

# LEVEL 3 COMMUNICATIONS INC

## FORM 10-Q (Quarterly Report)

Filed 08/10/01 for the Period Ending 06/30/01

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

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Filed 8/10/2001 For Period Ending 6/30/2001

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**FORM 10-Q**  
**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

(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, 2001**

or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934 For the transition period \_\_\_\_\_ to \_\_\_\_\_**

*Commission file number 0-15658*

**LEVEL 3 COMMUNICATIONS, INC.**

(Exact name of registrant as specified in its charter)

Delaware  
(State of Incorporation)

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

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

80021  
(Zip Code)

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

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

The number of shares outstanding of each class of the issuer's common stock, as of July 31, 2001:

Common Stock 368,266,866 shares

## Part I - Financial Information

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

(dollars in millions, except per share data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2001 ----	2000 ----	2001 ----	2000 ----
Revenue.....	\$ 389	\$ 234	\$ 838	\$ 411
Costs and Expenses:				
Cost of revenue.....	211	154	479	284
Depreciation and amortization.....	329	139	568	227
Selling, general and administrative.....	345	249	707	485
Restructuring charges.....	40	--	50	--
Impairments.....	61	--	61	--
	-----	-----	-----	-----
Total Costs and Expenses.....	986	542	1,865	996
	-----	-----	-----	-----
Loss from Operations.....	(597)	(308)	(1,027)	(585)
Other Income (Expense):				
Interest income.....	47	104	108	168
Interest expense, net.....	(174)	(81)	(312)	(131)
Equity in earnings (losses) of unconsolidated subsidiaries, net.....	4	(61)	2	(116)
Gain on equity investee stock transactions.....	--	57	--	95
Other, net.....	(11)	(3)	(37)	(3)
	-----	-----	-----	-----
Total Other Income (Expense).....	(134)	16	(239)	13
	-----	-----	-----	-----
Loss Before Income Taxes.....	(731)	(292)	(1,266)	(572)
Income Tax Benefit.....	--	11	--	20
	-----	-----	-----	-----
Net Loss.....	\$ (731) =====	\$ (281) =====	\$ (1,266) =====	\$ (552) =====
Net Loss Per Share (Basic and Diluted).....	\$ (1.99) =====	\$ (0.77) =====	\$ (3.44) =====	\$ (1.54) =====
Total Number of Weighted Average Shares Outstanding Used to Compute Basic and Diluted Loss Per Share (in thousands).....	368,211 =====	365,916 =====	368,012 =====	358,008 =====

See accompanying notes to consolidated condensed financial statements.

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

(dollars in millions, except per share data)	June 30, 2001 ----	December 31, 2000 ----
<b>Assets</b>		
<b>Current Assets:</b>		
Cash and cash equivalents.....	\$ 1,418	\$ 1,265
Marketable securities.....	1,743	2,742
Restricted securities.....	148	219
Receivables, less allowances for doubtful accounts of \$34 and \$33, respectively.....	484	617
Recoverable income taxes.....	25	67
Other.....	78	135
	-----	-----
Total Current Assets.....	3,896	5,045
Net Property, Plant and Equipment.....	10,480	9,383
Investments.....	111	146
Other Assets, net.....	401	345
	-----	-----
	\$ 14,888	\$ 14,919
	=====	=====

See accompanying notes to consolidated condensed financial statements.

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

(dollars in millions, except per share data)	June 30, 2001 ----	December 31, 2000 ----
<b>Liabilities and Stockholders' Equity</b>		
<b>Current Liabilities:</b>		
Accounts payable.....	\$ 1,341	\$ 1,486
Current portion of long-term debt.....	9	7
Accrued payroll and employee benefits.....	114	90
Accrued interest.....	124	124
Deferred revenue.....	87	68
Restructuring liability.....	39	--
Other.....	174	147
	-----	-----
Total Current Liabilities.....	1,888	1,922
Long-Term Debt, less current portion.....	7,959	7,318
Deferred Revenue.....	1,168	652
Accrued Reclamation Costs.....	94	94
Other Liabilities.....	394	384
<b>Commitments and Contingencies</b>		
<b>Stockholders' Equity:</b>		
Preferred stock, \$.01 par value, authorized 10,000,000 shares: no shares outstanding.....	--	--
Common stock:		
Common stock, \$.01 par value, authorized 1,500,000,000 shares: 368,249,281 outstanding in 2001 and 367,599,870 outstanding in 2000.....	4	4
Class R, \$.01 par value, authorized 8,500,000 shares: no shares outstanding.....	--	--
Additional paid-in capital.....	5,336	5,167
Accumulated other comprehensive loss.....	(140)	(73)
Accumulated deficit.....	(1,815)	(549)
	-----	-----
Total Stockholders' Equity.....	3,385	4,549
	-----	-----
	\$ 14,888	\$ 14,919
	=====	=====

See accompanying notes to consolidated condensed financial statements.

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

	Six Months Ended June 30,	
	2001	2000
	----	----
(dollars in millions)		
Cash Flows from Operating Activities:		
Net Loss.....	\$(1,266)	\$ (552)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Equity earning (losses), net.....	(2)	115
Depreciation and amortization.....	568	228
Dark fiber cost of revenue.....	131	17
Amortization of debt issuance costs.....	14	10
(Gain) loss on sale of assets.....	(13)	1
Compensation expense attributable to stock awards.....	162	97
Impairments.....	98	--
Gain on equity investee stock transactions.....	--	(95)
Amortization of discounts on marketable securities.....	--	(17)
Federal income tax refunds.....	43	245
Deferred revenue.....	516	215
Deposits.....	50	(148)
Accrued interest on long-term debt.....	59	87
Changes in working capital items:		
Receivables.....	114	(99)
Other assets.....	4	(22)
Payables.....	(82)	354
Other liabilities.....	53	48
Other.....	(47)	(17)
	-----	-----
Net Cash Provided by Operating Activities.....	402	467
Cash Flows from Investing Activities:		
Proceeds from sales and maturities of marketable securities.....	2,120	3,413
Purchases of marketable securities.....	(1,112)	(5,888)
Decrease (increase) in restricted securities.....	70	(4)
Capital expenditures.....	(1,952)	(3,038)
Other.....	17	(1)
	-----	-----
Net Cash Used in Investing Activities.....	(857)	(5,518)
Cash Flows from Financing Activities:		
Long-term debt borrowings, net of issuance costs.....	636	3,088
Payments on long-term debt, including current portion.....	(3)	(3)
Issuances of common stock, net of issuance costs.....	--	2,407
Other.....	11	12
	-----	-----
Net Cash Provided by Financing Activities.....	644	5,504
Effect of Exchange Rates on Cash and Cash Equivalents.....	(36)	(19)
	-----	-----
Net Change in Cash and Cash Equivalents.....	153	434
Cash and Cash Equivalents at Beginning of Period.....	1,265	1,214
	-----	-----
Cash and Cash Equivalents at End of Period.....	\$ 1,418	\$ 1,648
	=====	=====

See accompanying notes to consolidated condensed financial statements.



LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES  
Consolidated Statement of Changes in Stockholders' Equity  
For the six months ended June 30, 2001  
(unaudited)

(dollars in millions)	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total
Balances at December 31, 2000.....	\$ 4	\$ 5,167	\$ (73)	\$ (549)	\$ 4,549
Common Stock:					
Stock options exercised.....	--	2	--	--	2
Stock plan grants.....	--	162	--	--	162
Shareworks plan grants.....	--	5	--	--	5
Net Loss.....	--	--	--	(1,266)	(1,266)
Other Comprehensive Loss.....	--	--	(67)	--	(67)
	-----	-----	-----	-----	-----
Balances at June 30, 2001.....	\$ 4	\$ 5,336	\$ (140)	\$ (1,815)	\$ 3,385
	=====	=====	=====	=====	=====

See accompanying notes to consolidated condensed 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,		June 30,	
	2001	2000	2001	2000
	----	----	----	----
Net Loss.....	\$ (731)	\$ (281)	\$(1,266)	\$ (552)
Other Comprehensive Loss Before Tax:				
Foreign currency translation losses.....	(28)	(28)	(69)	(47)
Unrealized holding gains (losses) arising during				
period.....	(2)	--	2	(3)
Reclassification adjustment for gains included				
in net loss.....	--	--	--	--
	----	----	----	----
Other Comprehensive Loss Before Tax.....	(30)	(28)	(67)	(50)
Income Tax Benefit Related to Items of Other				
Comprehensive Loss.....	--	--	--	--
	----	----	----	----
Other Comprehensive Loss Net of Taxes.....	(30)	(28)	(67)	(50)
	----	----	----	----
Comprehensive Loss.....	\$ (761)	\$ (309)	\$(1,333)	\$ (602)
	=====	=====	=====	=====

See accompanying notes to consolidated condensed financial statements.

# LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## Notes to Consolidated Condensed Financial Statements

### 1. Summary of Significant Accounting Policies

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

The consolidated condensed balance sheet of Level 3 Communications, Inc. and subsidiaries at December 31, 2000 has been condensed from the Company's audited balance sheet as of that date. All other financial statements contained herein are unaudited and, in the opinion of management, contain all adjustments (consisting only of normal recurring accruals) necessary for a fair presentation of financial position, results of operations and cash flows for the periods presented. The Company's accounting policies and certain other disclosures are set forth in the notes to the consolidated financial statements contained in the Company's Annual Report on Form 10-K as amended, for the year ended December 31, 2000. These financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto. The preparation of the consolidated condensed financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities and the reported amount of revenue and expenses during the reported period. Actual results could differ from these estimates.

The Company is a facilities-based provider (that is, a provider that owns or leases a substantial portion of the property, plant and equipment necessary to provide its services) of a broad range of integrated communications services in the United States, Europe and Asia. The Company has created, through a combination of construction, purchase and leasing of facilities and other assets, an advanced international, end-to-end, facilities-based communications network. The Company has built and continues to build the network based on Internet Protocol technology in order to leverage the efficiencies of this technology to provide lower cost communications services.

Effective July 1, 1999, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 43, "Real Estate Sales, an Interpretation of FASB Statement No. 66." Certain sale and long-term indefeasible right-to-use ("IRU") agreements of dark fiber and capacity entered into after June 30, 1999 are required to be accounted for in the same manner as sales of real estate with property improvements or integral equipment. Dark fiber is considered integral equipment and accordingly, a lease must include a provision allowing title to transfer to the lessee in order for the lease to be accounted for as a sales-type lease. Failure to satisfy the requirements of the FASB Interpretation results in the deferral of revenue recognition for these agreements over the term of the agreement (currently up to 20 years). This FASB Interpretation does not have a current effect on the Company's cash flows however, it will result in substantial amounts of deferred revenue related to long-term dark fiber and capacity IRU agreements.

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

In 2000, Level 3 utilized a portion of its accumulated net operating tax losses to offset prior year taxable income. The remaining net operating losses not utilized can be carried forward for 20 years to offset future taxable income. A valuation allowance has been recorded against the entire balance of net deferred tax assets as the Company is unable to conclude under relevant accounting standards that it is more likely than not that net operating losses will be realizable.

In June 2001, the FASB approved Statement of Financial Accounting Standard ("SFAS") No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 prospectively prohibits the pooling of interest method of accounting for business combinations initiated after June 30, 2001. SFAS No. 142 requires companies to cease amortizing goodwill on December 31, 2001. Any goodwill resulting from acquisitions completed after June 30, 2001 will not be amortized. SFAS No. 142 also establishes a new method of testing goodwill for impairment on an annual basis or on an interim basis if an event occurs or circumstances change that would reduce the fair value of a reporting unit below its carrying value, beginning in the first quarter of 2002.

The results of operations for the six months ended June 30, 2001 are not necessarily indicative of the results expected for the full year.

Where appropriate, items within the consolidated condensed financial statements have been reclassified from the previous periods to conform to current period presentation.

## 2. Loss Per Share

Basic loss per share amounts have been computed using the weighted average number of shares during each period. The Company had a net loss for the three and six month periods ended June 30, 2001 and 2000. Therefore, the dilutive impact of the approximate 19 million shares attributable to the Company's convertible subordinated notes, and the approximate 33 million options and warrants outstanding at June 30, 2001 and approximate 19 million shares attributable to the Company's convertible subordinated notes and approximate 21 million options and warrants outstanding at June 30, 2000 have not been included in the computation of diluted loss per share because the resulting computation would have been anti-dilutive.

## 3. Restructuring and Impairment Charges

On June 18, 2001, the Company announced that due to the duration and severity of the economic slowdown for the telecommunications industry, it was reducing its revenue and EBITDA forecasts for 2001 and 2002. In conjunction with this revised revenue outlook, the Company also announced that it would be necessary to reduce operating expenses as well as reduce and reprioritize capital expenditures in an effort to be in a position to benefit when the economy recovers. As a result of this action, the Company is reducing its global work force by approximately 1,400 employees, primarily in the communications business. A restructuring charge of approximately \$40 million was recorded in the second quarter of 2001, of which \$35 million related to staff reduction and related costs and \$5 million to real estate lease termination costs. The Company had previously recorded a \$10 million charge for a workforce realignment action taken in the first quarter. In total, the Company has paid \$11 million in severance and related fringe benefit costs as of June 30, 2001 for both of these actions. The remaining cash expenditures relating to the workforce reduction and the lease terminations are expected to be substantially paid by the end of 2001.

The capital reprioritization discussed above resulted in certain telecommunications assets being identified as excess or impaired. As a result, the Company recorded a non-cash impairment charge of \$61 million, representing the excess of the carrying value over the fair value of these assets. The fair value of the excess equipment was based on recent cash sales of similar equipment. The impaired assets were written-off, as the Company does not expect to utilize them to generate future cash flows.

#### 4. Marketable Securities

At June 30, 2001 and December 31, 2000, marketable securities consisted of the following:

(dollars in millions)	June 30, 2001 ----	December 31, 2000 ----
U.S. Treasury Securities .....	\$1,743	\$2,538
Commercial Paper.....	--	204
	-----	-----
	\$1,743	\$2,742
	=====	=====

#### 5. Receivables

Receivables at June 30, 2001 and December 31, 2000 were as follows:

(dollars in millions)	Communications	Information Services	Coal	Other	Total
June 30, 2001					
Accounts Receivable - Trade:					
Services.....	\$ 174	\$ 23	\$ 10	\$ 1	\$ 208
Dark Fiber.....	50	--	--	--	50
Joint Build Costs.....	204	--	--	--	204
Other Receivables.....	56	--	--	--	56
Allowance for Doubtful Accounts.....	(31)	(3)	--	--	(34)
	-----	-----	-----	-----	-----
	\$ 453	\$ 20	\$ 10	\$ 1	\$ 484
	=====	=====	=====	=====	=====
December 31, 2000					
Accounts Receivable - Trade:					
Services.....	\$ 147	\$ 26	\$ 19	\$ 1	\$ 193
Dark Fiber.....	161	--	--	--	161
Joint Build Costs.....	247	--	--	--	247
Other Receivables.....	49	--	--	--	49
Allowance for Doubtful Accounts.....	(29)	(4)	--	--	(33)
	-----	-----	-----	-----	-----
	\$ 575	\$ 22	\$ 19	\$ 1	\$ 617
	=====	=====	=====	=====	=====

Joint build receivables primarily relate to costs incurred by the Company for construction of network assets in which Level 3 is partnering with other companies. Generally, under these types of agreements, the sponsoring partner will initially incur all of the construction costs and subsequently bill the other party as certain construction milestones are accomplished. Joint build receivables at June 30, 2001 and December 31, 2000 include \$72 million and \$90 million, respectively, attributable to FLAG Telecom Limited for its share of the costs of the Northern Asia submarine cable system.

