has obligations under non-cancelable operating leases for certain colocation and office facilities, including lease obligations for which facility related restructuring charges have been recorded. The lease agreements have various expiration dates through 2072. Rent expense, including common area maintenance, under non-cancelable lease agreements was \$132 million in 2006, \$76 million in 2005 and \$88 million in 2004.

For those leases involving communications colocation and right-of-way agreements, the Company anticipates that it will renew these leases under option provisions contained in the lease agreements given the significant cost to relocate the Company's network and other facilities.

Future minimum payments, including common area maintenance, for the next five years under right-of-way agreements and non-cancelable operating leases consist of the following at December 31, 2006 (dollars in millions):

	Right-of-Way Agreements	Facilities	Other Assets	Total
2007	\$ 61	\$ 116	\$ 2	\$ 179
2008	58	118	5	181
2009	49	98	—	147
2010	45	84	—	129
2011	43	76	—	119
Thereafter	597	373	—	970
Total	<u>\$ 853</u>	<u>\$ 865</u>	<u>\$ 7</u>	<u>\$ 1,725</u>

Other

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, 2006 and 2005, Level 3 had outstanding letters of credit of approximately \$45 million and \$19 million, respectively, which are collateralized by cash and are reflected on the consolidated balance sheet as restricted cash. 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.

(20) Condensed Consolidating Financial Information

As discussed in Note 13, in October 2003, Level 3 Financing issued \$500 million 10.75% Senior Notes due in 2011. These notes are unsecured obligations of Level 3 Financing, however, they are also jointly and severally and fully and unconditionally guaranteed on an unsecured senior basis by Level 3 Communications, Inc. and Level 3 Communications, LLC (a wholly owned subsidiary). The 10.75% Senior Notes were registered with the Securities and Exchange Commission in 2005.

In March 2006, Level 3 Financing issued \$150 million Floating Rate Senior Notes due 2011 and \$250 million 12.25% Senior Notes due 2013. In addition, on April 6, 2006, Level 3 Financing issued an additional \$300 million of 12.25% Senior Notes due 2013. Level 3 Financing issued \$600 million of its 9.25% Senior Notes due 2014 in October 2006 and issued an additional \$650 million of its 9.25% Senior Notes due 2014 in December 2006. These notes are unsecured obligations of Level 3 Financing, however, they are fully and unconditionally guaranteed on an unsecured senior basis by Level 3 Communications, Inc. and with respect to the Floating Rate Senior Notes due 2011 and the 12.25% Senior Notes due 2013, Level 3 Communications, LLC. Upon receipt of all applicable state regulatory approvals that are currently being obtained, Level 3 Communications, LLC will also severally and fully and unconditionally guarantee on an unsecured basis the 9.25% Senior Notes due 2014.

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

Condensed Consolidating Statements of Operations for the years ended December 31, 2006, 2005 and 2004 follow. Level 3 Communications, LLC leases equipment and certain facilities from other wholly owned subsidiaries of Level 3 Communications, Inc. These transactions are eliminated in the consolidated results of the Company.

Condensed Consolidating Statements of Operations
For the year ended December 31, 2006

	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC (dollars in millions)	Other Subsidiaries	Eliminations	Total
Revenue	\$ —	\$ —	\$ 1,304	\$ 2,270	\$ (196)	\$ 3,378
Costs and Expenses:						
Cost of Revenue	—	—	525	1,179	(187)	1,517
Depreciation and Amortization	—	—	358	372	—	730
Selling, General and Administrative	6	—	816	445	(9)	1,258
Restructuring and Impairment Charges	—	—	9	4	—	13
Total Costs and Expenses	6	—	1,708	2,000	(196)	3,518
Operating Income (Loss)	(6)	—	(404)	270	—	(140)
Other Income (Loss), net:						
Interest Income	16	1	40	7	—	64
Interest Expense	(432)	(207)	—	(9)	—	(648)
Interest Income (Expense) Affiliates, net	860	666	(1,572)	46	—	—
Equity in Net Earnings (Losses) of Subsidiaries	(1,209)	(1,561)	141	—	2,629	—
Other Income (Expense)	27	(108)	7	10	—	(64)
Other Income (Loss)	(738)	(1,209)	(1,384)	54	2,629	(648)
Income (Loss) from Continuing Operations Before Income Taxes	(744)	(1,209)	(1,788)	324	2,629	(788)
Income Tax (Expense) Benefit	—	—	—	(2)	—	(2)
Income (Loss) from Continuing Operations	(744)	(1,209)	(1,788)	322	2,629	(790)
Income from Discontinued Operations	—	—	—	46	—	46
Net Income (Loss)	\$ (744)	\$ (1,209)	\$ (1,788)	\$ 368	\$ 2,629	\$ (744)

Condensed Consolidating Statements of Operations
For the year ended December 31, 2005

