

# LEVEL 3 COMMUNICATIONS INC

## FORM 10-Q (Quarterly Report)

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Sector	Services
Fiscal Year	12/31

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

**FORM 10-Q**

(Mark One)

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

For the Quarterly Period Ended June 30, 2013

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 of Incorporation)

**47-0210602**

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

**1025 Eldorado Blvd., Broomfield, CO**

(Address of principal executive offices)

**80021-8869**

(Zip Code)

**(720) 888-1000**

(Registrant's telephone number,  
including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☐

(Do not check if a smaller reporting company)

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

The number of shares outstanding of each class of the issuer's common stock, as of August 2, 2013 :

Common Stock: 222,653,024 shares.

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

	<u>Page No.</u>
<u>Part I - Financial Information</u>	
Item 1.	<u><a href="#">Financial Statements :</a></u>
	<u><a href="#">Consolidated Statements of Operations</a></u>
	<u><a href="#">Consolidated Statements of Comprehensive Loss</a></u>
	<u><a href="#">Supplementary Stockholders' Equity Information</a></u>
	<u><a href="#">Consolidated Balance Sheets</a></u>
	<u><a href="#">Consolidated Statements of Cash Flows</a></u>
	<u><a href="#">Notes to Unaudited Consolidated Financial Statements</a></u>
Item 2.	<u><a href="#">Management's Discussion and Analysis of Financial Condition and Results of Operations</a></u>
Item 3.	<u><a href="#">Quantitative and Qualitative Disclosures about Market Risk</a></u>
Item 4.	<u><a href="#">Controls and Procedures</a></u>
<u>Part II - Other Information</u>	
Item 1.	<u><a href="#">Legal Proceedings</a></u>
Item 1A.	<u><a href="#">Risk Factors</a></u>
Item 6.	<u><a href="#">Exhibits</a></u>
<u><a href="#">Signatures</a></u>	<u><a href="#">44</a></u>
Certifications	

**Part I - Financial Information**
**ITEM 1. FINANCIAL STATEMENTS**

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

	Three Months Ended		Six Months Ended	
	June 30,	June 30,	June 30,	June 30,
(dollars in millions, except per share data)	2013	2012	2013	2012
Revenue	\$ 1,565	\$ 1,586	\$ 3,142	\$ 3,172
Costs and Expenses Exclusive of Depreciation and Amortization shown separately below:				
Cost of Revenue	616	648	1,245	1,305
Depreciation and Amortization	199	191	393	378
Selling, General and Administrative	610	614	1,209	1,240
Total Costs and Expenses	1,425	1,453	2,847	2,923
Operating Income	140	133	295	249
Other Income (Expense):				
Interest income	—	1	—	2
Interest expense	(167)	(181)	(336)	(370)
Loss on extinguishment of debt, net	—	—	—	(61)
Other, net	14	(7)	(36)	2
Total Other Expense	(153)	(187)	(372)	(427)
Loss Before Income Taxes	(13)	(54)	(77)	(178)
Income Tax Expense	(11)	(8)	(25)	(22)
Net Loss	\$ (24)	\$ (62)	\$ (102)	\$ (200)
Net Loss Per Share (Basic and Diluted)	\$ (0.11)	\$ (0.29)	\$ (0.46)	\$ (0.94)
Shares Used to Compute Basic and Diluted Net Loss per Share (in thousands)	221,609	216,399	220,445	213,081

See accompanying notes to unaudited consolidated financial statements.

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

(dollars in millions)	Three Months Ended		Six Months Ended	
	June 30, 2013	June 30, 2012	June 30, 2013	June 30, 2012
Net Loss	\$ (24)	\$ (62)	\$ (102)	\$ (200)
Other Comprehensive Loss Before Income Taxes:				
Foreign Currency Translation Adjustment	(12)	(66)	(56)	(32)
Holding Gain on Interest Rate Swaps	—	9	—	16
Other, net	1	1	(7)	2
Other Comprehensive Loss, Before Income Taxes	(11)	(56)	(63)	(14)
Income Tax Related to Items of Other Comprehensive Loss	—	—	—	—
Other Comprehensive Loss, Net of Income Taxes	(11)	(56)	(63)	(14)
Comprehensive Loss	<u>\$ (35)</u>	<u>\$ (118)</u>	<u>\$ (165)</u>	<u>\$ (214)</u>

See accompanying notes to unaudited consolidated financial statements.

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES**  
**Supplementary Stockholders' Equity Information**  
**Changes in Accumulated Other Comprehensive Income (Loss)**  
**(unaudited)**

<b>(dollars in millions)</b>	<b>Net Foreign Currency Translation Adjustment</b>	<b>Defined Benefit Pension Plans</b>	<b>Total</b>
Balance at December 31, 2012	\$ 56	\$ (30)	\$ 26
Other comprehensive loss before reclassifications	(44)	(9)	(53)
Amounts reclassified from accumulated other comprehensive loss	—	1	1
Balance at March 31, 2013	12	(38)	(26)
Other comprehensive loss before reclassifications	(12)	—	(12)
Amounts reclassified from accumulated other comprehensive loss	—	1	1
Balance at June 30, 2013	\$ —	\$ (37)	\$ (37)

See accompanying notes to unaudited consolidated financial statements.

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

(dollars in millions, except share data)	June 30, 2013	December 31, 2012
Assets:		
Current Assets:		
Cash and cash equivalents	\$ 596	\$ 979
Restricted cash and securities	7	8
Receivables, less allowances for doubtful accounts of \$32 and \$31, respectively	721	714
Other	179	141
Total Current Assets	1,503	1,842
Property, Plant and Equipment, net of accumulated depreciation of \$8,671 and \$8,359, respectively	8,171	8,199
Restricted Cash and Securities	27	35
Goodwill	2,565	2,565
Other Intangibles, net	232	268
Other Assets, net	367	398
Total Assets	<u>\$ 12,865</u>	<u>\$ 13,307</u>
Liabilities and Stockholders' Equity		
Current Liabilities:		
Accounts payable	\$ 688	\$ 779
Current portion of long-term debt	30	216
Accrued payroll and employee benefits	177	211
Accrued interest	192	209
Current portion of deferred revenue	226	251
Other	190	136
Total Current Liabilities	1,503	1,802
Long-Term Debt, less current portion	8,506	8,516
Deferred Revenue, less current portion	906	887
Other Liabilities	842	931
Total Liabilities	11,757	12,136
Commitments and Contingencies	—	—
Stockholders' Equity:		
Preferred stock, \$.01 par value, authorized 10,000,000 shares: no shares issued or outstanding	—	—
Common stock, \$.01 par value, authorized 343,333,333 shares in both periods; 221,915,741 issued and outstanding at June 30, 2013 and 218,380,070 issued and outstanding at December 31, 2012	2	2
Additional paid-in capital	14,102	14,000
Accumulated other comprehensive income (loss)	(37)	26
Accumulated deficit	(12,959)	(12,857)
Total Stockholders' Equity	1,108	1,171
Total Liabilities and Stockholders' Equity	<u>\$ 12,865</u>	<u>\$ 13,307</u>

See accompanying notes to unaudited consolidated financial statements.

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

(dollars in millions)	Six Months Ended	
	June 30, 2013	June 30, 2012
<b>Cash Flows from Operating Activities:</b>		
Net loss	\$ (102)	\$ (200)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	393	378
Non-cash compensation expense attributable to stock awards	85	53
Loss on extinguishment of debt, net	—	61
Accretion of debt discount and amortization of debt issuance costs	18	21
Accrued interest on long-term debt, net	(17)	11
Deferred income taxes	(7)	3
Gain on sale of property, plant and equipment and other assets	(1)	—
Other, net	(2)	12
Changes in working capital items:		
Receivables	(25)	(43)
Other current assets	(33)	(32)
Payables	(93)	(56)
Deferred revenue	4	(23)
Other current liabilities	3	(77)
<b>Net Cash Provided by Operating Activities</b>	<b>223</b>	<b>108</b>
<b>Cash Flows from Investing Activities:</b>		
Capital expenditures	(377)	(318)
Decrease in restricted cash and securities, net	8	4
Proceeds from the sale of property, plant and equipment and other assets	—	5
Other	(14)	—
<b>Net Cash Used in Investing Activities</b>	<b>(383)</b>	<b>(309)</b>
<b>Cash Flows from Financing Activities:</b>		
Long-term debt borrowings, net of issuance costs	—	880
Payments on and repurchases of long-term debt, including current portion and refinancing costs	(199)	(863)
Proceeds from stock options exercised	—	1
<b>Net Cash Provided by (Used in) Financing Activities</b>	<b>(199)</b>	<b>18</b>
Effect of Exchange Rates on Cash and Cash Equivalents	(24)	(2)
<b>Net Change in Cash and Cash Equivalents</b>	<b>(383)</b>	<b>(185)</b>
Cash and Cash Equivalents at Beginning of Period	979	918
<b>Cash and Cash Equivalents at End of Period</b>	<b>\$ 596</b>	<b>\$ 733</b>
<b>Supplemental Disclosure of Cash Flow Information:</b>		
Cash interest paid	\$ 335	\$ 338
Income taxes paid, net of refunds	\$ 20	\$ 19
<b>Non-cash Financing Activities:</b>		
Long-term debt conversion into equity	\$ —	\$ 100
Premium on long-term debt conversion into equity	\$ —	\$ 39
Accrued interest conversion into equity	\$ —	\$ 2

See accompanying notes to unaudited consolidated financial statements.





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

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

*Description of Business*

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

*Principles of Consolidation and Basis of Presentation*

The consolidated financial statements include the accounts of Level 3 Communications, Inc. and subsidiaries in which it has a controlling interest. All significant intercompany accounts and transactions have been eliminated. The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP").

As part of its consolidation policy, the Company considers its controlled subsidiaries, investments in businesses in which the Company is not the primary beneficiary or does not have effective control but has the ability to significantly influence operating and financial policies, and variable interests resulting from economic arrangements that give the Company rights to economic risks or rewards of a legal entity. The Company does not have variable interests in a variable interest entity.

The accompanying consolidated balance sheet as of December 31, 2012, which was derived from audited consolidated financial statements, and the unaudited interim consolidated financial statements as of June 30, 2013 and for the three and six months ended June 30, 2013 and 2012 have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") for quarterly reports on Form 10-Q and do not include all of the information and note disclosures required by GAAP for complete financial statements. These financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto included in the Company's Form 10-K for the year ended December 31, 2012. In the opinion of the Company's management, these financial statements contain all adjustments necessary for a fair presentation of financial position, results of operations and cash flows at the dates and for the interim periods presented herein. The results of operations for an interim period are not necessarily indicative of the results of operations expected for a full fiscal year.

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses during the reported period. Actual results could differ from these estimates under different assumptions or conditions and such differences could be material.

*Reclassifications*

Certain amounts in the prior period consolidated financial statements and accompanying footnotes have been reclassified to conform to the current year's presentation.

*Goodwill and Acquired Indefinite-Lived Intangible Assets*

Accounting guidance prohibits the amortization of goodwill and purchased intangible assets with indefinite useful lives. The Company reviews goodwill and purchased intangible assets with indefinite lives for impairment

annually and whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable.

In the second quarter of 2013, the Company changed the date of its annual assessment of goodwill impairment from December 31 to October 1. This is a change in method of applying an accounting principle which management believes is a preferable alternative as the new date of the assessment provides additional time prior to the Company's year-end to complete the goodwill impairment testing and report the results in the Company's Annual Report on Form 10-K, and is more closely aligned with the Company's strategic planning process. The change in the assessment date does not delay, accelerate or avoid a potential impairment charge.