## 6. Property, Plant and Equipment, net

### Construction-in-Progress

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

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

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

(dollars in millions)	Cost	Accumulated Depreciation	Book Value
June 30, 2001			
Land and Mineral Properties.....	\$ 222	\$ (12)	\$ 210
Facility and Leasehold Improvements			
Communications.....	1,921	(95)	1,826
Information Services.....	25	(4)	21
Coal Mining.....	67	(64)	3
CPTC.....	92	(13)	79
Network Infrastructure.....	4,923	(207)	4,716
Operating Equipment			
Communications.....	2,166	(809)	1,357
Information Services.....	61	(31)	30
Coal Mining.....	82	(73)	9
CPTC.....	17	(10)	7
Network Construction Equipment.....	121	(29)	92
Furniture, Fixtures and Office Equipment.....	154	(60)	94
Construction-in-Progress.....	2,036	--	2,036
	-----	-----	-----
	\$11,887	\$ (1,407)	\$10,480
	=====	=====	=====

(dollars in millions)	Cost	Accumulated Depreciation	Book Value
December 31, 2000			
Land and Mineral Properties.....	\$ 166	\$ (11)	\$ 155
Facility and Leasehold Improvements			
Communications.....	1,384	(53)	1,331
Information Services.....	25	(4)	21
Coal Mining.....	68	(64)	4
CPTC.....	92	(12)	80
Network Infrastructure.....	3,400	(43)	3,357
Operating Equipment			
Communications.....	1,584	(555)	1,029
Information Services.....	50	(26)	24
Coal Mining.....	93	(85)	8
CPTC.....	17	(9)	8
Network Construction Equipment.....	139	(27)	112
Furniture, Fixtures and Office Equipment.....	150	(45)	105
Construction-in-Progress.....	3,149	--	3,149
	-----	-----	-----
	\$10,317	\$ (934)	\$ 9,383
	=====	=====	=====

It is the Company's policy to review the carrying amount of long lived assets for impairment whenever events or changes in circumstances indicate the carrying amount may not be recoverable. The determination of any impairment includes a comparison of estimated undiscounted future operating cash flows anticipated to be generated during the remaining useful life of the asset to the net carrying value of the asset.

Due to the current economic conditions in the telecommunications industry and previously discussed reductions in the Company's estimated short-term revenue, the Company performed an impairment review in accordance with SFAS No.

121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" to determine whether its telecommunications network required any write down to fair value. No financial statement adjustments were required as a result of the analysis. The Company will continue to monitor expected cash flows from the telecommunications business and the carrying value of its network to determine if future impairments are necessary.

## 7. Investments

The Company holds significant equity positions in two publicly traded companies: RCN Corporation ("RCN") and Commonwealth Telephone Enterprises, Inc. ("Commonwealth Telephone"). RCN is a facilities-based provider of bundled local and long distance phone, cable television and Internet services to residential markets primarily on the East and West coasts as well as Chicago. Commonwealth Telephone holds Commonwealth Telephone Company, an incumbent local exchange carrier operating in various rural Pennsylvania markets.

On June 30, 2001, Level 3 owned approximately 27% and 46% of the outstanding shares of RCN and Commonwealth Telephone, respectively, and accounts for each entity using the equity method. The market value of the Company's investment in RCN and Commonwealth Telephone was \$146 million and \$452 million, respectively, on June 30, 2001.

During the fourth quarter of 2000, Level 3's proportionate share of RCN's losses exceeded the remaining carrying value of Level 3's investment in RCN. Level 3 does not have additional financial commitments to RCN; therefore it recognized equity losses only to the extent of its investment in RCN. If RCN becomes profitable, Level 3 will not record its equity in RCN's earnings until unrecorded equity in losses have been offset. The Company's investment in RCN, including goodwill, was zero at June 30, 2001 and December 31, 2000. The Company did not recognize an estimated \$197 million and \$276 million of additional equity losses attributable to RCN for the three and six months ended June 30, 2001, respectively, bringing the total amount of estimated suspended equity losses to approximately \$296 million at June 30, 2001.

The Company recognizes gains from the sale, issuance and repurchase of stock by its equity method investees in its statements of operations. The increase in the Company's proportionate share of RCN's net assets as a result of these transactions resulted in a pre-tax gain of \$57 million and \$95 million for the Company for the three and six months ended June 30, 2000, respectively. The Company does not expect to recognize future gains on RCN stock activity until the Company recognizes suspended equity losses.

The following is summarized financial information of RCN for the three and six months ended June 30, 2001 and 2000, and as of June 30, 2001 and December 31, 2000 (dollars in millions).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
Operations:				
RCN Corporation:				
Revenue .....	\$ 111	\$ 79	\$ 217	\$ 150
Net loss available to common shareholders.....	(677)	(208)	(935)	(362)
Level 3's Share:				
Net loss.....	\$ --	(63)	\$ --	(119)
Goodwill amortization.....	--	--	--	(1)
	-----	-----	-----	-----
	\$ --	\$ (63)	\$ --	\$ (120)
	=====	=====	=====	=====
			June 30,	December 31,
			2001	2000
			----	----
Financial Position:				
Current Assets.....			\$ 1,244	\$ 1,854
Other Assets .....			2,678	2,922
			-----	-----
Total assets.....			3,922	4,776
Current Liabilities.....			394	531
Other Liabilities.....			2,366	2,284
Minority Interest.....			61	75
Preferred Stock.....			2,065	1,991
			-----	-----
Total liabilities and preferred stock.....			4,886	4,881
			-----	-----
Common equity.....			\$ (964)	\$ (105)
			=====	=====
Level 3's Investment:				
Equity in net assets.....			\$ --	\$ --
Goodwill.....			--	--
			-----	-----
			\$ --	\$ --
			=====	=====



The Company's investment in Commonwealth Telephone, including goodwill, was \$107 million and \$105 million at June 30, 2001 and December 31, 2000, respectively.

The Company has made investments in certain public and private early stage IP centric entities in connection with those entities agreeing to purchase various services from the Company. The Company records these transactions as investments and deferred revenue. The value of the investment and deferred revenue is equal to the estimated fair value of the securities at the time of the transaction or the value of the services to be provided, whichever is more readily determinable. Level 3 closely monitors the success of these investees in executing their business plans. For those companies that are publicly traded, Level 3 also monitors current and historical market values of the investee as it compares to the carrying value of the investment. The Company recorded a charge of \$9 million and \$37 million during the three and six months ended June 30, 2001, respectively, for an other-than temporary decline in the value of such investments which is included in Other, net on the consolidated condensed statements of operations. If any of the privately held investments become publicly-traded and meet the criteria for "available-for-sale" securities pursuant to SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," they will be accounted for accordingly. Otherwise, future appreciation will be recognized only upon sale or other disposition of these securities. After the \$9 million charge recorded in the second quarter, the carrying amount of the investments was zero. The carrying amount of the investments was \$37 million at December 31, 2000. The Company recognized revenue of approximately \$2 million and \$10 million for services related to this program for the three and six months ended June 30, 2001, respectively. The Company recognized revenue of less than \$1 million for services related to this program for the three and six months ended June 30, 2000.

#### 8. Other Assets, net

At June 30, 2001 and December 31, 2000 other assets consisted of the following:

(dollars in millions)	June 30, 2001	December 31, 2000
	----	----
Debt Issuance Costs, net.....	\$158	\$161
Goodwill, net of accumulated amortization of \$130 and \$102.....	40	68
Deposits.....	52	53
Prepaid Network Assets.....	32	35
Deferred Network Costs.....	37	--
Assets Held for Sale, net.....	50	--
CPTC Deferred Development and Financing Costs.....	13	14
Other.....	19	14
	-----	-----
	\$401	\$345
	=====	=====

Goodwill amortization expense, excluding amortization expense attributable to equity method investees, was \$6 million and \$28 million for the three and six months ended June 30, 2001. Goodwill amortization expense, excluding amortization expense attributable to equity method investees, was \$9 million and \$19 million for the three and six months ended June 30, 2000, respectively.