	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC (dollars in millions)	Other Subsidiaries	Eliminations	Total
Revenue	\$ —	\$ —	\$ 1,457	\$ 440	\$ (178)	\$ 1,719
Costs and Expenses:						
Cost of Revenue	—	—	575	104	(163)	516
Depreciation and Amortization	—	—	444	203	—	647
Selling, General and Administrative	4	—	640	140	(15)	769
Restructuring and Impairment Charges	—	—	21	2	—	23
Total Costs and Expenses	4	—	1,680	449	(178)	1,955
Operating Income (Loss)	(4)	—	(223)	(9)	—	(236)
Other Income (Loss), net:						
Interest Income	19	1	11	4	—	35
Interest Expense	(390)	(133)	—	(7)	—	(530)
Interest Income (Expense) Affiliates, net	784	527	(1,336)	25	—	—
Equity in Net Earnings (Losses) of Subsidiaries	(1,048)	(1,492)	(1)	—	2,541	—
Other Income (Expense)	1	—	12	16	—	29
Other Income (Loss)	(634)	(1,097)	(1,314)	38	2,541	(466)
Income (Loss) from Continuing Operations Before Income Taxes	(638)	(1,097)	(1,537)	29	2,541	(702)
Income Tax Expense	—	—	—	(5)	—	(5)
Income (Loss) from Continuing Operations	(638)	(1,097)	(1,537)	24	2,541	(707)
Income from Discontinued Operations	—	49	—	20	—	69
Net Income (Loss)	\$ (638)	\$ (1,048)	\$ (1,537)	\$ 44	\$ 2,541	\$ (638)

Condensed Consolidating Statements of Operations
For the year ended December 31, 2004

	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC (dollars in millions)	Other Subsidiaries	Eliminations	Total
Revenue	\$ —	\$ —	\$ 1,514	\$ 554	\$ (292)	\$ 1,776
Costs and Expenses:						
Cost of Revenue	—	—	692	85	(274)	503
Depreciation and Amortization	—	—	423	248	—	671
Selling, General and Administrative	7	—	681	152	(18)	822
Restructuring and Impairment Charges	—	—	6	8	—	14
Total Costs and Expenses	7	—	1,802	493	(292)	2,010
Operating Income (Loss)	(7)	—	(288)	61	—	(234)
Other Income (Loss), net:						
Interest Income	—	—	11	2	—	13
Interest Expense	(405)	(61)	(13)	(6)	—	(485)
Interest Income (Expense) Affiliates, net	809	396	(1,206)	1	—	—
Equity in Net Earnings (Losses) of Subsidiaries	(907)	(1,243)	(1)	—	2,151	—
Other Income (Expense)	52	1	150	26	—	229
Other Income (Loss)	(451)	(907)	(1,059)	23	2,151	(243)
Income (Loss) from Continuing Operations Before Income Taxes	(458)	(907)	(1,347)	84	2,151	(477)
Income Tax Expense	—	—	—	(1)	—	(1)
Income (Loss) from Continuing Operations	(458)	(907)	(1,347)	83	2,151	(478)
Income from Discontinued Operations	—	—	—	20	—	20
Net Income (Loss)	\$ (458)	\$ (907)	\$ (1,347)	\$ 103	\$ 2,151	\$ (458)

Condensed Consolidating Balance Sheets as of December 31, 2006 and 2005 follow:

Condensed Consolidating Balance Sheets
December 31, 2006

	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC (dollars in millions)	Other Subsidiaries	Eliminations	Total
Assets						
Current Assets:						
Cash and cash equivalents	\$ 15	\$ 12	\$ 1,592	\$ 62	\$ —	\$ 1,681
Marketable securities	235	—	—	—	—	235
Restricted cash and securities	—	—	31	15	—	46
Accounts receivable, net	—	—	97	229	—	326
Due from (to) affiliates	11,183	6,432	(18,631)	1,016	—	—
Other	17	6	41	37	—	101
Total Current Assets	11,450	6,450	(16,870)	1,359	—	2,389
Property, Plant and Equipment, net	—	—	3,268	3,200	—	6,468
Marketable Securities	—	—	—	—	—	—
Restricted Cash and Securities	17	—	—	73	—	90
Goodwill and Other Intangibles, net	—	—	44	875	—	919
Investment in Subsidiaries	(6,419)	(10,170)	2,639	—	13,950	—
Other Assets, net	43	41	12	32	—	128
Total Assets	\$ 5,091	\$ (3,679)	\$ (10,907)	\$ 5,539	\$ 13,950	\$ 9,994
Liabilities and Stockholders' Equity						
(Deficit)						
Current Liabilities:						
Accounts payable	\$ —	\$ 1	\$ 160	\$ 230	\$ —	\$ 391
Current portion of long-term debt	—	—	—	5	—	5
Accrued payroll and employee benefits	—	—	59	33	—	92
Accrued interest	93	49	—	1	—	143
Deferred revenue	—	—	98	44	—	142
Other	1	2	56	97	—	156
Total Current Liabilities	94	52	373	410	—	929
Long-Term Debt, less current portion	4,581	2,688	—	88	—	7,357
Deferred Revenue	—	—	628	125	—	753
Other Liabilities	42	—	199	340	—	581
Stockholders' Equity (Deficit)	374	(6,419)	(12,107)	4,576	13,950	374
Total Liabilities and Stockholders' Equity (Deficit)	\$ 5,091	\$ (3,679)	\$ (10,907)	\$ 5,539	\$ 13,950	\$ 9,994