For a more detailed description of the Company's goodwill impairment assessment process, please see Note 1 of the Company's Form 10-K for the year ended December 31, 2012, filed with the SEC.

#### *Recently Issued Accounting Pronouncements*

In February 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. The guidance in this ASU requires an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under GAAP to be reclassified in its entirety to net income. For other amounts that are not required under GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under GAAP that provide additional detail about those amounts. The amendments in this ASU do not change the current requirements for reporting net income or other comprehensive income in financial statements. Public companies are required to comply with the requirements of this ASU for all reporting periods (interim and annual) beginning after December 15, 2012. The Company adopted this amendment in the first quarter of 2013. The impact of its adoption was limited to disclosure requirements.

In July 2013, the FASB issued ASU 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. Under current GAAP, there is no explicit guidance on presentation of unrecognized tax benefits when such carryforwards exist, which has led to diversity in practice. ASU 2013-11 requires entities to present an unrecognized tax benefit as a reduction of a deferred tax asset for a net operating loss (NOL) carryforward whenever the NOL or tax credit carryforward would be available to reduce the additional taxable income or tax due if the tax position is disallowed. The ASU is effective for fiscal years beginning after December 15, 2013, and interim periods within those years. The adoption of this guidance is not expected to have a material effect on the Company's consolidated results of operations or financial condition.

## **(2) Loss Per Share**

The Company computes basic net loss per share by dividing net loss for the period by the weighted average number of shares of common stock outstanding during the period. Diluted net loss per share is computed by dividing net loss for the period by the weighted average number of shares of common stock outstanding during the period and including the dilutive effect of common stock that would be issued assuming conversion or exercise of outstanding convertible notes, stock based compensation awards and other dilutive securities.

The effect of approximately 28 million and 35 million shares issuable pursuant to the various series of convertible notes outstanding at June 30, 2013 and June 30, 2012, 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 6 million stock options, outperform stock appreciation rights ("OSOs"), restricted stock units and warrants outstanding at both June 30, 2013 and June 30, 2012, have not been included in the computation of diluted loss per share because their inclusion would have been anti-dilutive to the computation.

### (3) Acquired Intangible Assets

Identifiable acquisition-related intangible assets as of June 30, 2013 and December 31, 2012, were as follows (dollars in millions):

	Gross Carrying Amount	Accumulated Amortization	Net
<b>June 30, 2013</b>			
<i>Finite-Lived Intangible Assets:</i>			
Customer Contracts and Relationships	\$ 776	\$ (655)	\$ 121
Trademarks	55	(24)	31
Patents and Developed Technology	158	(110)	48
	989	(789)	200
<i>Indefinite-Lived Intangible Assets:</i>			
Vyvx Trade Name	32	—	32
	<u>\$ 1,021</u>	<u>\$ (789)</u>	<u>\$ 232</u>
<b>December 31, 2012</b>			
<i>Finite-Lived Intangible Assets:</i>			
Customer Contracts and Relationships	\$ 776	\$ (633)	\$ 143
Trademarks	55	(17)	38
Patents and Developed Technology	158	(103)	55
	989	(753)	236
<i>Indefinite-Lived Intangible Assets:</i>			
Vyvx Trade Name	32	—	32
	<u>\$ 1,021</u>	<u>\$ (753)</u>	<u>\$ 268</u>

Acquired finite-lived intangible asset amortization expense was \$18 million and \$36 million for the three and six months ended June 30, 2013 and \$25 million and \$50 million for the three and six months ended June 30, 2012 .

At June 30, 2013 , the weighted average remaining useful lives of the Company's acquired finite-lived intangible assets was 2.7 years for customer contracts and relationships, 2.3 years for trademarks and 3.5 years for patents and developed technology.

As of June 30, 2013 , estimated amortization expense for the Company's finite-lived acquisition-related intangible assets over the next five years and thereafter is as follows (dollars in millions):

2013 (remaining six months)	\$ 37
2014	61
2015	45
2016	28
2017	13
2018	13
Thereafter	3
	<u>\$ 200</u>

#### **(4) Fair Value of Financial Instruments**

The Company's financial instruments consist of cash and cash equivalents, restricted cash and securities, accounts receivable, accounts payable, capital leases, other liabilities, interest rate swaps and long-term debt (including the current portion). The carrying values of cash and cash equivalents, restricted cash and securities, accounts receivable, accounts payable, capital leases and other liabilities approximated their fair values at June 30, 2013 and December 31, 2012. The interest rate swaps are recorded in the consolidated balance sheets at fair value (see Note 5 - Derivative Financial Instruments).

GAAP defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements and disclosures for assets and liabilities required to be recorded at fair value, the Company considers the principal or most advantageous market in which it would transact and considers assumptions that market participants would use when pricing the asset or liability, such as interest and foreign exchange rates, transfer restrictions, and risk of nonperformance.

##### *Fair Value Hierarchy*

GAAP establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The fair value measurement of each class of assets and liabilities is dependent upon its categorization within the fair value hierarchy, based upon the lowest level of input that is significant to the fair value measurement of each class of asset and liability. GAAP establishes three levels of inputs that may be used to measure fair value:

*Level 1* — Unadjusted quoted prices in active markets for identical assets or liabilities.

*Level 2* — Unadjusted quoted prices for similar assets or liabilities in active markets, or unadjusted quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs other than quoted prices that are observable for the asset or liability.

*Level 3* — Unobservable inputs for the asset or liability.

The table below presents the fair values for the Company's interest rate swaps and long-term debt as well as the input levels used to determine these fair values as of June 30, 2013 and December 31, 2012:

(dollars in millions)	Fair Value Measurement Using					
	Total Carrying Value in Consolidated Balance Sheet		Unadjusted Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)		Significant Other Observable Inputs (Level 2)	
	June 30, 2013	December 31, 2012	June 30, 2013	December 31, 2012	June 30, 2013	December 31, 2012
<i>Liabilities Recorded at Fair Value in the Financial Statements:</i>						
Derivatives:						
Interest Rate Swap Liabilities (included in other current and non-current liabilities)	\$ 34	\$ 56	\$ —	\$ —	\$ 34	\$ 56
Total Derivative Liabilities Recorded at Fair Value in the Financial Statements	\$ 34	\$ 56	\$ —	\$ —	\$ 34	\$ 56
<i>Liabilities Not Recorded at Fair Value in the Financial Statements:</i>						
Long-term Debt, including the current portion:						
Term Loans	\$ 2,602	\$ 2,603	\$ 2,617	\$ 2,631	\$ —	\$ —
Senior Notes	5,186	5,185	5,504	5,712	—	—
Convertible Notes	675	846	274	286	558	748
Capital Leases and Other	73	98	—	—	73	98
Total Long-term Debt, including the current portion:	\$ 8,536	\$ 8,732	\$ 8,395	\$ 8,629	\$ 631	\$ 846

The Company does not have any assets or liabilities where the fair value is measured using significant unobservable inputs (Level 3).

#### Derivatives

The fair value of interest rate swaps are estimated using discounted cash flow techniques that use observable market inputs, such as LIBOR-based forward yield curves, forward rates, non-performance risk adjustment and the specific swap rate stated in each of the swap agreements.

#### Term Loans

The fair value of the Term Loans referenced above was approximately \$2.6 billion at both June 30, 2013 and December 31, 2012. The fair value of each loan is based on quoted prices for identical terms and maturities. Each loan tranche is actively traded.

The Term Loans are secured by a pledge of the equity interests in certain U.S.-based subsidiaries of Level 3 Financing, Inc.; 65% of the equity interests in each of Level 3 Financing, Inc.'s Canadian subsidiary and its

Bermuda subsidiary that indirectly owns Global Crossing's non-U.S. subsidiaries; and liens on the assets of Level 3 Communications, Inc. and certain U.S.-based subsidiaries of Level 3 Financing, Inc. In addition, Level 3 Communications, Inc. and certain U.S.-based subsidiaries of Level 3 Financing, Inc. have provided full and unconditional guarantees of the obligations under the Term Loans.

#### *Senior Notes*

The fair value of the Senior Notes referenced above was approximately \$5.5 billion and \$5.7 billion at June 30, 2013 and December 31, 2012, respectively, based on quoted prices for identical terms and maturities. Each series of notes is actively traded.

The 11.875% Senior Notes due 2019 and the 8.875% Senior Notes due 2019 were issued by Level 3 Communications, Inc. and are not guaranteed by any of the Company's subsidiaries. The remaining Senior Notes are obligations of Level 3 Financing, Inc. and are all fully and unconditionally guaranteed by Level 3 Communications, Inc. and by Level 3 Communications, LLC.

#### *Convertible Notes*

The fair value of the Company's actively traded 6.5% Convertible Senior Notes due 2016 was approximately \$274 million and \$286 million at June 30, 2013 and December 31, 2012, respectively. The fair value of the Company's actively traded Convertible Notes referenced above is based on the trading quotes for identical notes. The fair value of the Company's Convertible Notes that are not actively traded, such as the 7% Convertible Senior Notes due 2015, the 7% Convertible Senior Notes due 2015, Series B, and the 15% Convertible Senior Notes due 2013 which were repaid in full at maturity during the quarter ended March 31, 2013, was approximately \$558 million and \$748 million at June 30, 2013 and December 31, 2012, respectively. The estimated fair value of the Convertible Notes that are not actively traded are based on a Black-Scholes valuation model and an income approach using discounted cash flows. The most significant inputs affecting the valuation are the pricing quotes provided by market participants that incorporate spreads to the Treasury curve, security coupon (ranging from 7% to 15% ), convertible optionality, corporate and security credit ratings, maturity date (ranging from 2013 to 2015), liquidity, and other equity option inputs, such as the risk-free rate, underlying stock price, strike price of the embedded derivative, estimated volatility and maturity inputs for the option component and for the bond component, among other security characteristics and relative value at both the borrower entity level and across other securities with similar terms. The fair value of each instrument is obtained by adding together the value derived by discounting the security's coupon or interest payment using a risk-adjusted discount rate and the value calculated from the embedded equity option based on the estimated volatility of the Company's stock price, conversion rate of the particular Convertible Note, remaining time to maturity, and risk-free rate. The Convertible Notes are unsecured obligations of Level 3 Communications, Inc. No subsidiary of Level 3 Communications, Inc. has provided a guarantee of the Convertible Notes.

## (5) Derivative Financial Instruments

The Company has floating rate long-term debt (see Note 6 - Long-Term Debt). Such debt exposes the Company to variability in interest payments due to changes in interest rates. If interest rates increase, interest expense increases. Conversely, if interest rates decrease, interest expense also generally decreases. The Company uses interest rate swaps in an attempt to manage its exposure to fluctuations in interest rate movements. The Company's primary objective in managing interest rate risk is to decrease the volatility of its earnings and cash flows affected by changes in the underlying rates. The Company does not use derivative financial instruments for speculative purposes.

In March 2007, Level 3 Financing, Inc. entered into two interest rate swap agreements to hedge the interest payments on \$1 billion notional amount of floating rate debt. The Company had designated these interest rate swap agreements as cash flow hedges. The two interest rate swap agreements are with different counterparties and are for \$500 million each. The arrangements began in April 2007 and mature in January 2014. Under the terms of these arrangements, the Company receives interest payments based on rolling three month LIBOR terms and pays interest at the fixed rate of 4.93% under one arrangement and approximately 4.92% under the other.