Assets held for sale include certain corporate facilities that the Company has elected to dispose. The Company recorded an impairment charge in depreciation expense of \$35 million in the second quarter representing the difference between the carrying value and market value of these facilities, as determined by a commercial real estate broker. Also included in assets held for sale is certain telecommunications equipment identified as excess due to the Company's decision in June 2001 to reprioritize its capital expenditures.

## 9. Long-Term Debt

At June 30, 2001 and December 31, 2000, long-term debt was as follows:

(dollars in millions)	June 30, 2001 ----	December 31, 2000 ----
Senior Notes (9.125% due 2008).....	\$2,000	\$2,000
Senior Notes (11% due 2008).....	800	800
Senior Discount Notes (10.5% due 2008).....	651	619
Senior Euro Notes (10.75% due 2008).....	422	465
Senior Discount Notes (12.875% due 2010).....	425	399
Senior Euro Notes (11.25% due 2010).....	253	279
Senior Notes (11.25% due 2010).....	250	250
Senior Secured Credit Facility:		
Term Loan Facility:		
Tranche A (6.77% due 2007).....	450	200
Tranche B (7.77% due 2008).....	275	275
Tranche C (7.75% due 2008).....	400	--
Commercial Mortgage:		
GMAC (6.46% due 2003).....	120	120
Lehman (7.97% due 2001-2004).....	113	113
Convertible Subordinated Notes (6.0% due 2010).....	863	863
Convertible Subordinated Notes (6.0% due 2009).....	823	823
CPTC Long-term Debt (with recourse only to CPTC):		
(7.6%-9.5% due 2004 -2017).....	115	115
Other .....	8	4
	-----	-----
	7,968	7,325
Less current portion.....	(9)	(7)
	-----	-----
	\$7,959	\$7,318
	=====	=====

### Senior Secured Credit Facility

On January 8, 2001, the Company borrowed the remaining \$250 million available under the existing tranche A of the Senior Secured Credit Facility. On March 22, 2001, Level 3 entered into an amendment to increase the borrowing capacity under the Senior Secured Credit Facility by \$400 million, to \$1.775 billion. As part of the agreement, Level 3 borrowed \$400 million under a new tranche C of the term loan facility. The net proceeds will be used for implementing the business plan, including the purchase of telecommunications assets.

The equipment that is purchased with the proceeds of the term loan facility secures all obligations under the term loan facility.

Amounts drawn under the new tranche C will bear interest, at the option of the Company, at an alternate base rate or reserve-adjusted LIBOR plus applicable margins. The new tranche C applicable margins are fixed at 300 basis points over the alternate base rate and 400 basis points over LIBOR. Simultaneously with the addition of tranche C, the applicable LIBOR margin for tranche B of the term loan facility was increased by 25 basis points, to 375 basis points over LIBOR. Interest on tranche C of the term loan facility will be payable based on the interest rate option chosen by the Company.

Tranche C of the term loan facility amortizes in consecutive quarterly payments beginning on June 30, 2004, commencing at \$1 million per quarter and increasing to \$97 million per quarter in 2007, with the final installment due January 30, 2008.

The Senior Secured Credit Facility contains certain covenants, which among other things, limit additional indebtedness, dividend payments, certain investments and transactions with affiliates. Level 3 and certain Level 3 subsidiaries must also comply with specific financial and operational tests and maintain certain financial ratios. The Company believes it is in compliance with all such covenants at June 30, 2001. In addition to the original Senior Secured Credit Facility debt issuance costs, \$14 million of debt issuance costs associated with tranche C were capitalized and are amortized as interest expense over the remaining term of the Senior Secured Credit Facility.

The Senior Secured Credit Facility also contains a \$650 million senior secured revolving credit facility. As of June 30, 2001, Level 3 had not borrowed any funds under this revolving facility. The availability of funds is contingent upon the continued compliance with the relevant debt covenants.

In an effort to reduce the risk of increased interest rates related to the Lehman commercial mortgage, in January 2001 the Company entered into an interest rate cap agreement. The interest rate cap notional amount is \$113 million and has a maturity date of January 31, 2004. The terms of the agreement provide that the net interest expense related to the Lehman commercial mortgage will not exceed 8% plus 400 basis points. The Company has elected not to account for this transaction as a hedge as permitted by SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"). Upon inception of the agreement, the Company recorded an asset equal to the fair value of the interest rate cap of less than \$1 million. For the three and six months ended June 30, 2001, the Company recorded, in the statement of operations, less than \$1 million in losses related to the change in the fair value of the interest rate cap.

The Company capitalized \$14 million and \$57 million of interest expense and amortized debt issuance costs related to network construction and business systems development projects for the three and six month periods ending June 30, 2001, respectively. Capitalized interest for the three and six months ended June 30, 2000 was \$90 million and \$157 million, respectively.

#### 10. Employee Benefit Plans

The Company adopted the recognition provisions of SFAS No. 123, "Accounting for Stock Based Compensation" ("SFAS No. 123") in 1998. Under SFAS No. 123, the fair value of an option (as computed in accordance with accepted option valuation models) on the date of grant is amortized over the vesting periods of the options in accordance with FASB Interpretation No. 28 "Accounting For Stock Appreciation Rights and Other Variable Stock Option or Award Plans". Although the recognition of the value of the instruments results in compensation or professional expenses in an entity's financial statements, the expense differs from other compensation and professional expenses in that these charges may not be settled in cash, but rather, generally, are settled through issuance of common stock.

The adoption of SFAS No. 123 has resulted in material non-cash charges to operations since its adoption in 1998, and will continue to do so. The amount of the non-cash charges will be dependent upon a number of factors, including the number of grants and the fair value of each grant estimated at the time of its award. The Company recognized a total of \$85 million and \$162 million of non-cash compensation for the three and six months ended June 30, 2001, respectively. In addition, the Company capitalized \$5 million and \$9 million of non-cash compensation for those employees directly involved in the construction of the network or development of the business support systems for the three and six months ended June 30, 2001, respectively.

The Company recognized a total of \$49 million and \$97 million of non-cash compensation for the three and six months ended June 30, 2000, respectively. In addition, the Company capitalized \$2 million and \$5 million of non-cash compensation for those employees directly involved in the construction of the network or development of the business support systems for the three and six months ended June 30, 2000, respectively.

## **Non-Qualified Stock Options and Warrants**

The Company granted warrants to purchase approximately 900,000 shares of common stock to consultants in 2001 for services to be provided. These warrants vest in equal quarterly installments over 33 months commencing in March 2001 with each portion expiring seven years from the vesting date. The exercise price of these warrants is \$29. The fair value determined pursuant to SFAS No. 123 for these warrants at issuance was \$14 million. The Company did not grant any nonqualified stock options ("NQSO") to employees during the three and six months ended June 30, 2001. The expense recognized for the three and six months ended June 30, 2001 for NQSOs and warrants outstanding at June 30, 2001 in accordance with SFAS No. 123 was \$5 million and \$11 million, respectively. In addition to the expense recognized, the Company capitalized less than \$1 million of non-cash compensation costs for the three and six months ended June 30, 2001 related to NQSOs and warrants for employees directly involved in the construction of the network and the development of the business support systems. As of June 30, 2001, the Company had not reflected \$16 million of unamortized compensation expense in its financial statements for NQSOs and warrants previously granted.

The Company did not grant any NQSOs or warrants to employees during the six months ended June 30, 2000. The Company recognized \$1 million and \$2 million of expense for the three and six months ended June 30, 2000, respectively, for NQSOs and warrants outstanding at June 30, 2000. In addition to the expense recognized, the Company capitalized less than \$1 million of non-cash compensation costs for the three and six months ended June 30, 2000.