Condensed Consolidating Balance Sheets
December 31, 2005

	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC (dollars in millions)	Other Subsidiaries	Eliminations	Total
Assets						
Current Assets:						
Cash and cash equivalents	\$ 37	\$ 8	\$ 275	\$ 59	\$ —	\$ 379
Marketable securities	173	3	—	—	—	176
Restricted cash and securities	—	3	20	11	—	34
Accounts receivable, net	—	—	84	308	—	392
Due from (to) affiliates	10,117	4,613	(14,853)	123	—	—
Current assets of discontinued operations	—	—	—	597	—	597
Other	16	4	29	43	—	92
Total Current Assets	10,343	4,631	(14,445)	1,141	—	1,670
Property, Plant and Equipment, net	—	—	3,409	2,223	—	5,632
Marketable Securities	234	—	—	—	—	234
Restricted Cash and Securities	16	—	—	59	—	75
Goodwill and Other Intangibles, net	—	—	85	206	—	291
Investment in Subsidiaries	(6,251)	(9,651)	802	—	15,100	—
Noncurrent Assets of Discontinued Operations						
Operations	—	—	—	264	—	264
Other Assets, net	44	21	14	32	—	111
Total Assets	\$ 4,386	\$ (4,999)	\$ (10,135)	\$ 3,925	\$ 15,100	\$ 8,277
Liabilities and Stockholders' Equity (Deficit)						
Current Liabilities:						
Accounts payable	\$ —	\$ 1	\$ 141	\$ 225	\$ —	\$ 367
Current portion of long-term debt	—	—	—	—	—	—
Accrued payroll and employee benefits	—	—	46	33	—	79
Accrued interest	83	18	—	1	—	102
Deferred revenue	—	—	138	61	—	199
Current liabilities of discontinued operations	—	—	—	539	—	539
Other	1	2	50	84	—	137
Total Current Liabilities	84	21	375	943	—	1,423
Long-Term Debt, less current portion	4,722	1,230	—	71	—	6,023
Deferred Revenue	—	—	633	104	—	737
Other Liabilities	56	1	196	317	—	570
Stockholders' Equity (Deficit)	(476)	(6,251)	(11,339)	2,490	15,100	(476)
Total Liabilities and Stockholders' Equity (Deficit)	\$ 4,386	\$ (4,999)	\$ (10,135)	\$ 3,925	\$ 15,100	\$ 8,277

Condensed Consolidating Statements of Cash Flows for the years ended December 31, 2006, 2005 and 2004 follow:

Condensed Consolidating Statements of Cash Flows
For the year ended December 31, 2006

	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC (dollars in millions)	Other Subsidiaries	Eliminations	Total
Net Cash Provided by (Used in)						
Operating Activities of Continuing Operations	\$ (380)	\$ (183)	\$ 62	\$ 722	\$ —	\$ 221
Cash Flows from Investing Activities:						
Proceeds from sale and maturity of marketable securities	175	5	100	—	—	280
Purchases of marketable securities	—	—	(98)	—	—	(98)
Decrease (increase) in restricted cash and securities	1	2	(10)	(14)	—	(21)
Capital expenditures	—	—	(166)	(226)	—	(392)
Investments and acquisitions	—	—	(761)	12	—	(749)
Proceeds from sale of discontinued operations, net of cash sold	—	—	—	307	—	307
Advances to discontinued operations, net	—	—	—	18	—	18
Proceeds from sale of property, plant and equipment and other assets	—	—	6	1	—	7
Net Cash Provided by (Used in) Investing Activities	176	7	(929)	98	—	(648)
Cash Flows from Financing Activities:						
Long-term debt borrowings, net of issuance costs	326	1,930	—	—	—	2,256
Payments on long-term debt, including current portion (net of restricted cash)	(513)	(596)	—	(1)	—	(1,110)
Equity offering	543			—		543
Increase (decrease) due from affiliates, net	(174)	(1,154)	2,170	(842)	—	—
Net Cash Provided by (Used in) Financing Activities	182	180	2,170	(843)	—	1,689
Net Cash Used in Discontinued Operations	—	—	—	(43)	—	(43)
Effect of Exchange Rates on Cash and Cash Equivalents	—	—	14	(4)	—	10
Net Change in Cash and Cash Equivalents	(22)	4	1,317	(70)	—	1,229
Cash and Cash Equivalents at Beginning of Year (includes cash of discontinued operations)	37	8	275	132	—	452
Cash and Cash Equivalents at End of Year	<u>\$ 15</u>	<u>\$ 12</u>	<u>\$ 1,592</u>	<u>\$ 62</u>	<u>\$ —</u>	<u>\$ 1,681</u>