Interest Rate Derivative	Number of Instruments	Notional (dollars in millions)
Interest rate swaps	Two	\$ 1,000

On a quarterly basis through August 6, 2012, the Company evaluated the effectiveness of the hedges by measuring the extent to which the change in the variable portion of the interest rate swaps offset the changes in interest expense paid due to fluctuations in the LIBOR-based interest rate. Prior to August 6, 2012, these derivatives were deemed effective cash flow hedges and hedge ineffectiveness was not material in any periods presented. As a result, the change in the fair value of the interest rate swap agreements was reflected in Accumulated Other Comprehensive Income ("AOCI") and was subsequently reclassified into earnings through an interest expense yield adjustment, as interest expense on the hedged debt obligation was incurred.

As a result of the refinancing of the Tranche A Term Loan on August 6, 2012, the two interest rate swap agreements maturing in early 2014 that had effectively hedged changes in the interest rate on a portion of the Tranche A Term Loan were deemed "ineffective" under GAAP and cash flow hedge accounting was discontinued. After August 6, 2012, the Company has recorded the change in the fair value of the swaps in Other Income in its Consolidated Statement of Operations until maturity of the swaps in early 2014. For the three and six months ended June 30, 2013, the Company recognized a loss of \$1 million, in Other, net in the Company's Consolidated Statement of Operations.

The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the consolidated balance sheets (dollars in millions):

Derivatives not designated as hedging instruments	Liability Derivatives			
	June 30, 2013		December 31, 2012	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Interest rate swap agreements	Other current liabilities	\$ 34	Other non-current liabilities	\$ 56



The amount of net gains (losses) recognized in Accumulated Other Comprehensive Income (Loss), including reclassification gains (losses) consists of the following (dollars in millions):

Derivatives designated as hedging instruments	2013		2012	
Cash flow hedging contracts				
Three Months Ended June 30,	\$	—	\$	9
Six Months Ended June 30,	\$	—	\$	16

The amount of gains (losses) reclassified from Accumulated Other Comprehensive Income (Loss) to earnings (effective portions) consists of the following (dollars in millions):

Derivatives designated as hedging instruments	Statement of Operations Location	2013		2012	
Cash flow hedging contracts					
Three Months Ended June 30,	Interest Expense	\$	—	\$	(11)
Six Months Ended June 30,	Interest Expense	\$	—	\$	(22)

The Company is exposed to credit related losses in the event of non-performance by counterparties. The counterparties to the financial derivatives the Company has entered into are major institutions with investment grade credit ratings. The Company evaluates counterparty credit risk before entering into any hedge transaction and continues to closely monitor the financial market and the risk that its counterparties will default on their obligations. This credit risk is generally limited to the unrealized gains in such contracts, should any of these counterparties fail to perform as contracted.

## (6) Long-Term Debt

As of June 30, 2013 and December 31, 2012, long-term debt was as follows:

(dollars in millions)	June 30, 2013	December 31, 2012
Senior Secured Term Loan*	\$ 2,611	\$ 2,614
Floating Rate Senior Notes due 2015 (4.215% as of June 30, 2013 and 4.469% as of December 31, 2012)	300	300
10% Senior Notes due 2018	640	640
11.875% Senior Notes due 2019	605	605
9.375% Senior Notes due 2019	500	500
8.125% Senior Notes due 2019	1,200	1,200
8.875% Senior Notes due 2019	300	300
8.625% Senior Notes due 2020	900	900
7% Senior Notes due 2020	775	775
15% Convertible Senior Notes due 2013	—	172
7% Convertible Senior Notes due 2015	200	200
7% Convertible Senior Notes due 2015 Series B	275	275
6.5% Convertible Senior Notes due 2016	201	201
Capital Leases	71	86
Other	2	12
Total Debt Obligations	8,580	8,780
Unamortized Discount:		
Discount on Senior Secured Term Loan	(9)	(11)
Discount on 10% Senior Notes due 2018	(9)	(10)
Discount on 11.875% Senior Notes due 2019	(9)	(9)
Discount on 9.375% Senior Notes due 2019	(8)	(8)
Discount on 8.125% Senior Notes due 2019	(8)	(8)
Discount on 7% Convertible Senior Notes due 2015	(1)	(2)
Total Unamortized Discount	(44)	(48)
Carrying Value of Debt	8,536	8,732
Less current portion	(30)	(216)
Long-term Debt, less current portion	\$ 8,506	\$ 8,516

\* The \$596 million Tranche B 2016 Term Loan due 2016, the \$815 million Tranche B 2019 Term Loan due 2019 and the \$1.2 billion Tranche B-II 2019 Term Loan due 2019 had interest rates of 4.75%, 5.25% and 4.75%, respectively, as of June 30, 2013. The \$599 million Tranche B 2016 Term Loan due 2016, the \$815 million Tranche B 2019 Term Loan due 2019 and the \$1.2 billion Tranche B-II 2019 Term Loan due 2019 had interest rates of 4.75%, 5.25% and 4.75%, respectively, as of December 31, 2012. The Tranche B 2016 Term Loan requires repayment of 0.25% of the original \$600 million aggregate principal amount on the last day of each March, June, September and December, beginning with December 31, 2012 and ending with such last day to occur prior to maturity.

## 2013 Debt Redemptions and Registrations

### 15% Convertible Senior Notes due 2013

On January 15, 2013, the Company repaid at maturity approximately \$172 million of its 15% Convertible Senior Notes due 2013.

### 8.875% Senior Notes due 2019

The 8.875% Senior Notes due 2019 issued by Level 3 Communications, Inc. were not originally registered under the Securities Act of 1933, as amended. During the second quarter of 2013, all of the originally placed notes were exchanged for a new issue of 8.875% Senior Notes due 2019 with identical terms and conditions, other than those related to registration rights, in a registered exchange offer and are now freely tradeable.

### 7% Senior Notes due 2020

The 7% Senior Notes due 2020 issued by Level 3 Financing, Inc. were not originally registered under the Securities Act of 1933, as amended. During the second quarter of 2013, all of the originally placed notes were exchanged for a new issue of 7% Senior Notes due 2020 with identical terms and conditions, other than those related to registration rights, in a registered exchange offer and are now freely tradeable. The 7% Senior Notes due 2020 are guaranteed by Level 3 Communications, Inc. and Level 3 Communications, LLC.

## Long-Term Debt Maturities

Aggregate future contractual maturities of long-term debt and capital leases (excluding discounts) were as follows as of June 30, 2013 (dollars in millions):

2013 (remaining six months)	\$	18
2014		22
2015		788
2016		788
2017		5
2018		645
Thereafter		6,314
	\$	<u>8,580</u>

## (7) Stock-Based Compensation

The following table summarizes non-cash compensation expense and capitalized non-cash compensation for the three and six months ended June 30, 2013 and 2012 (dollars in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
OSO	\$ 11	\$ 4	\$ 16	\$ 6
Restricted Stock Units and Shares	14	14	21	18
401(k) Match Expense	5	6	13	13
Restricted Stock Unit Bonus Grant	14	5	29	16
Management Incentive and Retention Plan	4	—	6	—
	48	29	85	53
Capitalized Non-Cash Compensation	—	—	—	—
	\$ 48	\$ 29	\$ 85	\$ 53

The Company capitalizes non-cash compensation for those employees directly involved in the construction of the network, installation of services for customers or the development of business support systems. As of June 30, 2013, there were approximately 2 million OSOs outstanding. As of June 30, 2013, there were approximately 4 million nonvested restricted stock and restricted stock units (“RSUs”) outstanding (including those related to the Management Incentive and Retention Plan). In addition, as of June 30, 2013, there were approximately 55 thousand non-qualified stock options outstanding.

## (8) Commitments, Contingencies and Other Items

The Company is subject to various legal proceedings and other contingent liabilities that individually or in the aggregate could materially affect its financial condition, future results of operations or cash flows. Amounts accrued for such contingencies aggregate to \$259 million and are included in “Other” current liabilities and “Other Liabilities” in the Company's consolidated balance sheet as at June 30, 2013. The establishment of an accrual does not mean that actual funds have been set aside to satisfy a given contingency. Thus, the resolution of a particular contingency for the amount accrued may have no effect on the Company's results of operations but could materially adversely affect its cash flows for the affected period.

In accordance with the accounting guidance for contingencies, the Company accrues its estimate of a contingent liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Where it is probable that a liability has been incurred and there is a range of expected loss for which no amount in the range is more likely than any other amount, the Company accrues at the low end of the range. The Company reviews its accruals at least quarterly and adjusts them to reflect the impact of negotiations, settlements, rulings, advice of legal counsel, and other information and events pertaining to a particular matter.

Below is a description of material legal proceedings and other contingencies pending at June 30, 2013. Although the Company believes it has accrued for these matters in accordance with the accounting guidance for contingencies, contingencies are inherently unpredictable and it is possible that results of operations or cash flows could be materially and adversely affected in any particular period by unfavorable developments in, or resolution or disposition of, one or more of these matters. For those contingencies in respect of which the Company believes that it is reasonably possible that a loss may result that is materially in excess of the accrual (if any) established for the matter, the Company has below either provided an estimate of such possible loss or range of loss or included a statement that such an estimate cannot be made. In addition to the contingencies described below, the Company is

party to many other legal proceedings and contingencies the resolution of which is not expected to materially affect its financial condition or future results of operations beyond the amounts accrued.

#### *Rights-of-Way Litigation*

The Company is party to a number of purported class action lawsuits involving its right to install fiber optic cable network in railroad right-of-ways adjacent to plaintiffs' land. In general, the Company obtained the rights to construct its networks from railroads, utilities, and others, and has installed its 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 fiber optic cable networks pass, and that the railroads, utilities, and others who granted the Company the right to construct and maintain its network 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 Company has also received, and may in the future receive, claims and demands related to rights-of-way issues similar to the issues in these cases that may be based on similar or different legal theories. The Company has defeated motions for class certification in a number of these actions but expects that, absent settlement of these actions, plaintiffs in the pending lawsuits will continue to seek certification of statewide or multi-state classes. The only lawsuit in which a class was certified against the Company, absent an agreed upon settlement, occurred in *Koyle, et. al. v. Level 3 Communications, Inc., et. al.*, a purported two state class action filed in the United States District Court for the District of Idaho. The *Koyle* lawsuit has been dismissed pursuant to a settlement reached in November 2010 as described further below.

The Company negotiated a series of class settlements affecting all persons who own or owned land next to or near railroad rights of way in which it has installed its fiber optic cable networks. The United States District Court for the District of Massachusetts in *Kingsborough v. Sprint Communications Co. L.P.* granted preliminary approval of the proposed settlement; however, on September 10, 2009, the court denied a motion for final approval of the settlement on the basis that the court lacked subject matter jurisdiction and dismissed the case.

In November 2010, the Company negotiated revised settlement terms for a series of state class settlements affecting all persons who own or owned land next to or near railroad rights of way in which the Company has installed its fiber optic cable networks. The Company is currently pursuing presentment of the settlement in applicable jurisdictions. The settlements, affecting current and former landowners, have received final federal court approval in multiple states and the parties are engaged in the claims process for those states. The settlement has also been presented to federal courts in additional states and approval is pending.

Management believes that the Company has substantial defenses to the claims asserted in all of these actions and intends to defend them vigorously if a satisfactory settlement is not ultimately approved for all affected landowners.