## **Outperform Stock Option Plan**

In April 1998, the Company adopted an outperform stock option ("OSO") program that was designed so that the Company's stockholders would receive a market return on their investment before OSO holders receive any return on their options. The Company believes that the OSO program aligns directly participants' and stockholders' interests by basing stock option value on the Company's ability to outperform the market in general, as measured by the Standard & Poor's ("S&P") 500 Index. Participants in the OSO program do not realize any value from awards unless Level 3's Common Stock outperforms the S&P 500 Index. When the stock price gain is greater than the corresponding gain on the S&P 500 Index, the value received for awards under the OSO plan is based on a formula involving a multiplier related to the level by which the Common Stock outperforms the S&P 500 Index. To the extent that Level 3's common stock outperforms the S&P 500 Index, the value of OSOs to a holder may exceed the value of non-qualified stock options.

OSO awards are made quarterly to eligible participants on the date of the grant. Each award vests in equal quarterly installments over two years and has a four-year life. Awards granted prior to December 2000 typically have a two-year moratorium on exercise from the date of grant. As a result, once a participant is 100% vested in the grant, the two-year moratorium expires. Therefore, awards granted prior to December 2000 have an exercise window of two years. Level 3 granted 3.1 million OSOs to employees in December 2000. Included in the grant were 2.1 million OSOs that vest 25% after six months with the remaining 75% vesting after 18 months. These OSOs and all additional OSOs granted after March 31, 2001 are exercisable immediately upon vesting and have a four-year life.

The fair value recognized under SFAS No. 123 for the approximately 6.9 million OSOs awarded to participants during the six months ended June 30, 2001 was approximately \$161 million. The Company recognized \$63 million and \$115 million of compensation expense for the three and six months ended June 30, 2001, respectively, for OSOs granted since 1999. In addition to the expense recognized, \$3 million and \$5 million of non-cash compensation was capitalized for the three and six months ended June 30, 2001, respectively, for employees directly involved in the construction of the network and development of business support systems. As of June 30, 2001, the Company had not reflected \$180 million of unamortized compensation expense in its financial statements for OSOs granted previously. The Company recognized \$44 million and \$87 million of expense for the three and six months ended June 30, 2000, respectively, for

OSOs outstanding at June 30, 2000. In addition to the expense recognized, the Company capitalized \$2 million and \$4 million of non-cash compensation for the three and six months ended June 30, 2000, respectively.

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

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

The Company recognized \$11 million and \$26 million of compensation expense for the three and six months ended June 30, 2001, respectively for C-OSOs awarded in 2000. In addition to the expense recognized, \$1 million and \$2 million of non-cash compensation was capitalized for the three and six months ended June 30, 2001, respectively for employees directly involved in the construction of the network and development of business support systems. As of June 30, 2001, the Company had not reflected \$72 million of unamortized compensation expense in its financial statements for C-OSOs awarded in 2000.

### **Shareworks and Restricted Stock**

The Company recorded \$6 million and \$10 million of non-cash compensation expense for the three and six months ended June 30, 2001, respectively, related to the Shareworks and restricted stock programs. In addition to the expense recognized, \$1 million of non-cash compensation was capitalized for the three and six months ended June 30, 2001 for employees directly involved in the construction of the network and development of business support systems. The non-cash compensation expense for the Shareworks and restricted stock programs was \$4 million and \$8 million for the three and six months ended June 30, 2000, respectively.

As of June 30, 2001, the Company had not reflected unamortized compensation expense of \$22 million for Shareworks and restricted stock granted in prior years in its financial statements.

### **11. Industry and Segment Data**

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

EBITDA, as defined by the Company, consists of earnings (loss) before interest, income taxes, depreciation, amortization, non-cash operating expenses (including stock-based compensation and impairments) and other non-operating income or expense. The Company excludes non-cash compensation due to its adoption of the expense recognition provisions of SFAS No. 123. EBITDA is

commonly used in the communications industry to analyze companies on the basis of operating performance. EBITDA is not intended to represent cash flow for the periods presented and is not recognized under Generally Accepted Accounting Principles ("GAAP").

The information presented in the tables following includes information for three and six months ended June 30, 2001 and 2000 for all income statement and cash flow information presented, and as of June 30, 2001 and December 31, 2000 for all balance sheet information presented. Revenue and the related expenses are attributed to foreign countries based on where services are provided.

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

(dollars in millions)	Communications	Information Services	Coal Mining	Other	Total
Three Months Ended June 30, 2001					
Revenue:					
North America.....	\$ 277	\$ 27	\$ 21	\$ 6	\$ 331
Europe.....	51	4	--	--	55
Asia.....	3	--	--	--	3
	-----	-----	-----	-----	-----
	\$ 331	\$ 31	\$ 21	\$ 6	\$ 389
	=====	=====	=====	=====	=====
EBITDA:					
North America.....	\$ (98)	\$ 3	\$ 5	\$ 1	\$ (89)
Europe.....	(21)	1	--	--	(20)
Asia.....	(13)	--	--	--	(13)
	-----	-----	-----	-----	-----
	\$ (132)	\$ 4	\$ 5	\$ 1	\$ (122)
	=====	=====	=====	=====	=====
Capital Expenditures:					
North America.....	\$ 713	\$ 5	\$ 1	\$ --	\$ 719
Europe.....	45	--	--	--	45
Asia.....	8	--	--	--	8
	-----	-----	-----	-----	-----
	\$ 766	\$ 5	\$ 1	\$ --	\$ 772
	=====	=====	=====	=====	=====
Depreciation and Amortization:					
North America.....	\$ 257	\$ 3	\$ --	\$ 1	\$ 261
Europe.....	62	1	--	--	63
Asia.....	5	--	--	--	5
	-----	-----	-----	-----	-----
	\$ 324	\$ 4	\$ --	\$ 1	\$ 329
	=====	=====	=====	=====	=====

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

(dollars in millions)	Communications	Information Services	Coal Mining	Other	Total
Six Months Ended June 30, 2001					
Revenue:					
North America.....	\$ 633	\$ 56	\$ 46	\$ 12	\$ 747
Europe.....	79	8	--	--	87
Asia.....	4	--	--	--	4
	-----	-----	-----	-----	-----
	\$ 716	\$ 64	\$ 46	\$ 12	\$ 838
	=====	=====	=====	=====	=====
EBITDA:					
North America.....	\$ (177)	\$ 4	\$ 12	\$ 4	\$ (157)
Europe.....	(57)	1	--	--	(56)
Asia.....	(23)	--	--	--	(23)
	-----	-----	-----	-----	-----
	\$ (257)	\$ 5	\$ 12	\$ 4	\$ (236)
	=====	=====	=====	=====	=====
Capital Expenditures:					
North America.....	\$ 1,700	\$ 10	\$ 3	\$ --	\$ 1,713
Europe.....	151	--	--	--	151
Asia.....	88	--	--	--	88
	-----	-----	-----	-----	-----
	\$ 1,939	\$ 10	\$ 3	\$ --	\$ 1,952
	=====	=====	=====	=====	=====
Depreciation and Amortization:					
North America.....	\$ 446	\$ 6	\$ 1	\$ 3	\$ 456
Europe.....	101	1	--	--	102
Asia.....	10	--	--	--	10
	-----	-----	-----	-----	-----
	\$ 557	\$ 7	\$ 1	\$ 3	\$ 568
	=====	=====	=====	=====	=====
Three Months Ended June 30, 2000					
Revenue:					
North America.....	\$ 141	\$ 24	\$ 48	\$ 5	\$ 218
Europe.....	12	4	--	--	16
Asia.....	--	--	--	--	--
	-----	-----	-----	-----	-----
	\$ 153	\$ 28	\$ 48	\$ 5	\$ 234
	=====	=====	=====	=====	=====
EBITDA:					
North America.....	\$ (106)	\$ 2	\$ 21	\$ (3)	\$ (86)
Europe.....	(26)	1	--	--	(25)
Asia.....	(9)	--	--	--	(9)
	-----	-----	-----	-----	-----
	\$ (141)	\$ 3	\$ 21	\$ (3)	\$ (120)
	=====	=====	=====	=====	=====
Capital Expenditures:					
North America.....	\$ 1,248	\$ 2	\$ 4	\$ --	\$ 1,254
Europe.....	468	--	--	--	468
Asia.....	30	--	--	--	30
	-----	-----	-----	-----	-----
	\$ 1,746	\$ 2	\$ 4	\$ --	\$ 1,752
	=====	=====	=====	=====	=====
Depreciation and Amortization:					
North America.....	\$ 114	\$ 3	\$ 2	\$ --	\$ 119
Europe.....	19	1	--	--	20
Asia.....	--	--	--	--	--
	-----	-----	-----	-----	-----
	\$ 133	\$ 4	\$ 2	\$ --	\$ 139
	=====	=====	=====	=====	=====