Condensed Consolidating Statements of Cash Flows
For the year ended December 31, 2005

	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC (dollars in millions)	Other Subsidiaries	Eliminations	Total
Net Cash Provided by (Used in)						
Operating Activities of						
Continuing Operations	\$ (306)	\$ (128)	\$ 226	\$ 90	\$ —	\$ (118)
Cash Flows from Investing Activities:						
Proceeds from sale and maturity of						
marketable securities	243	—	340	1	—	584
Purchases of marketable securities	(648)	—	—	—	—	(648)
Decrease (increase) in						
restricted cash and securities	—	3	(6)	(1)	—	(4)
Capital expenditures	—	—	(167)	(133)	—	(300)
Investments and acquisitions	(10)	—	(497)	128	—	(379)
Proceeds from sale of discontinued						
operations	—	82	—	—	—	82
Advances to discontinued						
operations, net	—	—	—	13	—	13
Proceeds from sale of property,						
plant and equipment and other						
assets	—	—	3	8	—	11
Net Cash Provided by (Used in)						
Investing Activities	(415)	85	(327)	16	—	(641)
Cash Flows from Financing						
Activities:						
Long-term debt borrowings,						
net of issuance costs	877	—	—	66	—	943
Payments on long-term						
debt, including current portion						
(net of restricted cash)	—	—	(26)	(104)	—	(130)
Increase (decrease) due from						
affiliates, net	(121)	34	170	(83)	—	—
Net Cash Provided by (Used in)						
Financing Activities	756	34	144	(121)	—	813
Net Cash Used in Discontinued						
Operations	—	—	—	(32)	—	(32)
Effect of Exchange Rates on Cash and						
Cash Equivalents	(1)	—	(13)	1	—	(13)
Net Change in Cash and Cash						
Equivalents	34	(9)	30	(46)	—	9
Cash and Cash Equivalents at						
Beginning of Year (includes cash of						
discontinued operations)	3	17	245	178	—	443
Cash and Cash Equivalents at						
End of Year (includes cash of						
discontinued operations)	\$ 37	\$ 8	\$ 275	\$ 132	\$ —	\$ 452

Condensed Consolidating Statements of Cash Flows
For the year ended December 31, 2004

	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC (dollars in millions)	Other Subsidiaries	Eliminations	Total
Net Cash Provided by (Used in)						
Operating Activities of Continuing Operations	\$ (379)	\$ (26)	\$ (30)	\$ 313	\$ —	\$ (122)
Cash Flows from Investing Activities:						
Proceeds from sale and maturity of marketable securities	—	—	70	—	—	70
Purchases of marketable securities	—	—	(410)	—	—	(410)
Decrease (increase) in restricted cash and securities	7	21	(4)	(3)	—	21
Capital expenditures	—	—	(174)	(98)	—	(272)
Acquisitions	—	—	(69)	—	—	(69)
Advances to discontinued operations, net	—	—	—	7	—	7
Proceeds from sale of property, plant and equipment, and other assets	—	—	9	51	—	60
Net Cash Provided by (Used in) Investing Activities	7	21	(578)	(43)	—	(593)
Cash Flows from Financing Activities:						
Long-term debt borrowings, net of issuance costs	272	713	—	—	—	985
Payments and repurchases of long-term debt, including current portion (net of restricted cash)	(949)	—	(75)	(3)	—	(1,027)
Increase (decrease) in due from affiliates, net	1,049	(706)	341	(684)	—	—
Net Cash Provided by (Used in) Financing Activities	372	7	266	(687)	—	(42)
Net Cash Provided by Discontinued Operations	—	—	—	56	—	56
Effect of Exchange Rates on Cash and Cash Equivalents	2	—	5	8	—	15
Net Change in Cash and Cash Equivalents	2	2	(337)	(353)	—	(686)
Cash and Cash Equivalents at Beginning of Year (includes cash of discontinued operations)	1	15	582	531	—	1,129
Cash and Cash Equivalents at End of Year (includes cash of discontinued operations)	<u>\$ 3</u>	<u>\$ 17</u>	<u>\$ 245</u>	<u>\$ 178</u>	<u>\$ —</u>	<u>\$ 443</u>

(21) Subsequent Events

Broadwing Acquisition

On January 3, 2007, Level 3 acquired Broadwing Corporation, a publicly held provider of optical network communications services. Under the terms of the merger agreement dated October 16, 2006, Level 3 paid \$8.18 of cash plus 1.3411 shares of Level 3 common stock for each share of Broadwing common stock outstanding at closing. In total, Level 3 paid approximately \$744 million of cash and issued approximately 122 million shares of the Company's common stock, valued at \$688 million. In connection with the acquisition of Broadwing, the Company guaranteed \$180 million in aggregate principal amount of Broadwing Corporation's 3.125% Convertible Senior Debentures due 2026 (the "Broadwing Debentures"). As of February 16, 2007, the holders of \$179 million in aggregate principal amount of the Broadwing Debentures had converted their Broadwing Debentures into a total of 17 million shares of Level 3 common stock and approximately \$106 million in cash pursuant to the terms of the indenture governing the Broadwing Debentures and the agreement whereby Level 3 acquired Broadwing. The remaining \$1 million in aggregate principal amount of the Broadwing Debentures was repurchased by Broadwing at 100% of par as required by the indenture governing the Broadwing Debentures.