#### *Peruvian Tax Litigation*

Beginning in 2005, one of the Company's Peruvian subsidiaries received a number of assessments for tax, penalties and interest for calendar years 2001 and 2002. Peruvian tax authorities (SUNAT) took the position that the Peruvian subsidiary incorrectly documented its importations resulting in additional income tax withholding and value-added taxes (VAT). The total amount of the asserted claims, including potential interest and penalties, was \$26 million, consisting of \$3 million for income tax withholding in connection with the import of services for calendar years 2001 and 2002, \$7 million for VAT in connection with the import of services for calendar years 2001 and 2002, and \$16 million in connection with the disallowance of VAT credits for periods beginning in 2005. Due to accrued interest and foreign exchange effects, and taking into account the developments described below, the total amount of exposure has increased to \$92 million at June 30, 2013.

The Company challenged the tax assessments during 2005 by filing administrative claims before SUNAT. During August 2006 and June 2007, SUNAT rejected the Company's administrative claims, thereby confirming the assessments. Appeals were filed in September 2006 and July 2007 in the Tax Court, which is the highest administrative authority. In October 2011, the Tax Court issued a ruling regarding VAT, associated penalties and penalties associated with withholding taxes, adjudicating the central issue underlying the assessments in the

government's favor, while confirming the assessment in part and denying a portion of the assessment on procedural grounds. Other than an immaterial amount, all assessed items dismissed by the Tax Court in this ruling remain open for reassessment by SUNAT. While this Tax Court ruling applies only to 2002, the Company believes the Tax Court will issue a similar ruling with respect to 2001, and all material amounts likely to be waived due to procedural defects similarly remain open for reassessment.

In November 2011, the Tax Court issued a ruling with respect to assessed 2001 withholding tax, holding that the statute of limitations had run prior to assessment by SUNAT. The Company believes that this adjudication of the withholding tax issue is likely to be final, and the Company expects to win a similar verdict with respect to assessed 2002 withholding tax. However, penalties with respect to withholding tax are not time-barred, and were confirmed in the Tax Court's October 2011 ruling.

The Company has appealed the Tax Court's October 2011 decision to the judicial court in Peru. The Company has not received Tax Court rulings for all periods, but it has received adjudications of each substantive issue for at least one period. As a result, the Company expects decisions for the remaining open periods to be consistent with decisions already rendered. The Company intends to appeal any Tax Court verdict with respect to 2001 to the extent consistent with the October 2011 decision in the government's favor and will protest any reassessment of amounts dismissed by the Tax Court on procedural grounds.

#### *Employee Severance and Contractor Termination Disputes*

A number of former employees and third-party contractors have asserted a variety of claims in litigation against certain Latin American subsidiaries of the Company for separation pay, severance, commissions, pension benefits, unpaid vacation pay, breach of employment contracts, unpaid performance bonuses, property damages, moral damages and related statutory penalties, fines, costs and expenses (including accrued interest, attorneys fees and statutorily mandated inflation adjustments) as a result of their separation from the Company or termination of service relationships. The Company is vigorously defending itself against the asserted claims, which aggregate to approximately \$40 million .

#### *Brazilian Tax Claims*

In December 2004, March 2009 and April 2009, the São Paulo state tax authorities issued tax assessments against one of the Company's Brazilian subsidiaries for the Tax on Distribution of Goods and Services ("ICMS") with respect to revenue from leasing movable properties (in the case of the December 2004 and March 2009 assessments) and revenue from the provision of Internet access services (in the case of the April 2009 assessment), by treating such activities as the provision of communications services, to which the ICMS tax applies. In September 2002, July 2009 and May 2012, the Rio de Janeiro state tax authorities issued tax assessments to the same Brazilian subsidiary on similar issues. The Company has filed objections to these assessments, arguing that the lease of assets and the provision of Internet access are not communication services subject to ICMS. The objections to the December 2004 and September 2002 assessments were rejected by the respective state administrative courts, and the Company has appealed those decisions to the judicial courts. In October 2012, the Company received a favorable ruling from the lower court on the December 2004 assessment regarding equipment leasing, but that ruling is subject to appeal by the state. No ruling has been obtained with respect to the September 2002 assessment. The objections to the March, April and July 2009 and May 2012 assessments are still pending final administrative decisions.

The Company is vigorously contesting all such assessments in both states, and in particular, views the assessment of ICMS on revenue from leasing movable properties to be without merit. Nevertheless, the Company believes that it is reasonably possible that these assessments could result in a loss of up to \$59 million in excess of the accruals established for these matters.

*Letters of Credit*

It is customary for Level 3 to use various financial instruments in the normal course of business. These instruments include letters of credit. Letters of credit are conditional commitments issued on behalf of Level 3 in accordance with specified terms and conditions. As of June 30, 2013 and December 31, 2012, Level 3 had outstanding letters of credit or other similar obligations of approximately \$27 million and \$31 million, respectively, of which \$25 million and \$29 million, are collateralized by cash, that is reflected on the consolidated balance sheets as restricted cash. The Company does not believe exposure to loss related to its letters of credit is material.

**(9) Condensed Consolidating Financial Information**

Level 3 Financing, Inc., a wholly owned subsidiary of the Company, has issued senior notes that are unsecured obligations of Level 3 Financing, Inc.; however, they are also fully and unconditionally and jointly and severally guaranteed on an unsecured senior basis by Level 3 Communications, Inc. and Level 3 Communications, LLC.

In conjunction with the registration of the senior notes, 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 is not intended to present the operating results of those legal entities on a stand-alone basis. Level 3 Communications, LLC leases equipment and certain facilities from other wholly owned subsidiaries of Level 3 Communications, Inc. These transactions are eliminated in the consolidated results of the Company.

**Condensed Consolidating Statements of Comprehensive Income (Loss)**  
**Three Months Ended June 30, 2013**

	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC	Other Non- Guarantor Subsidiaries	Eliminations	Total
	(dollars in millions)					
Revenue	\$ —	\$ —	\$ 694	\$ 928	\$ (57)	\$ 1,565
Costs and Expense:						
Cost of Revenue	—	—	256	417	(57)	616
Depreciation and Amortization	—	—	71	128	—	199
Selling, General and Administrative	—	—	412	198	—	610
Total Costs and Expenses	—	—	739	743	(57)	1,425
Operating Income (Loss)	—	—	(45)	185	—	140
Other Income (Expense):						
Interest expense	(37)	(125)	—	(5)	—	(167)
Interest income (expense) affiliates, net	272	425	(669)	(28)	—	—
Equity in net earnings (losses) of subsidiaries	(259)	(559)	130	—	688	—
Other, net	—	—	1	13	—	14
Total Other Expense	(24)	(259)	(538)	(20)	688	(153)
Income (Loss) before Income Taxes	(24)	(259)	(583)	165	688	(13)
Income Tax Expense	—	—	—	(11)	—	(11)
Net Income (Loss)	(24)	(259)	(583)	154	688	(24)
Other Comprehensive Loss, Net of Income Taxes	(11)	(11)	—	(11)	22	(11)
Comprehensive Income (Loss)	\$ (35)	\$ (270)	\$ (583)	\$ 143	\$ 710	\$ (35)



**Condensed Consolidating Statements of Comprehensive Income (Loss)**  
**Six Months Ended June 30, 2013**

	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC	Other Non- Guarantor Subsidiaries	Eliminations	Total
	(dollars in millions)					
Revenue	\$ —	\$ —	\$ 1,379	\$ 1,884	\$ (121)	\$ 3,142
Costs and Expense:						
Cost of Revenue	—	—	517	849	(121)	1,245
Depreciation and Amortization	—	—	142	251	—	393
Selling, General and Administrative	1	—	793	415	—	1,209
Total Costs and Expenses	1	—	1,452	1,515	(121)	2,847
Operating Income (Loss)	(1)	—	(73)	369	—	295
Other Income (Expense):						
Interest expense	(76)	(251)	(1)	(8)	—	(336)
Interest income (expense) affiliates, net	545	855	(1,338)	(62)	—	—
Equity in net earnings (losses) of subsidiaries	(570)	(1,173)	276	—	1,467	—
Other, net	—	(1)	2	(37)	—	(36)
Total Other Expense	(101)	(570)	(1,061)	(107)	1,467	(372)
Income (Loss) before Income Taxes	(102)	(570)	(1,134)	262	1,467	(77)
Income Tax Expense	—	—	(1)	(24)	—	(25)
Net Income (Loss)	(102)	(570)	(1,135)	238	1,467	(102)
Other Comprehensive Loss, Net of Income Taxes	(63)	(63)	—	(63)	126	(63)
Comprehensive Income (Loss)	\$ (165)	\$ (633)	\$ (1,135)	\$ 175	\$ 1,593	\$ (165)

**Condensed Consolidating Statements of Comprehensive Income (Loss)**  
**Three Months Ended June 30, 2012**

	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC	Other Non-Guarantor Subsidiaries	Eliminations	Total
	(dollars in millions)					
Revenue	\$ —	\$ —	\$ 659	\$ 991	\$ (64)	\$ 1,586
Costs and Expense:						
Cost of Revenue	—	—	244	465	(61)	648
Depreciation and Amortization	—	—	66	125	—	191
Selling, General and Administrative	—	—	396	221	(3)	614
Total Costs and Expenses	—	—	706	811	(64)	1,453
Operating Income (Loss)	—	—	(47)	180	—	133
Other Income (Expense):						
Interest income	—	—	—	1	—	1
Interest expense	(38)	(134)	(1)	(8)	—	(181)
Interest income (expense) affiliates, net	245	403	(558)	(90)	—	—
Equity in net earnings (losses) of subsidiaries	(269)	(538)	25	—	782	—
Other, net	—	—	2	(9)	—	(7)
Total Other Expense	(62)	(269)	(532)	(106)	782	(187)
Income (Loss) before Income Taxes	(62)	(269)	(579)	74	782	(54)
Income Tax Expense	—	—	(1)	(7)	—	(8)
Net Income (Loss)	(62)	(269)	(580)	67	782	(62)
Other Comprehensive Loss, Net of Income Taxes	(56)	(56)	—	(65)	121	(56)
Comprehensive Income (Loss)	\$ (118)	\$ (325)	\$ (580)	\$ 2	\$ 903	\$ (118)

**Condensed Consolidating Statements of Comprehensive Income (Loss)**  
**Six Months Ended June 30, 2012**

	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC	Other Non-Guarantor Subsidiaries	Eliminations	Total
(dollars in millions)						
Revenue	\$ —	\$ —	\$ 1,285	\$ 2,014	\$ (127)	\$ 3,172
Costs and Expense:						
Cost of Revenue	—	—	480	946	(121)	1,305
Depreciation and Amortization	—	—	133	245	—	378
Selling, General and Administrative	1	—	797	448	(6)	1,240
Total Costs and Expenses	1	—	1,410	1,639	(127)	2,923
Operating Income (Loss)	(1)	—	(125)	375	—	249
Other Income (Expense):						
Interest income	—	—	1	1	—	2
Interest expense	(80)	(273)	(1)	(16)	—	(370)
Interest income (expense) affiliates, net	490	802	(1,117)	(175)	—	—
Equity in net earnings (losses) of subsidiaries	(570)	(1,077)	61	—	1,586	—
Other, net	(39)	(22)	3	(1)	—	(59)
Total Other Expense	(199)	(570)	(1,053)	(191)	1,586	(427)
Income (Loss) before Income Taxes	(200)	(570)	(1,178)	184	1,586	(178)
Income Tax Expense	—	—	(2)	(20)	—	(22)
Net Income (Loss)	(200)	(570)	(1,180)	164	1,586	(200)
Other Comprehensive Loss, Net of Income Taxes	(14)	(14)	—	(30)	44	(14)
Comprehensive Income (Loss)	\$ (214)	\$ (584)	\$ (1,180)	\$ 134	\$ 1,630	\$ (214)