(dollars in millions)	Communications	Information Services	Coal Mining	Other	Total
Six Months Ended June 30, 2000					
Revenue:					
North America.....	\$ 225	\$ 48	\$ 96	\$ 11	\$ 380
Europe.....	25	6	--	--	31
Asia.....	--	--	--	--	--
	-----	-----	-----	-----	-----
	\$ 250	\$ 54	\$ 96	\$ 11	\$ 411
	=====	=====	=====	=====	=====
EBITDA:					
North America.....	\$ (237)	\$ 3	\$ 43	\$ (1)	\$ (192)
Europe.....	(57)	1	--	--	(56)
Asia.....	(13)	--	--	--	(13)
	-----	-----	-----	-----	-----
	\$ (307)	\$ 4	\$ 43	\$ (1)	\$ (261)
	=====	=====	=====	=====	=====
Capital Expenditures					
North America.....	\$ 2,240	\$ 3	\$ 4	\$ --	\$ 2,247
Europe.....	752	--	--	--	752
Asia.....	39	--	--	--	39
	-----	-----	-----	-----	-----
	\$ 3,031	\$ 3	\$ 4	\$ --	\$ 3,038
	=====	=====	=====	=====	=====
Depreciation and Amortization:					
North America.....	\$ 185	\$ 6	\$ 3	\$ 2	\$ 196
Europe.....	30	1	--	--	31
Asia.....	--	--	--	--	--
	-----	-----	-----	-----	-----
	\$ 215	\$ 7	\$ 3	\$ 2	\$ 227
	=====	=====	=====	=====	=====
Identifiable Assets					
-----					
June 30, 2001					
North America.....	\$ 9,076	\$ 71	\$ 302	\$ 3,161	\$ 12,610
Europe.....	1,814	8	--	53	1,875
Asia.....	383	--	--	20	403
	-----	-----	-----	-----	-----
	\$ 11,273	\$ 79	\$ 302	\$ 3,234	\$ 14,888
	=====	=====	=====	=====	=====
December 31, 2000					
North America.....	\$ 8,197	\$ 78	\$ 310	\$ 4,009	\$ 12,594
Europe.....	1,877	9	--	107	1,993
Asia.....	304	--	--	28	332
	-----	-----	-----	-----	-----
	\$ 10,378	\$ 87	\$ 310	\$ 4,144	\$ 14,919
	=====	=====	=====	=====	=====
Long-Lived Assets					
-----					
June 30, 2001					
North America.....	\$ 8,479	\$ 51	\$ 16	\$ 438	\$ 8,984
Europe.....	1,637	3	--	--	1,640
Asia.....	368	--	--	--	368
	-----	-----	-----	-----	-----
	\$ 10,484	\$ 54	\$ 16	\$ 438	\$ 10,992
	=====	=====	=====	=====	=====
December 31, 2000					
North America.....	\$ 7,640	\$ 49	\$ 15	\$ 217	\$ 7,921
Europe.....	1,633	3	--	--	1,636
Asia.....	317	--	--	--	317
	-----	-----	-----	-----	-----
	\$ 9,590	\$ 52	\$ 15	\$ 217	\$ 9,874
	=====	=====	=====	=====	=====



Product information for the Company's communications segment follows:

(dollars in millions)	Services	Reciprocal Compensation	Dark Fiber	Total
Communications Revenue				
-----				
Three Months Ended June 30, 2001				
North America.....	\$ 176	\$ 40	\$ 61	\$ 277
Europe.....	51	--	--	51
Asia.....	3	--	--	3
	-----	-----	-----	-----
	\$ 230	\$ 40	\$ 61	\$ 331
	=====	=====	=====	=====
Six Months Ended June 30, 2001				
North America.....	\$ 339	\$ 77	\$ 216	\$ 632
Europe.....	80	--	--	80
Asia.....	4	--	--	4
	-----	-----	-----	-----
	\$ 423	\$ 77	\$ 216	\$ 716
	=====	=====	=====	=====
Three Months Ended June 30, 2000				
North America.....	\$ 92	\$ 14	\$ 35	\$ 141
Europe.....	12	--	--	12
Asia.....	--	--	--	--
	-----	-----	-----	-----
	\$ 104	\$ 14	\$ 35	\$ 153
	=====	=====	=====	=====
Six Months Ended June 30, 2000				
North America.....	\$ 167	\$ 22	\$ 36	\$ 225
Europe.....	25	--	--	25
Asia.....	--	--	--	--
	-----	-----	-----	-----
	\$ 192	\$ 22	\$ 36	\$ 250
	=====	=====	=====	=====

The majority of North American revenue consists of services and products delivered within the United States. The majority of European revenue consists of services and products delivered within the United Kingdom.

The following information provides a reconciliation of EBITDA to loss from continuing operations for the three and six months ended June 30, 2001 and 2000 (dollars in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
EBITDA .....	\$ (122)	\$ (120)	\$ (236)	\$ (261)
Depreciation and Amortization Expense.....	(329)	(139)	(568)	(227)
Non-Cash Compensation Expense.....	(85)	(49)	(162)	(97)
Impairment Charges.....	(61)	--	(61)	--
	-----	-----	-----	-----
Loss from Operations.....	(597)	(308)	(1,027)	(585)
Other Income (Expense).....	(134)	16	(239)	13
Income Tax Benefit.....	--	11	--	20
	-----	-----	-----	-----
Net Loss.....	\$ (731)	\$ (281)	\$ (1,266)	\$ (552)
	=====	=====	=====	=====

## 12. Related Party Transactions

Peter Kiewit Sons', Inc. ("Kiewit") acted as the general contractor on several significant projects for the Company in 2001 and 2000. These projects include the U.S. intercity network, local loops and gateway sites, and the Company's corporate headquarters in Colorado. Kiewit provided approximately \$516 million and \$972 million of construction services related to these projects in the first six months of 2001 and 2000, respectively.

Level 3 also receives certain mine management services from Kiewit. The expense for these services was \$1 million and \$3 million for the three and six months ended June 30, 2001, respectively, and is recorded in selling, general and administrative expenses. The expense for these services was \$8 million and \$16 million for the three and six months ended June 30, 2000, respectively.

## 13. Other Matters

In August 1999, the Company was named as a defendant in *Schweizer vs. Level 3 Communications, Inc. et. al.*, a purported national class action, filed in the District Court, County of Boulder, State of Colorado which involves the Company's right to install its fiber optic cable network in easements and right-of-ways crossing the plaintiff's land. In general, the Company obtained the rights to construct its network from railroads, utilities, and others, and is installing its network along the rights-of-way so granted. Plaintiffs in the purported class action assert that they are the owners of the lands over which the Company's fiber optic cable network passes, and that the railroads, utilities and others who granted the Company the right to construct and maintain its network did not have the legal ability to do so. The action purports to be on behalf of a national class of owners of land over which the Company's network passes or will pass. The complaint seeks damages on theories of trespass, unjust enrichment and slander of title and property, as well as punitive damages. The Company may in the future receive claims and demands related to the rights-of-way issues similar to the issues in the *Schweizer* litigation that may be based on similar or different legal theories. Although it is too early for the Company to reach a conclusion as to the ultimate outcome of this litigation, management believes the Company has substantial defenses to the claims asserted in the *Schweizer* action (and any similar claims which may be named in the future), and intends to defend them vigorously.