Broadwing is a provider of optical network communications services. Broadwing delivers data, voice and media solutions to enterprises and service providers over its 19,000 mile intercity fiber network. Approximately half of Broadwing's revenue comes from the wholesale market, with business customers comprising the remaining revenue.

SAVVIS CDN Services Business Acquisition

On January 23, 2007, Level 3 completed the acquisition of the SAVVIS Content Delivery Network ("CDN") services business of SAVVIS, Inc. ("SAVVIS CDN Business"). Under the terms of the agreement, Level 3 paid \$132.5 million in cash to acquire certain assets, including network elements, customer contracts, employees and intellectual property used in SAVVIS's CDN Business. The purchase price is subject to certain customary post closing working capital adjustments.

SAVVIS's CDN Business provides solutions that improve performance, reliability, scalability and reach of customers' online content. Initially developed in 1996 as Sandpiper Networks, the division developed, deployed and operated the world's first content delivery network. It has a globally distributed infrastructure in more than 20 countries.

2007 Debt Exchange

In January 2007, in two separate transactions, Level 3 completed the exchanges of \$605 million in aggregate principal amount of its 10% Convertible Senior Notes due 2011 for a total of 196.8 million shares of Level 3's common stock. The shares of the Company's common stock issued pursuant to these announced exchanges are exempt from registration pursuant to Section 3(a)(9) under the Securities Act of 1933, as amended. The Company expects to recognize a \$177 million loss on the early extinguishment of debt for the exchanges.

Senior Secured Term Loan Refinancing

On February 8, 2007, Level 3 announced that its subsidiary, Level 3 Financing, Inc. is seeking to refinance its existing \$730 million amended and restated Senior Secured Term Loan due 2011 with a new Senior Secured Term Loan due 2014. The Company is seeking, among other things, to increase the principal to up to \$1.4 billion, reduce the interest rate payable under the agreement and extend the maturity from 2011 to 2014. There is no assurance that Level 3 will be successful in the refinancing of its Senior Secured Term Loan due 2011.

Issuance of 8.75% Senior Notes Due 2017 and Floating Rate Senior Notes Due 2015

On February 14, 2007, Level 3 Financing, Inc. received \$982 million of net proceeds after transaction costs, from a private offering of \$700 million aggregate principal amount of its 8.75% Senior Notes due 2017 (the “8.75% Senior Notes”) and \$300 million aggregate principal amount of its Floating Rate Senior Notes due 2015 (the “2015 Floating Rate Senior Notes”). The 8.75% Senior Notes and the 2015 Floating Rate Senior Notes are senior unsecured obligations of Level 3 Financing, ranking equal in right of payment with all other senior unsecured obligations of Level 3 Financing. Level 3 Communications, Inc. has guaranteed the 8.75% Senior Notes and the 2015 Floating Rate Senior Notes. Interest on the 8.75% Senior Notes accrues at 8.75% interest per year and is payable semi-annually in cash on February 15th and August 15th beginning August 15, 2007. The principal amount of the 8.75% Senior Notes will be due on February 15, 2017. Interest on the 2015 Floating Rate Senior Notes accrues at LIBOR plus 3.75% per annum, reset semiannually. The interest rate was 9.15% as determined at the commencement of the interest period beginning February 15, 2007. Interest on the 2015 Floating Rate Senior notes is payable semi-annually in cash on February 15th and August 15th beginning August 15, 2007. The principal amount of the 2015 Floating Rate Senior Notes will be due on February 15, 2015.

The 8.75% Senior Notes and the 2015 Floating Rate Senior Notes are not currently registered under the Securities Act of 1933 or any state securities laws and, unless so registered, may not be offered or sold except pursuant to an applicable exemption from the registration requirements of the Securities Act of 1933 and applicable state securities laws. On February 14, 2006, Level 3, Level 3 Financing and the initial purchasers of the 8.75% Senior Notes and the 2015 Floating Rate Senior Notes entered into a registration rights agreement relating to the 8.75% Senior Notes and the 2015 Floating Rate Senior Notes pursuant to which Level 3 and Level 3 Financing agreed to file an exchange offer registration statement with the Securities and Exchange Commission.