# **Condensed Consolidating Balance Sheets** **June 30, 2013**

	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC	Other Non- Guarantor Subsidiaries	Eliminations	Total
(dollars in millions)						
<b>Assets</b>						
<b>Current Assets:</b>						
Cash and cash equivalents	\$ 9	\$ 5	\$ 357	\$ 225	\$ —	\$ 596
Restricted cash and securities	—	—	1	6	—	7
Receivables, less allowances for doubtful accounts	—	—	103	618	—	721
Due from affiliates	15,017	16,312	—	—	(31,329)	—
Other	4	16	67	92	—	179
<b>Total Current Assets</b>	<b>15,030</b>	<b>16,333</b>	<b>528</b>	<b>941</b>	<b>(31,329)</b>	<b>1,503</b>
Property, Plant, and Equipment, net	—	—	2,970	5,201	—	8,171
Restricted Cash and Securities	7	—	17	3	—	27
Goodwill and Other Intangibles, net	—	—	412	2,385	—	2,797
Investment in Subsidiaries	(12,322)	(21,656)	4,358	—	29,620	—
Other Assets, net	14	110	11	232	—	367
<b>Total Assets</b>	<b>\$ 2,729</b>	<b>\$ (5,213)</b>	<b>\$ 8,296</b>	<b>\$ 8,762</b>	<b>\$ (1,709)</b>	<b>\$ 12,865</b>
<b>Liabilities and Stockholders' Equity (Deficit)</b>						
<b>Current Liabilities:</b>						
Accounts payable	\$ 1	\$ 1	\$ 42	\$ 644	\$ —	\$ 688
Current portion of long-term debt	—	6	3	21	—	30
Accrued payroll and employee benefits	—	—	131	46	—	177
Accrued interest	33	158	—	1	—	192
Current portion of deferred revenue	—	—	106	120	—	226
Due to affiliates	—	—	31,035	294	(31,329)	—
Other	1	36	48	105	—	190
<b>Total Current Liabilities</b>	<b>35</b>	<b>201</b>	<b>31,365</b>	<b>1,231</b>	<b>(31,329)</b>	<b>1,503</b>
Long-Term Debt, less current portion	1,571	6,886	18	31	—	8,506
Deferred Revenue, less current portion	—	—	593	313	—	906
Other Liabilities	15	26	23	778	—	842
Commitments and Contingencies	—	—	—	—	—	—
Stockholders' Equity (Deficit)	1,108	(12,326)	(23,703)	6,409	29,620	1,108
<b>Total Liabilities and Stockholders' Equity (Deficit)</b>	<b>\$ 2,729</b>	<b>\$ (5,213)</b>	<b>\$ 8,296</b>	<b>\$ 8,762</b>	<b>\$ (1,709)</b>	<b>\$ 12,865</b>

# **Condensed Consolidating Balance Sheets** **December 31, 2012**

	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC	Other Non- Guarantor Subsidiaries	Eliminations	Total
(dollars in millions)						
<b>Assets</b>						
<b>Current Assets:</b>						
Cash and cash equivalents	\$ 253	\$ 5	\$ 386	\$ 335	\$ —	\$ 979
Restricted cash and securities	—	—	1	7	—	8
Receivables, less allowances for doubtful accounts	—	—	93	621	—	714
Due from affiliates	14,446	15,709	—	7	(30,162)	—
Other	3	16	49	73	—	141
<b>Total Current Assets</b>	<b>14,702</b>	<b>15,730</b>	<b>529</b>	<b>1,043</b>	<b>(30,162)</b>	<b>1,842</b>
Property, Plant, and Equipment, net	—	—	2,926	5,273	—	8,199
Restricted Cash and Securities	12	—	17	6	—	35
Goodwill and Other Intangibles, net	—	—	429	2,404	—	2,833
Investment in Subsidiaries	(11,756)	(20,470)	3,242	—	28,984	—
Other Assets, net	16	119	11	252	—	398
<b>Total Assets</b>	<b>\$ 2,974</b>	<b>\$ (4,621)</b>	<b>\$ 7,154</b>	<b>\$ 8,978</b>	<b>\$ (1,178)</b>	<b>\$ 13,307</b>
<b>Liabilities and Stockholders' Equity (Deficit)</b>						
<b>Current Liabilities:</b>						
Accounts payable	\$ 1	\$ 2	\$ 53	\$ 723	\$ —	\$ 779
Current portion of long-term debt	172	6	6	32	—	216
Accrued payroll and employee benefits	—	—	161	50	—	211
Accrued interest	45	163	—	1	—	209
Current portion of deferred revenue	—	—	109	142	—	251
Due to affiliates	—	—	30,162	—	(30,162)	—
Other	1	1	29	105	—	136
<b>Total Current Liabilities</b>	<b>219</b>	<b>172</b>	<b>30,520</b>	<b>1,053</b>	<b>(30,162)</b>	<b>1,802</b>
Long-Term Debt, less current portion	1,570	6,886	20	40	—	8,516
Deferred Revenue, less current portion	—	—	602	285	—	887
Other Liabilities	14	81	75	761	—	931
Commitments and Contingencies	—	—	—	—	—	—
Stockholders' Equity (Deficit)	1,171	(11,760)	(24,063)	6,839	28,984	1,171
<b>Total Liabilities and Stockholders' Equity (Deficit)</b>	<b>\$ 2,974</b>	<b>\$ (4,621)</b>	<b>\$ 7,154</b>	<b>\$ 8,978</b>	<b>\$ (1,178)</b>	<b>\$ 13,307</b>

**Condensed Consolidating Statements of Cash Flows**  
**Six Months Ended June 30, 2013**

	<b>Level 3 Communications, Inc.</b>	<b>Level 3 Financing, Inc.</b>	<b>Level 3 Communications, LLC</b>	<b>Other Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Total</b>
	(dollars in millions)					
Net Cash Provided by (Used in) Operating Activities	\$ (86)	\$ (269)	\$ 74	\$ 504	\$ —	\$ 223
Cash Flows from Investing Activities:						
Capital Expenditures	—	—	(159)	(218)	—	(377)
Decrease in restricted cash and securities, net	5	—	—	3	—	8
Other	—	—	—	(14)	—	(14)
Net Cash Provided by (Used in) Investing Activities	5	—	(159)	(229)	—	(383)
Cash Flows from Financing Activities:						
Payments on and repurchases of long-term debt, including current portion and refinancing costs	(172)	(3)	(4)	(20)	—	(199)
Increase (decrease) due from/to affiliates, net	9	272	60	(341)	—	—
Net Cash Provided by (Used in) Financing Activities	(163)	269	56	(361)	—	(199)
Effect of Exchange Rates on Cash and Cash Equivalents	—	—	—	(24)	—	(24)
Net Change in Cash and Cash Equivalents	(244)	—	(29)	(110)	—	(383)
Cash and Cash Equivalents at Beginning of Period	253	5	386	335	—	979
Cash and Cash Equivalents at End of Period	\$ 9	\$ 5	\$ 357	\$ 225	\$ —	\$ 596

**Condensed Consolidating Statements of Cash Flows**  
**Six Months Ended June 30, 2012**

	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC	Other Non-Guarantor Subsidiaries	Eliminations	Total
(dollars in millions)						
Net Cash Provided by (Used in) Operating Activities	\$ (144)	\$ (245)	\$ (66)	\$ 563	\$ —	\$ 108
Cash Flows from Investing Activities:						
Capital Expenditures	—	—	(123)	(195)	—	(318)
Decrease in restricted cash and securities, net	3	—	—	1	—	4
Proceeds from sale of property, plant and equipment and other assets	—	—	—	5	—	5
Net Cash Provided by (Used in) Investing Activities	3	—	(123)	(189)	—	(309)
Cash Flows from Financing Activities:						
Long-term debt borrowings, net of issuance costs	—	880	—	—	—	880
Payments on and repurchases of long-term debt, including current portion and refinancing costs	—	(825)	—	(38)	—	(863)
Proceeds from stock options exercised	1	—	—	—	—	1
Increase (decrease) due from/to affiliates, net	140	190	(13)	(317)	—	—
Net Cash Provided by (Used in) Financing Activities	141	245	(13)	(355)	—	18
Effect of Exchange Rates on Cash and Cash Equivalents	—	—	—	(2)	—	(2)
Net Change in Cash and Cash Equivalents	—	—	(202)	17	—	(185)
Cash and Cash Equivalents at Beginning of Period	2	6	618	292	—	918
Cash and Cash Equivalents at End of Period	\$ 2	\$ 6	\$ 416	\$ 309	\$ —	\$ 733

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the Level 3 Communications, Inc. and its subsidiaries ("Level 3" or the "Company") consolidated financial statements (including the notes thereto), included elsewhere herein and the Company's Form 10-K for the year ended December 31, 2012, filed with the Securities and Exchange Commission.

This document contains forward looking statements and information that are based on the beliefs of management as well as assumptions made by and information currently available to the Company. When used in this document, the words "anticipate", "believe", "plan", "estimate" and "expect" and similar expressions, as they relate to the Company or its management, are intended to identify forward-looking statements. Such statements reflect the current views of the Company with respect to future events and are subject to certain risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described in this document. For a more detailed description of these risks and factors, please see the Company's Form 10-K for the year ended December 31, 2012, filed with the Securities and Exchange Commission and Item 1A in Part II of this Form 10-Q.

### Executive Summary

#### *Overview*

The Company is a facilities-based provider of a broad range of communications services. Revenue for communications services is generally recognized on a monthly basis as these services are provided. For contracts involving private line, wavelength and dark fiber services, Level 3 may receive up-front payments for services to be delivered for a period of generally up to 25 years. In these situations, Level 3 defers the revenue and amortizes it on a straight-line basis to earnings over the term of the contract.

#### *Business Strategy and Objectives*

The Company pursues the strategies discussed in Item 1. Business, "Business Overview and Strategy" as discussed in its Form 10-K for the year ended December 31, 2012. In particular, with respect to strategic financial objectives, the Company focuses its attention on the following:

- growing Core Network Services revenue by increasing sales;
- continually improving the customer experience to increase customer retention and reduce customer churn;
- completing the integration of acquired businesses;
- reducing network costs and operating expenses;
- achieving sustainable generation of positive cash flows from operations in excess of capital expenditures;
- continuing to show improvement in Adjusted EBITDA (as defined in this Item below) as a percentage of revenue;
- concentrating its capital expenditures on those technologies and assets that enable the Company to develop its Core Network Services or expand its addressable market;
- managing Wholesale Voice Services for margin contribution; and
- refinancing its future debt maturities.

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

The successful integration of acquired businesses into Level 3 is important to the success of Level 3. The Company must identify synergies and integrate acquired networks and support organizations, while maintaining the



service quality levels expected by customers to realize the anticipated benefits of any acquisition. Successful integration of any acquired businesses will depend on the Company's ability to manage the operations, realize opportunities for revenue growth presented by strengthened service offerings and expanded geographic market coverage, and eliminate redundant and excess costs to fully realize the expected synergies. If the Company is not able to efficiently and effectively integrate any businesses or operations it acquires, the Company may experience material negative consequences to its business, financial condition or results of operations.

The Company has also been focused on improving its liquidity and financial condition, and extending the maturity dates of certain debt, as described below and in greater detail in Note 6 - Long-Term Debt in the notes to the consolidated financial statements.