The Company is involved in various other lawsuits, claims and regulatory proceedings incidental to its business. Management believes that any resulting liability for legal proceedings beyond that provided should not materially affect the Company's financial position, future results of operations or future cash flows.

On January 18, 2001, Level 3 announced that in order to provide the Company with additional flexibility in funding its business plan, it filed a "universal" shelf registration statement with the Securities and Exchange Commission relating to \$3.0 billion of common stock, preferred stock, debt securities, warrants, stock purchase agreements and depositary shares. The registration statement, (declared effective by the Securities and Exchange Commission on January 31, 2001), allows Level 3 to publicly offer these securities from time to time at prices and terms to be determined at the time of the offering. When combined with the remaining availability under its previously existing effective universal shelf registration statement, the availability under the registration statements allows Level 3 to offer an aggregate of up to \$3.156 billion of securities.

Level 3 intends to use the net proceeds of any offering of these securities for working capital, capital expenditures, acquisitions, and other general corporate purposes. Consistent with this approach, Level 3 may use the net proceeds for additions or expansions to its currently funded business plan.

On January 9, 2001, the Company announced that it signed an agreement in December 2000 to collaborate with FLAG Telecom on the development of the Northern Asia submarine cable system connecting Hong Kong, Japan, Korea and Taiwan. The system includes Level 3's previously announced eastern link

connecting Hong Kong, Taiwan and Japan and a new western link that FLAG Telecom is constructing to connect Hong Kong, Korea and Japan. The Hong Kong to Japan segment of the eastern link was placed in service during the second quarter of 2001. The Company expects the eastern link's Taiwan segment to follow in early 2002 and the entire western link to be ready for service in mid 2002. Level 3 and FLAG Telecom will each own three fiber pairs throughout the new system. The total cost of the entire Northern Asia system is estimated to be approximately \$900 million. Level 3's share of the cost is approximately \$450 million.

On April 26, 2001, the Company announced it has signed a new agreement with XO Communications, Inc. ("XO"), that amends the companies' previously announced dark fiber agreements. The original agreements between the companies included the purchase of 24 fibers, an empty conduit and tag-along rights for additional fibers in certain conduits of Level 3's North America network by XO for \$700 million. At the date of the announcement, over 60 percent of this commitment had been accepted and paid for. The previous agreements also provided that XO purchase nine European fiber networks and a pan-European intercity fiber network from Level 3 for \$148 million, as well as transatlantic capacity for an additional \$15 million. The new agreement provides that XO and Level 3 have canceled agreements relating to the purchase of the European metro and inter-city fiber networks from Level 3. The related \$128 million in payments that have already been made to Level 3 have been applied as a reduction in the remaining amounts payable by XO under its \$700 million North American intercity network commitment. Additionally, XO will purchase wavelength services from Level 3. XO will transfer certain transmission equipment it has purchased to Level 3, the value of which will be applied toward the purchase price of these services. Furthermore, XO will purchase transatlantic capacity per the original European agreement and give up certain previous contractual provisions including the tag-along rights for additional fibers in the North American network.

#### 14. Subsequent Events

On July 26, 2001, Level 3 announced that it had amended its Senior Secured Credit Facility to permit the Company to acquire certain of its outstanding indebtedness in exchange for shares of common stock. At the date of this announcement, various issuances of Level 3's outstanding senior notes, senior discount notes and convertible subordinated notes were trading at discounts to their respective face or accreted amounts. Level 3 may exchange shares of Level 3 common stock for these outstanding debt securities in open market or privately negotiated transactions. The amounts involved in any such transactions, individually or in the aggregate, may be material.

On July 30, 2001, CPTC announced that it had completed the refinancing of its development and construction debt. The \$135 million financing proceeds were used to repay CPTC's original lenders, repay subordinated debt carried by Orange County Transportation Authority and cover refinancing expenses. The debt carries an interest rate of 7.63% and requires principal payments in varying amounts through 2028. The debt is the obligation of CPTC and is nonrecourse to Level 3 Communications, Inc.

## LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

### Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the Company's consolidated condensed financial statements (including the notes thereto), included elsewhere herein.

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", "plans", "estimate" and "expect" and similar expressions, as they relate to the Company or its management, are intended to identify forward-looking statements. Such statements reflect the current views of the Company with respect to future events and are subject to certain risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described in this document. For a more detailed description of these risks and factors, please see the Company's additional filings with the Securities and Exchange Commission.

### Recent Developments

### Recent Accounting Developments

In June 1998, the Financial Accounting Standards Board, ("FASB"), SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"). SFAS No. 133, as amended by SFAS Nos. 137 and 138, is effective for fiscal years beginning January 1, 2001. SFAS No. 133 requires that all derivative instruments be recorded on the balance sheet at fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and, if it is, the type of hedge designated by the transaction. The Company currently makes minimal use of derivative instruments as defined by SFAS No. 133. Derivative instruments, as defined by SFAS No. 133, held by the Company at June 30, 2001 include an interest rate cap with a market value of less than \$1 million. The Company did not designate the interest rate cap as part of a hedge transaction. If the Company does not increase the utilization of derivatives, the adoption of this standard is expected to have a minimal effect on the Company's results of operations or its financial position.

Effective July 1, 1999, the FASB issued Interpretation No. 43, "Real Estate Sales, an Interpretation of FASB Statement No. 66." Certain sale and long-term indefeasible right-to-use agreements of dark fiber and capacity entered into after June 30, 1999 are required to be accounted for in the same manner as sales of real estate with property improvements or integral equipment. Failure to satisfy the requirements of the FASB Interpretation results in the deferral of revenue recognition for these agreements over the term of the agreement (currently up to 20 years). This FASB Interpretation does not have an effect on the Company's cash flows however, it results in substantial amounts of deferred revenue being recorded on the balance sheet.

In December 1999, the SEC staff released Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" ("SAB 101"). SAB 101 provides interpretive guidance on the recognition, presentation and disclosures of revenue in the financial statements effective for all transactions on or after January 1, 2000. The adoption of SAB 101 in 2000 did not have a material affect on the Company's financial results.

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

Telecommunications companies have historically applied sales-type lease accounting to certain capacity contracts that, among other required criteria, contained a provision that permitted the lessee the option to obtain ownership to the rights of way and/or the integral equipment at the end of the lease term in exchange for a nominal fee. Under EITF 00-11, the lessee must obtain title or its equivalent to the asset if sales-type lease accounting is to be used. Currently, Level 3 is treating certain transoceanic capacity agreements that meet the accounting requirements as sales-type leases but does not believe the issuance of EITF 00-11 will have a significant impact on its future operating results or financial condition.

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

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

In June 2001, the FASB also issued SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"). SFAS No. 142 is effective for fiscal years beginning January 1, 2002. SFAS No. 142 requires companies to segregate identifiable intangible assets acquired in a business combination from goodwill. The remaining goodwill is no longer subject to amortization over its estimated useful life. However, the fair value of the goodwill must be assessed at least annually for impairment using a fair value based test. Goodwill attributable to equity method investments will also no longer be amortized but is still subject to impairment analysis using existing guidance for equity method investments. The Company estimates that under previous accounting standards, amortization expense in 2002 would be approximately \$25 million. The Company has not segregated the identifiable intangible assets from goodwill but does not believe the adoption of SFAS No. 142 will have a material impact on the Company's results of operations or its financial position.