Under the terms of the registration rights agreement, Level 3 Financing may be required to pay “Special Interest” in the event of a registration default. Special Interest will accrue at a rate of 0.50% per annum on the principal amount during the 90-day period after the occurrence of the registration default and will increase by 0.25% per annum at the end of each subsequent 90-day period. In no event will the rate exceed 1.00% per annum on the principal amount. If the exchange offer is completed on the terms and within the period contemplated by the registration rights agreement, no special interest will be payable. A registration default may occur if the Company fails to file with the Securities and Exchange Commission and have declared effective the exchange offer registration statement by certain dates as specified in the registration rights agreement. The Company believes that the likelihood of having to make Special Interest payments under the terms of the registration rights agreement is remote and, as a result, has not accrued a liability for any obligation under the agreement.

A portion of the debt represented by the 8.75% Senior Notes and the 2015 Floating Rate Senior Notes will constitute purchase money indebtedness under the indentures of Level 3 Communications, Inc. and the portion of the net proceeds that constitutes purchase money indebtedness will be used solely to fund the cost of construction, installation, acquisition, lease, development or improvement of any assets to be used in the Company’s communications business, including the cash purchase price of any past, pending or future acquisitions.

The 8.75% Senior Notes are subject to redemption at the option of Level 3 Financing in whole or in part, at any time or from time to time, on or after February 15, 2012 at the redemption prices (expressed as a percentage of principal amount) set forth below, plus accrued and unpaid interest thereon to the redemption date, if redeemed during the twelve months beginning November 1, of the years indicated below:

Year	Redemption Price
2012	104.375%
2013	102.917%
2014	101.458%
2015	100.000%

At any time or from time to time on or prior to February 15, 2010, Level 3 Financing may redeem up to 35% of the original aggregate principal amount of the 8.75% Senior Notes at a redemption price equal to 108.75% of the principal amount of the 8.75% Senior Notes so redeemed, plus accrued and unpaid interest thereon (if any) to the redemption date (subject to the right of holders of record on the relevant record date to receive interest due on the relevant interest payment date), with the net cash proceeds contributed to the capital of Level 3 Financing of one or more private placements to persons other than affiliates of Level 3 or underwritten public offerings of common stock of Level 3 resulting, in each case, in gross proceeds of at least \$100 million in the aggregate; provided, however, that at least 65% of the original aggregate principal amount of the 8.75% Senior Notes would remain outstanding immediately after giving effect to such redemption. Any such redemption shall be made within 90 days of such private placement or public offering upon not less than 30 nor more than 60 days' prior notice.

The Floating Rate Senior Notes are subject to redemption at the option of Level 3 Financing in whole or in part, at any time or from time to time, on or after February 15, 2009 at the redemption prices (expressed as a percentage of principal amount) set forth below, plus accrued and unpaid interest thereon to the redemption date, if redeemed during the twelve months beginning November 1, of the years indicated below:

Year	Redemption Price
2009	102.0%
2010	101.0%
2011	100.0%

At any time or from time to time on or prior to February 15, 2010, Level 3 Financing may redeem up to 35% of the original aggregate principal amount of the 8.75% Senior Notes and the Floating Rate Senior Notes at a redemption price equal to 100.0% of the principal amount of the Floating Rate Senior Notes so redeemed, plus a premium equal to the interest rate on the Floating Rate Senior Notes applicable on the date that notice of the redemption is given, plus accrued and unpaid interest thereon (if any) to the redemption date (subject to the right of holders of record on the relevant record date to receive interest due on the relevant interest payment date), with the net cash proceeds contributed to the capital of Level 3 Financing of one or more private placements to persons other than affiliates of Level 3 or underwritten public offerings of common stock of Level 3 resulting, in each case, in gross proceeds of at least \$100 million in the aggregate; provided, however, that at least 65% of the original aggregate principal amount of the 8.75% Senior Notes and the Floating Rate Senior Notes would remain outstanding immediately after giving effect to such redemption. Any such redemption shall be made within 90 days of such private placement or public offering upon not less than 30 nor more than 60 days' prior notice.

Each of Level 3 Communications, Inc. and Level 3 Financing has agreed to endeavor in good faith using commercially reasonable efforts to cause Level 3 Communications, LLC to obtain all material

governmental authorizations and consents required in order for it to guarantee the 8.75% Senior Notes and the 2015 Floating Rate Senior Notes at the earliest practicable date and to enter into a guarantee of these notes promptly thereafter. However, there can be no assurance that Parent and the Issuer will be successful in obtaining the required regulatory approvals to permit Level 3 Communications, LLC to guarantee these notes.

Redemptions and Tender Offers

On February 15, 2007, Level 3 Communications, Inc. called for redemption all of its outstanding \$488 million aggregate principal amount of 12.875% Senior Notes due 2010 at a price equal to 102.146% of the principal amount thereof, all of its outstanding \$96 million aggregate principal amount of 11.25% Senior Notes due 2010 at a price equal to 101.875% of principal amount thereof and all of its outstanding € 104 million aggregate principal amount of 11.25% Senior Euro Notes due 2010 at a price equal to 101.875% of principal amount thereof. Level 3 will pay accrued and unpaid interest on the senior notes to but not including the redemption date. All of these senior notes will be redeemed by Level 3 on March 16, 2007. The Company expects to recognize a loss of approximately \$49 million associated with these redemptions in the first quarter of 2007.