In January 2013, the Company repaid at maturity approximately \$172 million of its 15% Convertible Senior Notes due 2013.

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

*Revenue by Channel:*

(dollars in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
<b>Core Network Services:</b>				
North America - Wholesale Channel	\$ 367	\$ 382	\$ 739	\$ 763
North America - Enterprise Channel	603	574	1,198	1,135
EMEA - Wholesale Channel	88	94	177	190
EMEA - Enterprise Channel	99	91	196	179
EMEA - U.K. Government Channel	33	43	70	91
Latin America - Wholesale Channel	40	37	80	75
Latin America - Enterprise Channel	149	136	291	274
<b>Total Core Network Services</b>	<b>1,379</b>	<b>1,357</b>	<b>2,751</b>	<b>2,707</b>
Wholesale Voice Services and Other	186	229	391	465
<b>Total Revenue</b>	<b>\$ 1,565</b>	<b>\$ 1,586</b>	<b>\$ 3,142</b>	<b>\$ 3,172</b>

Total revenue consists of:

- Core Network Services revenue from colocation and data center services; transport and fiber; IP and data services; and local and enterprise voice services.
- Wholesale Voice Services and Other revenue from sales of long distance voice services, revenue from managed modem and its related intercarrier compensation services and revenue from the "SBC Master Services Agreement," which was obtained through an acquisition in 2005.

Core Network Services revenue represents higher margin services and Wholesale Voice Services and Other revenue represents lower margin services. Core Network Services revenue requires different levels of investment and focus and provides different contributions to the Company's operating results than Wholesale Voice Services and Other revenue. Management of Level 3 believes that growth in revenue from its Core Network Services is critical to the long-term success of its business. The Company also believes it must continue to effectively manage gross margin contribution from the Wholesale Voice Services component and the positive cash flows from the Other revenue component. The Company believes that trends in its communications business are best gauged by analyzing revenue changes in Core Network Services.

## Core Network Services

Colocation and data center services allow customers to place their network equipment and servers in suitable environments maintained by the Company with high-speed links providing on net access to more than 55 countries. These services are secure, redundant and flexible to fit the varying needs of the Company's customers. Services, which vary by location, include hosting network equipment used to transport high speed data and voice over Level 3's global network; providing managed IT services, installation, maintenance, storage and monitoring of enterprise services; and providing comprehensive IT outsource solutions.

Growth in transport (such as private line and wavelengths) and fiber revenue is largely dependent on increased demand for bandwidth services and available capital of companies requiring communications capacity for their own use or in providing capacity as a service provider to their customers. These expenditures may be in the form of monthly payments or, in the case of private line, wavelength or dark fiber services, either monthly payments or up-front payments. The Company is focused on providing end-to-end transport and fiber services to its customers to directly connect customer locations with a private network. Pricing for end-to-end metropolitan transport services have been relatively stable. For intercity transport and fiber services, the Company continues to experience pricing pressure in locations where a large number of carriers co-locate their facilities. An increase in demand may be offset by declines in unit pricing.

IP and data services primarily include the Company's high speed Internet Protocol ("IP"), dedicated Internet access ("DIA"), virtual private network ("VPN"), content delivery network ("CDN"), media delivery, Vyvx broadcast, Converged Business Network, Asynchronous Transfer mode ("ATM") and frame relay services. Level 3's IP and high speed IP service is high quality and is offered in a variety of capacities. The Company's VPN service permits businesses of any size to replace multiple networks with a single, cost-effective solution that greatly simplifies the converged transmission of voice, video, and data. This convergence to a single platform can be obtained without sacrificing the quality of service or security levels of traditional ATM and frame relay offerings. VPN service also permits customers to prioritize network application traffic so that high priority applications, such as voice and video, are not compromised in performance by the flow of low priority applications such as email.

Voice services comprise a broad range of local and enterprise voice services using VoIP and traditional circuit-switch based technologies, including VoIP enhanced local service, SIP Trunking, local inbound service, Primary Rate Interface service, long distance service and toll-free service. The Company's voice services also include its comprehensive suite of audio, web and video collaboration services.

The Company believes that one of the largest sources of future incremental demand for the Company's Core Network Services will be from customers that are seeking to distribute their feature rich content or video over the Internet. Revenue growth in this area is dependent on the continued increase in demand from customers and the pricing environment. An increase in the reliability and security of information transmitted over the Internet and declines in the cost to transmit data have resulted in increased utilization of e-commerce or web based services by businesses. Although the pricing for data services is currently relatively stable, the IP market is generally characterized by price compression and high unit growth rates depending upon the type of service. The Company experienced price compression in the high-speed IP and voice services markets in 2012, which has continued in 2013.

The following provides a discussion of the Company's Core Network Services revenue in terms of the enterprise and wholesale channels.

- The enterprise channel includes large, multi-national enterprises requiring large amounts of bandwidth to support their business operations, such as financial services companies, healthcare companies, content providers, and portal and search engine companies. It also includes medium sized enterprises, as well as government markets, including the U.S. federal government, the systems integrators supporting the U.S. federal government, U.S. state and local governments, academic consortia, and certain academic institutions. Included in the enterprise channel, but broken out separately in the table above, is the U.K. government channel, which includes revenue primarily from the government sector in the U.K.

- The wholesale channel includes revenue from incumbent and alternative carriers in each of the regions, global carriers, wireless carriers, cable companies, satellite companies, regional service providers and voice service providers.

The Company believes that the alignment of Core Network Services around channels should allow it to drive growth while enabling it to better focus on the needs of its customers. Each of these channels is supported by dedicated employees in sales. Each of these channels is also supported by non-dedicated, centralized service delivery and management, product management and development, corporate marketing, global network services, engineering, information technology, and corporate functions, including legal, finance, strategy and human resources.

#### *Wholesale Voice Services and Other*

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

The Company also has other revenue derived from mature services that are not critical areas of emphasis for the Company, including revenue from managed modem and its related intercarrier compensation services and SBC Contract Services, which includes revenue from the "SBC Master Services Agreement," obtained in the December 2005 acquisition of WilTel Communications Group, LLC. The Company and its customers continue to see consumers migrate from narrow band dial-up services to higher speed broadband services as the narrow band market matures. The Company is in the process of discontinuing managed modem services and has notified all current managed modem customers of this decision. The Company expects ongoing declines in the other revenue component of Wholesale Voice Services and Other similar to what has been experienced over the past several years.

The Company receives compensation from other carriers when it terminates traffic originating on those carriers' networks. This intercarrier compensation is based on interconnection agreements with the respective carriers or rates mandated by the Federal Communications Commission ("FCC"). The Company has interconnection agreements in place for the majority of traffic subject to intercarrier compensation. Along with addressing other matters, on November 18, 2011, the FCC established a prospective intercarrier compensation framework for terminating switched access and Voice over Internet Protocol ("VoIP") traffic, with elements of it becoming effective beginning on December 29, 2011. Under the framework, most terminating switched access charges and all intercarrier compensation charges are capped at current levels, and will be reduced to zero over, as relevant to Level 3, a six year transition period which began July 1, 2012. Several states, industry groups, and other telecommunications carriers filed petitions in federal court for reconsideration of the framework with the FCC, although the outcome of those petitions is unpredictable. A majority of the Company's existing intercarrier compensation revenue is associated with agreements that have expired terms, but remain effective in evergreen status. As these and other interconnection agreements expire, the Company will continue to evaluate simply allowing them to continue in evergreen status (so long as the counterparty allows the same) or negotiating new agreements. The Company earns intercarrier compensation revenue from providing managed modem services, which are declining. The Company also receives intercarrier compensation from its voice services. In this case, intercarrier compensation is reported within Core Network Services revenue.

For a detailed description of the Company's broad range of communications services, please see Item 1. "Business - Our Services Offerings" of the Company's Form 10-K for the year ended December 31, 2012, filed with the Securities and Exchange Commission.

#### **Critical Accounting Policies**

Refer to Item 7 of the Company's Form 10-K for the year ended December 31, 2012, for a description of the Company's critical accounting policies.

**Results of Operations for the Three and Six Months Ended June 30, 2013 vs. 2012**

(dollars in millions)	Three Months Ended June 30,			Six Months Ended June 30,		
	2013	2012	Change %	2013	2012	Change %
Revenue	\$ 1,565	\$ 1,586	(1)%	\$ 3,142	\$ 3,172	(1)%
Cost of Revenue	616	648	(5)%	1,245	1,305	(5)%
Depreciation and Amortization	199	191	4 %	393	378	4 %
Selling, General and Administrative	610	614	(1)%	1,209	1,240	(3)%
Total Costs and Expenses	1,425	1,453	(2)%	2,847	2,923	(3)%
Operating Income	140	133	5 %	295	249	18 %
Other Income (Expense):						
Interest income	—	1	(100)%	—	2	(100)%
Interest expense	(167)	(181)	(8)%	(336)	(370)	(9)%
Loss on extinguishment of debt, net	—	—	— %	—	(61)	(100)%
Other, net	14	(7)	NM	(36)	2	NM
Total Other Expense	(153)	(187)	(18)%	(372)	(427)	(13)%
Loss Before Income Taxes	(13)	(54)	(76)%	(77)	(178)	(57)%
Income Tax Expense	(11)	(8)	38 %	(25)	(22)	14 %
Net Loss	\$ (24)	\$ (62)	(61)%	\$ (102)	\$ (200)	(49)%

NM — Not meaningful

**Discussion of all significant variances:**
*Revenue by Service Offering:*

(dollars in millions)	Three Months Ended June 30,			Six Months Ended June 30,		
	2013	2012	Change %	2013	2012	Change %
Core Network Services Revenue	\$ 1,379	\$ 1,357	2 %	\$ 2,751	\$ 2,707	2 %
Wholesale Voice Services and Other Revenue	186	229	(19)%	391	465	(16)%
Total Revenue	\$ 1,565	\$ 1,586	(1)%	\$ 3,142	\$ 3,172	(1)%

### Revenue by Product Offering:

(dollars in millions)	Three Months Ended June 30,			Six Months Ended June 30,		
	2013	2012	Change %	2013	2012	Change %
Colocation and Data Center Services	\$ 145	\$ 139	4 %	\$ 287	\$ 277	4 %
Transport and Fiber	488	485	1 %	972	965	1 %
IP and Data Services	514	497	3 %	1,024	988	4 %
Voice Services (local and enterprise)	232	236	(2)%	468	477	(2)%
Total Core Network Services	1,379	1,357	2 %	2,751	2,707	2 %
Wholesale Voice Services and Other	186	229	(19)%	391	465	(16)%
Total Revenue	<u>\$ 1,565</u>	<u>\$ 1,586</u>	(1)%	<u>\$ 3,142</u>	<u>\$ 3,172</u>	(1)%

**Revenue** decreased 1% to \$1.565 billion in the three months ended June 30, 2013 compared to \$1.586 billion in the same period of 2012 and decreased 1% to \$3.142 billion in the six months ended June 30, 2013, from \$3.172 billion in the same period of 2012. The decrease was driven by declines in Wholesale Voice Services and Other revenue partially offset by growth in Core Network Services revenue from enterprise customers.

The Company experienced growth in its IP and data services and colocation and data center services during the three and six months ended June 30, 2013 compared to the same period of 2012 driven primarily by end user customer demand for content delivery over the Internet and enterprise bandwidth. The Company also experienced modest growth in transport and fiber services during the first half of 2013. Core Network Services revenue for voice services declined during the three and six months ended June 30, 2013, primarily due to the anticipated attrition of certain U.K. Government channel voice services.