Level 3 also announced on February 15, 2007 that Level 3 Financing, Inc. has commenced a tender offer to purchase for cash any and all of the outstanding \$150 million aggregate principal amount of its Floating Rate Senior Notes due 2011 for a price equal to \$1,080 per \$1,000 principal amount of the notes, which includes \$1,050 as the tender offer consideration and \$30.00 as a consent payment. Additionally, Level 3 Communications, Inc. commenced a tender offer to purchase for cash any and all of its outstanding \$78 million aggregate principal amount of 11% Senior Notes due 2008 for a price equal to \$1,054.28 per \$1,000 principal amount of the notes, which includes \$1,024.28 as the tender offer consideration and \$30.00 as a consent payment (together the “February 15th Tender Offers”). The Company expects to recognize a loss associated with these tender offers in the first quarter of 2007, the amount of which will depend on the amounts tendered for each issuance.

In connection with the February 15th Tender Offers, Level 3 Communications, Inc. and Level 3 Financing, Inc. are soliciting consents to certain proposed amendments to the respective indentures governing the notes that are subject to the February 15th Tender Offers to eliminate substantially all of the covenants, certain repurchase rights, certain discharge rights and certain events of default and related provisions contained in those indentures.

The February 15th Tender Offers are also subject to the satisfaction or waiver of certain other conditions as set forth in the Offer to Purchase. It is a condition to the consummation of the February 15th Tender Offers that the holders of at least a majority of the outstanding aggregate principal amount of the notes consent to the amendments to the indenture governing those notes.

On February 20, 2007, Level 3 Communications, Inc. commenced a tender offer to purchase for cash any and all of the outstanding \$692 million aggregate principal amount of its 11.5% Senior Notes due 2010 for a price equal to \$1,115.26 per \$1,000 principal amount of the 11.5% Senior Notes due 2010, which includes \$1,085.26 as the purchase price and \$30.00 as a consent payment (the “11.5% Notes Tender Offer”). Level 3 Communications, Inc. also commenced a tender offer to purchase for cash any and all of the outstanding €50 million aggregate principal amount of its 10.75% Senior Euro Notes due 2008 for a price equal to €1,061.45 per €1,000 principal amount of the Senior Euro Notes due 2008, which includes €1,031.45 as the purchase price and €30.00 as a consent payment (the “Euro Tender Offer” and together with the 11.5% Notes Tender Offer, the “February 20th Tender Offers”). The Company expects to recognize a loss associated with these tender offers in the first quarter of 2007, the amount of which will depend on the amounts tendered for each issuance.

In connection with the February 20th Tender Offers, Level 3 is soliciting consents to certain proposed amendments to the respective indentures governing these notes that are subject to the February 20th Tender Offers to eliminate substantially all of the covenants, certain repurchase rights, certain discharge rights and certain events of default and related provisions contained in those indentures.

The February 20th Tender Offers are also subject to the satisfaction or waiver of certain other conditions as set forth in the applicable Offer to Purchase. It is a condition to the consummation of the February 20th Tender Offers that the holders of at least a majority of the outstanding aggregate principal amount of each series of notes consent to the amendments to the applicable indenture governing those notes.

On February 23, 2007, Level 3 Financing completed a consent solicitation with respect to certain amendments to the indenture governing Level 3 Financing's outstanding 12.25% Senior Notes due 2013 that allow for the incurrence of debt based upon a multiple of cash flow available for fixed charges on a "pro forma" basis giving effect to any acquisition, merger or consolidation completed prior to February 1, 2007.

Conversion of Broadwing Corporation 3.125% Convertible Senior Debentures due 2026

On February 20, 2007, Level 3's wholly owned subsidiary, Broadwing Corporation, completed the repurchase of \$1.0 million aggregate principal amount of Broadwing's outstanding 3.125% Convertible Senior Debentures due 2026 (the "Debentures"). The indenture governing the Debentures required Broadwing to make the offer to repurchase the Debentures as a result of the Company's acquisition of Broadwing on January 3, 2007 (see discussion of acquisition above).

As a result of the acquisition, each \$1,000 principal amount of the Debentures was convertible at the option of the holder into \$492.77 in cash and 80.789 shares of Level 3 common stock, representing a conversion price equal to the consideration payable to Broadwing stockholders in the acquisition of (i) \$8.18 in cash per share of Broadwing, multiplied by 60.241, and (ii) 1.3411 shares of Level 3 common stock, multiplied by 60.241. Additionally, as a result of the acquisition, a make-whole premium was payable on Debentures converted prior to February 17, 2007, consisting of (i) 14.969 additional shares of Level 3 common stock and (ii) an additional \$91.31 in cash per \$1,000 principal amount of Debentures.

Holders owning \$179 million aggregate principal amount of the Debentures converted those Debentures into a total of approximately 17 million shares of Level 3 common stock and also received approximately \$106 million in cash. As a result of these conversions and the repurchase discussed above, as of February 17, 2007, the Debentures are no longer outstanding.

(22) Unaudited Quarterly Financial Data

	Three Months Ended							
	March 31,		June 30,		September 30,		December 31,	
	2006	2005	2006	2005	2006	2005	2006	2005
	(dollars in millions except per share data)							
Revenue	\$ 822	\$ 527	\$ 835	\$ 390	\$ 875	\$ 384	\$ 846	\$ 418
Operating Income (Loss)	(57)	26	(18)	(75)	(25)	(89)	(40)	(98)
Loss from Continuing Operations	(166)	(78)	(224)	(196)	(163)	(207)	(237)	(226)
Income (loss) from Discontinued Operations	(2)	1	23	8	25	3	—	57
Net Loss	(168)	(77)	(201)	(188)	(138)	(204)	(237)	(169)
Income (Loss) per Share (Basic and Diluted):								
Loss from Continuing Operations	\$ (0.20)	\$ (0.11)	\$ (0.25)	\$ (0.28)	\$ (0.14)	\$ (0.29)	\$ (0.20)	\$ (0.32)
Income from Discontinued Operations	—	—	0.02	0.01	0.02	—	—	0.08
Net Loss	\$ (0.20)	\$ (0.11)	\$ (0.23)	\$ (0.27)	\$ (0.12)	\$ (0.29)	\$ (0.20)	\$ (0.24)

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. As a result of the sale of (i) Structure and Software Spectrum in 2005 and 2006, respectively, certain amounts previously included in the 2005 and 2006 quarterly reports on Forms 10-Q have been reclassified from continuing operations to discontinued operations.

In the first quarter of 2006, the Company recognized \$27 million gain related to a debt exchange.

In the second quarter of 2006, the Company recognized a \$55 million loss on the amendment and restatement of the Company's Senior Secured term Loan due 2011.

In the third quarter of 2006, the Company recognized a \$33 million gain from the sale of Software Spectrum.

In the fourth quarter of 2006, the Company recognized a \$54 million loss on the extinguishment of debt and \$8 million of termination revenue.

In the fourth quarter of 2005, the Company recognized a \$49 million gain from the sale of (i)Structure.

In the first quarter of 2005, the Company recognized \$86 million and \$40 million of termination revenue related to 360networks (USA), Inc. and France Telecom Long Distance USA, LLC, respectively. The Company also recognized \$15 million in severance and related charges as a result of a workforce reduction of approximately 470 employees in the first quarter of 2005.

Consent of Independent Registered Public Accounting Firm

The Board of Directors
Level 3 Communications, Inc.:

We consent to the incorporation by reference in the registration statements (Nos. 333-53914, 333-91899, 333-68887, 333-71713, 333-115062, 333-123703, 333-125030, 333-125262, 333-130710, 333-132695, 333-134668, 333-136413, 333-139836, and 333-139838) on Forms S-3, the registration statements (Nos. 333-79533, 333-42465, 333-68447, 333-58691, 333-52697, 333-115472, and 333-115751) on Forms S-8, and the registration statement (No. 333-134324) on Form S-4 of Level 3 Communications, Inc. of our report dated March 1, 2007, except as to Note 20, which is as of December 12, 2007, with respect to the consolidated balance sheets of Level 3 Communications, Inc. and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, cash flows, changes in stockholders' equity (deficit), and comprehensive loss for each of the years in the three-year period ended December 31, 2006, and of our report dated March 1, 2007, with respect to management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2006 and the effectiveness of internal control over financial reporting as of December 31, 2006, which reports appear in the December 31, 2006 annual report on Form 10-K of Level 3 Communications, Inc.

/s/ KPMG LLP

Denver, Colorado
December 12, 2007

CERTIFICATIONS*

I, James Q. Crowe, certify that:

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

Date: December 12, 2007

/s/ James Q. Crowe

James Q. Crowe
Chief Executive Officer

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

CERTIFICATIONS*

I, Sunit S. Patel, certify that:

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

Date: December 12 , 2007

/s/ Sunit S. Patel

Sunit S. Patel

Group Vice President and Chief Financial Officer

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

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

In connection with the Form 10-K/A-1 of Level 3 Communications, Inc. (the "Company") for the year ended December 31, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I James Q. Crowe, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

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

/s/ James Q. Crowe

James Q. Crowe
Chief Executive Officer
December 12, 2007

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

In connection with the Form 10-K/A-1 of Level 3 Communications, Inc. (the "Company") for the year ended December 31, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I Sunit S. Patel, Group Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

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

/s/ Sunit S. Patel

Sunit S. Patel

Group Vice President and Chief Financial Officer

December 12, 2007