Core Network Services revenue increased in the North America and Latin America regions during the three and six months ended June 30, 2013 compared to the same period of 2012, as a result of growth in services provided to the existing enterprise customer base and the acquisition of new customers in the enterprise channel. These increases were partially offset by (i) a decrease in the EMEA region's Core Network Services revenue primarily as a result of lower U.K. Government and wholesale channel revenue and (ii) a decrease in wholesale channel revenue in the North American region.

Wholesale Voice Services and Other revenue decreased in the three and six months ended June 30, 2013 compared to the same period of 2012 primarily as a result of declines in usage. The Company continues to manage its combined wholesale voice services platform for margin contribution. In addition, the Company expects managed modem and SBC Contract Services revenue to continue to decline due to an increase in the number of subscribers migrating to broadband services and as a result of the migration of the SBC traffic to the AT&T network, respectively. The Company is in the process of discontinuing managed modem services and has notified all current managed modem customers of this decision.

**Cost of Revenue** includes leased capacity, right-of-way costs, access charges, satellite transponder lease costs, and other third party costs directly attributable to the network, but excludes depreciation and amortization and related impairment expenses.

Cost of revenue as a percentage of total revenue was 39% in the three months ended June 30, 2013 compared to 41% in the same period of 2012 and was 40% in the six months ended June 30, 2013 compared to 41% in the same period of 2012. The decrease is primarily due to an improving gross margin mix of higher margin on-net Core Network Services and a decrease in lower margin Wholesale Voice Services and Other. Additionally, the Company continues to implement initiatives to reduce both fixed and variable network expenses.

**Depreciation and Amortization** increased 4% to \$199 million in the three months ended June 30, 2013, from \$191 million in the same period of 2012 and increased 4% to \$393 million in the six months ended June 30, 2013,

from \$378 million in the same period in 2012. The increase is primarily attributable to incremental capital expenditures.

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

SG&A decreased 1% to \$610 million in the three months ended June 30, 2013 compared to \$614 million in the same period of 2012 and decreased 3% to \$1.209 billion in the six months ended June 30, 2013, from \$1.240 billion in the same period in 2012. The decreases are primarily due to lower employee cash compensation and other employee related costs, professional fees and vendor services and other discretionary costs. Employee cash compensation and other employee related costs decreased as the Company continued to integrate the Global Crossing business and achieve cost synergies through the reduction of headcount as well as the higher capitalization of labor costs related to the implementation of information technology systems, network deployment and customer installation activities. Professional fees and vendor services and other discretionary costs decreased primarily due to the rationalization and renegotiation of vendor services and lower travel and entertainment costs. In addition during the first quarter of 2012, the Company incurred approximately \$15 million of integration costs related to the Global Crossing acquisition. The integration was substantially complete by the end of 2012.

Also included in SG&A in the three and six months ended June 30, 2013, were \$48 million and \$85 million, respectively, and in the three and six months ended June 30, 2012, \$29 million and \$53 million, respectively, of non-cash, stock-based compensation expenses related to grants of outperform stock options, restricted stock units, accruals for the Company's annual discretionary bonus, incentive and retention plans and shares issued for the Company's matching contribution for the 401(k) plan. The increase in non-cash, stock-based compensation expense is primarily due to additional stock grants subsequent to March 31, 2012 and accruing the annual discretionary bonus at a higher target rate in 2013 than in 2012, as well as the vesting of long term incentive awards in connection with James Q. Crowe's departure from the Company, as described below.

On April 11, 2013, the Company announced that Jeff K. Storey had been appointed by the Board of Directors, effective immediately, to be the Company's president and Chief Executive Officer. As a result of the departure of James Q. Crowe, the Company incurred an SG&A charge of approximately \$23 million in the second quarter of 2013, consisting of \$6 million of additional cash compensation expenses and \$17 million in non-cash compensation expenses related to the vesting of certain of Mr. Crowe's long term incentive awards payable under the terms of his employment agreement.

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

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

Adjusted EBITDA excludes non-cash impairment charges and non-cash stock compensation expense because of the non-cash nature of these items. Adjusted EBITDA also excludes interest income, interest expense and income tax benefit (expense) because these items are associated with the Company's capitalization and tax structures. Adjusted EBITDA also excludes depreciation and amortization expense because these non-cash expenses reflect the

effect of capital investments which management believes are better evaluated through cash flow measures. Adjusted EBITDA excludes net other income (expense) because these items are not related to the primary operations of the Company.

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

The following information provides a reconciliation of Net Loss to Adjusted EBITDA as defined by the Company:

(dollars in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net Loss	\$ (24)	\$ (62)	\$ (102)	\$ (200)
Income Tax Expense	11	8	25	22
Total Other Expense	153	187	372	427
Depreciation and Amortization	199	191	393	378
Non-Cash Compensation Expense	48	29	85	53
Adjusted EBITDA	<u>\$ 387</u>	<u>\$ 353</u>	<u>\$ 773</u>	<u>\$ 680</u>

Consolidated Adjusted EBITDA was \$387 million in the three months ended June 30, 2013 compared to \$353 million in the same period of 2012 and was \$773 million in the six months ended June 30, 2013 compared to \$680 million in the same period of 2012. The increase in Adjusted EBITDA is primarily attributable to growth in the Company's higher incremental margin Core Network Services revenue, continued improvements in cost of revenue and lower SG&A expenses.

**Interest Expense** decreased 8% to \$167 million in the three months ended June 30, 2013, from \$181 million in the same period of 2012 and decreased 9% to \$336 million in the six months ended June 30, 2013, from \$370 million in the same period of 2012. Interest expense decreased as a result of lower cost of borrowing on refinanced debt partially offset by higher average debt balances for the three and six months ended June 30, 2013 compared to the same period of 2012.

The Company expects annual interest expense in 2013 to approximate \$665 million based on the Company's outstanding debt as of June 30, 2013 and taking into consideration the current interest rates on the Company's variable rate debt. See Note 6 - Long-Term Debt in the notes to consolidated financial statements for additional information on Level 3's financing activities.

**Loss on Extinguishment of Debt, net** was nil for both the three and six months ended June 30, 2013 compared to a loss of nil and \$61 million for the three and six months ended June 30, 2012. The loss recorded during the first quarter of 2012 was related to a charge of approximately \$22 million as a result of the redemption of the 9.25% Senior Notes due 2014 and a charge of approximately \$39 million as a result of the exchange of a portion of the 15% Convertible Senior Notes due 2013 for approximately 5.4 million shares of Level 3 stock. See Note 6 - Long-Term Debt in the notes to the consolidated financial statements for more details regarding the Company's financing activities.



**Other, net** is primarily comprised of gains and losses on the sale of non-operating assets, foreign currency gains and losses and other income and expense.

Other, net was \$14 million of income and \$36 million of expense in the three and six months ended June 30, 2013 compared to \$7 million of expense and \$2 million of income in the three and six months ended June 30, 2012. The Other, net income in the second quarter 2013 is primarily due to foreign currency gains attributable to the appreciation of the U.S. Dollar relative to local currencies of certain of the Company's foreign subsidiaries in Latin America which have the U.S. Dollar as their functional currency and appreciation of the local currencies relative to the U.S. Dollar for certain investments denominated in the local currency of foreign subsidiaries in EMEA that are not considered to be long-term in nature. The Other, net expense in the first quarter 2013 was incurred primarily due to foreign currency losses attributable to the devaluation of the Venezuelan Bolivar as discussed below, compared to the comparable period in 2012.

Effective February 13, 2013, the Venezuelan government devalued the Venezuelan bolivar by increasing the official rate from 4.30 Venezuelan bolivares to the U.S. Dollar to 6.30 Venezuelan bolivares to the U.S. Dollar. This devaluation reduced the Company's net monetary assets by \$22 million based on the bolivar balances as of February 13, 2013, resulting in a charge of \$22 million which was recognized in Other, net in the consolidated statement of operations in the first quarter of 2013.

**Income Tax Expense** was \$11 million and \$25 million in the three and six months ended June 30, 2013 compared to \$8 million and \$22 million in the three and six months ended June 30, 2012. The income tax expense in all periods is primarily related to taxes in foreign jurisdictions.

The Company incurs tax expense attributable to income in various Level 3 subsidiaries that are required to file state or foreign income tax returns on a separate legal entity basis. The Company also recognizes accrued interest and penalties in income tax expense related to uncertain tax benefits. Income tax for the three and six month period ended June 30, 2013 is not necessarily indicative of income tax expense for the year ended December 31, 2013. Our tax rate is volatile and may move up or down with changes in, among other things, the amount and source of income or loss, our ability to utilize foreign tax credits, changes in tax laws, and the movement of liabilities established for uncertain tax positions as statutes of limitations expire or positions are otherwise effectively settled.

### Financial Condition— For the Six Months Ended June 30, 2013 and 2012

Cash flows provided by or used in operating activities, investing activities and financing activities for the six months ended June 30, 2013 and 2012 are summarized as follows:

(dollars in millions)	Six Months Ended June 30,		
	2013	2012	Change
Net Cash Provided by Operating Activities	\$ 223	\$ 108	\$ 115
Net Cash Used in Investing Activities	(383)	(309)	(74)
Net Cash Provided by (Used in) Financing Activities	(199)	18	(217)
Effect of Exchange Rates on Cash and Cash Equivalents	(24)	(2)	(22)
Net Change in Cash and Cash Equivalents	<u>\$ (383)</u>	<u>\$ (185)</u>	<u>\$ (198)</u>

#### Operating Activities

Cash provided by operating activities was \$223 million in the six months ended June 30, 2013 compared to cash provided by operating activities of \$108 million in the same period of 2012. The increase in cash provided by operating activities was primarily due to growth in earnings and lower interest payments.



### *Investing Activities*

Cash used in investing activities increased in the six months ended June 30, 2013 compared to the same period of 2012 primarily as a result of additional capital expenditures, which totaled \$377 million in the six months ended June 30, 2013 and \$318 million in the same period of 2012. The increase is primarily due to additional investment in the network as well as higher capitalized labor.

### *Financing Activities*

Cash used in financing activities of \$199 million in the six months ended June 30, 2013 compared to \$18 million provided by financing activities in the same period of 2012 relates to greater net payments of debt and capital leases during 2013 primarily as a result of the repayment at maturity of the 15% Convertible Notes due January 15, 2013 as compared to greater net borrowings in the same period of 2012. See Note 6 - Long-Term Debt in the notes to the consolidated financial statements for more details regarding the Company's debt transactions during 2013.

### *Effect of Exchange Rates on Cash and Cash Equivalents*

The effect of exchange rates on cash and cash equivalents in the six months ended June 30, 2013, was primarily due to the devaluation of the Venezuelan bolivar. This devaluation reduced the Company's unrestricted cash and cash equivalents by \$21 million in the first quarter of 2013.

### **Liquidity and Capital Resources**

The Company incurred a net loss of \$102 million in the six months ended June 30, 2013 and \$200 million in the same period of 2012. The Company used cash of \$377 million for capital expenditures and \$199 million for financing activities in the six months ended June 30, 2013. This compares to \$318 million of cash used for capital expenditures and \$18 million of cash flows provided by financing activities in the six months ended June 30, 2012.

Net cash interest payments are expected to decrease to approximately \$645 million in 2013 from \$710 million in 2012 based on current interest rates on the Company's debt outstanding as of June 30, 2013.

Capital expenditures for 2013 are expected to remain relatively consistent as a percentage of revenue with 2012, as the Company invests in base capital expenditures (estimated capital required to keep the network operating efficiently and support new service development) with the remaining capital expenditures expected to be partly success-based, which is tied to a specific customer revenue opportunity, and partly project-based where capital is used to expand the network based on the Company's expectation that the project will eventually lead to incremental revenue. As of June 30, 2013, the Company had contractual debt obligations, including capital lease obligations, and excluding interest, discounts on debt issuance and fair value adjustments, of \$18 million that mature in the remaining six months of 2013, \$22 million in 2014 and \$788 million in 2015.

In January 2013, the Company repaid at maturity approximately \$172 million of its 15% Convertible Senior Notes.

For information related to financing activities that occurred during 2012, see Item 7 of the Company's Form 10-K for the year ended December 31, 2012.

The Company had \$596 million of cash and cash equivalents on hand at June 30, 2013. The Company also had \$34 million of current and non-current restricted cash and securities used to collateralize outstanding letters of credit and certain performance and operating obligations of the Company and other deposits at June 30, 2013. In addition, \$52 million of the Company's total cash and cash equivalents as of June 30, 2013 was held in Venezuelan bolivares by a Venezuelan subsidiary. In light of the Venezuelan exchange control regime, none of such \$52 million may be transferred to the Company in the form of loans, advances or cash dividends without the consent of the Venezuelan government. The \$52 million value of the Company's bolivar balance reflects the February 13, 2013 devaluation of

the bolivar that resulted from the increase in the official exchange rate from 4.30 Venezuelan bolivares to the U.S. Dollar to 6.30 Venezuelan bolivares to the U.S. Dollar. That devaluation reduced the Company's unrestricted cash and cash equivalents by \$21 million, based on the bolivar balances as of February 13, 2013.

Based on information available at this time, the Company believes that its current liquidity and anticipated future cash flows from operations will be sufficient to fund its business for at least the next twelve months.

The Company may need to refinance all or a portion of its indebtedness at or before maturity and cannot provide assurances that it will be able to refinance any such indebtedness on commercially reasonable terms or at all. In addition, the Company may elect to secure additional capital in the future, at acceptable terms, to improve its liquidity or fund acquisitions. In addition, in an effort to reduce future cash interest payments as well as future amounts due at maturity or to extend debt maturities, the Company may, from time to time, issue new debt, enter into debt for debt, debt for equity or cash transactions to purchase its outstanding debt securities in the open market or through privately negotiated transactions. The Company will evaluate any such transactions in light of the existing market conditions and the possible dilutive effect to stockholders. The amounts involved in any such transaction, individually or in the aggregate, may be material.

In addition to raising capital through the debt and equity markets, the Company may sell or dispose of existing businesses, investments or other non-core assets.

Consolidation of the communications industry may continue. The Company will continue to evaluate consolidation opportunities and could make additional acquisitions in the future.

### **Off-Balance Sheet Arrangements**

Level 3 has not entered into off-balance sheet arrangements.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

#### *Interest Rate Risk*

Level 3 is subject to market risks arising from changes in interest rates. As of June 30, 2013, the Company had borrowed a total of approximately \$2.9 billion primarily under a Senior Secured Term Loan (excluding discounts) and Floating Rate Senior Notes due 2015 that bear interest at LIBOR rates plus an applicable margin. As the LIBOR rates fluctuate, so too will the interest expense on amounts borrowed under the debt instruments, unless LIBOR rates are below the minimum LIBOR rate for a particular Senior Secured Term Loan. The weighted average interest rate on the variable rate instruments at June 30, 2013, was approximately 4.8%.

The Company's senior secured credit facility's variable interest rate is based on a fixed rate plus LIBOR with a fixed minimum LIBOR rate of 1.5%. The market LIBOR rate for the Company's senior secured credit facility was approximately 0.3% at June 30, 2013, which was below the 1.5% fixed minimum rate. Declines in LIBOR below the fixed minimum rate or increases up to the fixed minimum rate do not affect the Company's annual interest expense. A hypothetical increase in the weighted average rate by 1% point would increase the Company's annual interest rate expense on all of its variable rate instruments by approximately \$3 million as of June 30, 2013 (excluding any effect of interest rate swaps).

At June 30, 2013, the Company had \$5.7 billion (excluding discounts) of fixed rate debt bearing a weighted average interest rate of 8.7%. A decline in interest rates in the future will not generally benefit the Company with respect to the fixed rate debt due to the terms and conditions of the indentures relating to that debt that would require the Company to repurchase the debt at specified premiums if redeemed early. Indicated changes in interest rates are based on hypothetical movements and are not necessarily indicative of the actual results that may occur. Future earnings and losses will be affected by actual fluctuations in interest rates and foreign currency rates.

#### *Foreign Currency Exchange Rate Risk*

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

Effective February 13, 2013, the Venezuelan government devalued the Venezuelan bolivar by increasing the official rate from 4.30 Venezuelan bolivares to the U.S. Dollar to 6.30 Venezuelan bolivares to the U.S. Dollar. This devaluation reduced the Company's net monetary assets by \$22 million, including unrestricted cash and cash equivalents of \$21 million, based on the bolivar balances as of February 13, 2013. The devaluation of the Company's net monetary assets resulted in a charge of \$22 million which was recognized in Other, net in the consolidated statement of operations in the first quarter of 2013. The effects on revenue and operating income are not expected to be material in light of certain pricing adjustment mechanisms in many of the Company's contracts with Venezuelan customers and since most of the Company's costs in Venezuela are incurred in bolivares. However, the death of long-time president Hugo Chavez in March 2013 and the political instability arising out of the subsequent disputed presidential election create greater uncertainty for the Company's Venezuelan operations and the bolivar-U.S. dollar exchange rate.

#### ITEM 4. CONTROLS AND PROCEDURES

(a) *Disclosure controls and procedures.* The Company's Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the Company's disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as of June 30, 2013. Based upon such review, the Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective and are designed to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in reports it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

(b) *Internal controls.* There were no changes in the Company's internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13a-15 or 15d-15 that occurred during the second quarter of 2013 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## **Part II - Other Information**

### **ITEM 1. LEGAL PROCEEDINGS**

For information regarding legal proceedings in which we are involved, see Note 8, “Commitments, Contingencies and Other Items,” to our consolidated financial statements included in this quarterly report on Form 10-Q.

### **ITEM 1A. RISK FACTORS**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, “Item 1A. “Risk Factors” in Level 3’s Form 10-K for the year ended December 31, 2012, which could materially affect Level 3’s business, financial condition or future results. The risks described in Level 3’s Form 10-K are not the only risks facing the Company. Additional risks and uncertainties not currently known to Level 3 or that it currently deems to be immaterial also may materially adversely affect Level 3’s business, financial condition and/or operating results. There has not been a material change from the risk factors included in the Company’s Form 10-K for the year ended December 31, 2012.

### **ITEM 6. EXHIBITS**

- (a) Exhibits incorporated by reference are indicated in parentheses.
- 10.1 Amendment to the Key Executive Severance Plan, dated as of April 11, 2013 (incorporated by reference to Exhibit 10.1 to the Registrant’s Current Report on Form 8-K dated April 11, 2013).
- 12 Statements re computation of ratios.
- 18 Letter re change in accounting principles.
- 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.
- 101 The following materials from the Quarterly Report on Form 10-Q of Level 3 Communications, Inc. for the quarter ended June 30, 2013, formatted in XBRL (eXtensible Business Reporting Language); (i) Consolidated Statements of Operations, (ii) Consolidated Statements of Comprehensive Loss, (iii) Supplementary Stockholders’ Equity Information, (iv) Consolidated Balance Sheets, (v) Consolidated Statements of Cash Flows and (vi) Notes to Consolidated Financial Statements.

## **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.

LEVEL 3 COMMUNICATIONS, INC.

Dated: August 6, 2013

/s/ Eric J. Mortensen

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Eric J. Mortensen

Senior Vice President, Controller and Principal Accounting Officer

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES**  
**Statement Regarding Computation of Ratio of Earnings to Fixed Charges**  
**(unaudited)**

(dollars in millions)	Six Months Ended June 30,		Year Ended December 31,				
	2013	2012	2012	2011	2010	2009	2008
Loss from Continuing Operations Before Taxes	\$ (77)	\$ (178)	\$ (374)	\$ (786)	\$ (712)	\$ (623)	\$ (312)
Interest on Debt, Net of Capitalized Interest	336	370	733	716	586	595	570
Amortization of Capitalized Interest	—	—	—	—	—	—	48
Portion of rents deemed representative of the interest factor (1/3)	51	51	101	77	69	68	68
(Losses) Earnings Available for Fixed Charges	\$ 310	\$ 243	\$ 460	\$ 7	\$ (57)	\$ 40	\$ 374
Interest on Debt	336	370	733	716	586	595	570
Preferred Dividends	—	—	—	—	—	—	—
Interest Expense Portion of Rental Expense	51	51	101	77	69	68	68
Total Fixed Charges	\$ 387	\$ 421	\$ 834	\$ 793	\$ 655	\$ 663	\$ 638
Ratio of Earnings to Fixed Charges	—	—	—	—	—	—	—
Deficiency	\$ (77)	\$ (178)	\$ (374)	\$ (786)	\$ (712)	\$ (623)	\$ (264)

July 16, 2013

Level 3 Communications, Inc.

1025 Eldorado Blvd.

Broomfield, Colorado 80021

Ladies and Gentlemen:

We have been furnished with a copy of the quarterly report on Form 10-Q of Level 3 Communications, Inc. (the "Company") for the three months ended June 30, 2013, and have read the Company's statements contained in Note 1 to the condensed consolidated financial statements included therein. As stated in Note 1, the Company changed the date of its annual assessment of goodwill impairment from December 31 to October 1 and states that the change in method of applying the accounting principle is a preferable alternative as the new date of the assessment provides additional time prior to the Company's year-end to complete the goodwill impairment testing and report the results in its Annual Report on Form 10-K and is more closely aligned with the Company's strategic planning process. In accordance with your request, we have reviewed and discussed with Company officials the circumstances and business judgment and planning upon which the decision to make this change in the method of accounting was based.

We have not audited any financial statements of the Company as of any date or for any period subsequent to December 31, 2012, nor have we audited the information set forth in the aforementioned Note 1 to the condensed consolidated financial statements; accordingly, we do not express an opinion concerning the factual information contained therein.

With regard to the aforementioned accounting change, authoritative criteria have not been established for evaluating the preferability of one acceptable method of accounting over another acceptable method. However, for purposes of the Company's compliance with the requirements of the Securities and Exchange Commission, we are furnishing this letter.

Based on our review and discussion, with reliance on management's business judgment and planning, we concur that the newly adopted method of accounting is preferable in the Company's circumstances.

Very truly yours,

(Signed) KPMG LLP



**CERTIFICATIONS\***

I, Jeff K. Storey, certify that:

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

Date: August 6, 2013

/s/ Jeff K. Storey

Jeff K. Storey

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

Date: August 6, 2013

/s/ Sunit S. Patel

Sunit S. Patel

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-Q of Level 3 Communications, Inc. (the “Company”) for the three and six months ended June 30, 2013 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Jeff K. Storey, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

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

/s/ Jeff K. Storey

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Jeff K. Storey

President and Chief Executive Officer

August 6, 2013

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

In connection with the Form 10-Q of Level 3 Communications, Inc. (the “Company”) for the three and six months ended June 30, 2013 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Sunit S. Patel, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

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

/s/ Sunit S. Patel

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Sunit S. Patel

Chief Financial Officer

August 6, 2013