On April 26, 2001, the Company announced it has signed a new agreement with XO Communications, Inc. ("XO"), that amends the companies' previously announced dark fiber agreements. The original agreements between the companies included the purchase of 24 fibers, an empty conduit and tag-along rights for additional fibers in certain conduits of Level 3's North America network by XO for \$700 million. At the date of the announcement, over 60 percent of this commitment had been accepted and paid for. The previous agreements also provided that XO purchase nine European fiber networks and a pan-European intercity fiber network from Level 3 for \$148 million, as well as transatlantic capacity for an additional \$15 million. The new agreement provides that XO and Level 3 have canceled agreements relating to the purchase of the European metro and inter-city fiber networks from Level 3. The related \$128 million in payments that have already been made to Level 3 have been applied as a reduction in the remaining amounts payable by XO under its \$700 million North American intercity network commitment. Additionally, XO will purchase wavelength services from Level 3. XO will transfer certain transmission equipment it has purchased to Level 3, the value of which will be applied toward the purchase price of these services. Furthermore, XO will purchase transatlantic capacity per the original European agreement and give up certain previous contractual provisions including the tag-along rights for additional fibers in the North American network.

# Results of Operations 2001 vs. 2000

Revenue for the respective periods ended June 30, is summarized as follows (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
Communications.....	\$331	\$153	\$716	\$250
Information Services.....	31	28	64	54
Coal Mining.....	21	48	46	96
Other .....	6	5	12	11
	-----	-----	-----	-----
	\$389	\$234	\$838	\$411
	=====	=====	=====	=====

Communications revenue for the three months ended June 30, 2001 increased 116% compared to the same period in 2000. Included in total communications revenue of \$331 million, was \$230 million of services revenue and \$61 million of non-recurring revenue from dark fiber contracts entered into before June 30, 1999. Also, included in total communications revenue for the quarter was \$40 million attributable to reciprocal compensation. Communications revenue for the second quarter of 2000 was comprised of \$104 million of service revenue, \$35 million of dark fiber revenue and \$14 million of reciprocal compensation. The increase in service revenue from 2000 was due to growth in both existing customers as well as new customer contracts. Due to the current economic conditions of the telecommunications industry, the Company has recently experienced a significant increase in the numbers of customers terminating service in 2001. These terminations will result in slower growth of service revenue for the remainder of the year. The increase in dark fiber revenue is attributable to the completion of several segments of the Company's intercity network during the second quarter of 2001. Dark fiber revenue is expected to decline beginning in the third quarter, as the majority of the Company's intercity network is now complete and dark fiber on the intercity segments has been delivered to customers. The increase in reciprocal compensation in the second quarter of 2001 is a result of the Company receiving regulatory approval from several states regarding its agreements with SBC Communications and Bell South. These agreements established a rate structure for transmission and switching services provided by one carrier to complete or carry traffic originating on another carrier's network. It is the Company's policy not to recognize revenue from these agreements until the relevant regulatory authorities approve the agreements.

Communications revenue increased during the first six months of 2001 by 186% compared to the same period in 2000. Included in total communications revenue of \$716 million for the six months ended June 30, 2001 was \$423 million of service revenue, \$216 million of non-recurring revenue from dark fiber contracts entered into before June 30, 1999 and \$77 million attributable to reciprocal compensation. Communications revenue for the six months ended June 30, 2000 was comprised of \$192 million of services revenue, \$36 million of dark fiber revenue and \$22 million of reciprocal compensation.

Information services revenue, which is comprised of applications and outsourcing businesses, increased from \$28 million in the quarter ended June 30, 2000 to \$31 million for the respective period in 2001, and from \$54 million in the six months ended June 30, 2000 to \$64 million for the same period in 2001. These increases are primarily attributable to outsourcing revenue which increased to \$21 million for the second quarter of 2001 from \$15 million for the same period in 2000 and \$42 million for the six months ended June 30, 2001 compared to \$29 million for the same period in 2000. The increases in outsourcing revenue for the respective periods are primarily due to new long-term contracts signed in the last half of 2000.

The communications business generated Cash Revenue of \$642 million during the three months ended June 30, 2001. The Company defines Cash Revenue as communications revenue plus changes in cash deferred revenue during the respective period. Communications Cash Revenue reflects up front cash received for

dark fiber and other capacity sales that are recognized over the term of the contract under GAAP. Cash deferred revenue for the communications business for the second quarter increased \$179 million compared to the same period in 2000. This increase is a result of growth in services provided to existing customers and new customer contracts and cash collections from those customers. Communications Cash Revenue was \$285 million for the three months ended June 30, 2000. Cash Revenue is not intended to represent revenue under GAAP.

Cash Revenue for the six months ended June 30, 2001 was \$1.299 billion, an increase from \$412 million for the same period in 2000. This increase can be attributed to the growth in both services provided to existing customers as well as new customer contracts, and cash collections from those customers.

Coal mining revenue decreased \$27 million in the second quarter of 2001 compared to the same period in 2000. Coal mining revenue for the first six months of 2001 was \$46 million compared to \$96 million for the same period in 2000. These decreases in revenue are primarily attributable to the expiration of long-term coal contracts with Commonwealth Edison, the sale of the Company's interest in Walnut Creek Mining Company in September 2000 and the deferral of certain 2001 coal customer purchase commitments to the latter half of the year.

Other revenue for the three and six months ended June 30, 2001 was comparable to the respective periods in 2000 and is primarily attributable to California Private Transportation Company, L.P. ("CPTC") the owner-operator of the SR91 tollroad in southern California.

Cost of Revenue for the second quarter 2001 was \$211 million, representing a 37% increase over second quarter 2000 cost of revenue of \$154 million. This increase is a result of the expanding communications business. Overall the cost of revenue for the communications business, as a percentage of revenue, decreased significantly from 75% during the quarter ended June 30, 2000 to 53% during the same period of 2001. The cost of revenue for the six months ended June 30, 2001 was \$479 million, an increase from \$284 million for the same period in 2000. Cost of revenue for the six months ended June 30, 2001 for the communications business, as a percentage of revenue, was 56% as compared to 83% during the same period of 2000. The decreases for both periods can be attributed to the migration of customer traffic from a leased network to the Company's own operational network.

The cost of revenue for the information services businesses, as a percentage of its revenue, was 71% for the second quarter of 2001, and 77% for the six months ended June 30, 2001 and approximates the figures for the respective periods in 2000. The cost of revenue for the coal mining business, as a percentage of revenue, was 71% for the second quarter of 2001 up from 38% for the same period in 2000. Cost of revenue for the coal mining business, as a percentage of revenue, was 67% for the six months ended June 30, 2001 as compared to 39% for the same period in 2000. The increases related to coal are attributable to the expiration of high margin long-term coal contracts in 2000.

Depreciation and Amortization expenses for the quarter were \$329 million, a 137% increase from the second quarter 2000 depreciation and amortization expenses of \$139 million. Depreciation and amortization expenses for the six months ended June 30, 2001 were \$568 million, a 150% increase from \$227 million for the respective period in 2000. Included in depreciation expense for the three and six months ended June 30, 2001 is \$35 million for the impairment charge on the corporate facility the Company has elected to dispose. The remaining increases are a direct result of the communications assets placed in service in the latter half of 2000 and during the six months ended June 30, 2001, including gateways, local networks and intercity segments.

Selling, General and Administrative expenses were \$345 million in the three months ended June 30, 2001, a 39% increase over the second quarter 2000. This increase is primarily a result of the Company's additional employees hired since the end of second quarter 2000. Compensation costs, excluding non-cash compensation, increased 23% due to the additional employees. The Company also recorded \$85 million in non-cash compensation for the second quarter 2001 for expenses recognized under SFAS No. 123 related

to grants of stock options, warrants and other stock based compensation programs. The Company recorded \$49 million of non-cash compensation for the same period in 2000. The increase in non-cash compensation is predominantly due to an increase in the number of employees and the C-OSOs granted in September and December of 2000. Costs attributable to the communications business such as rent, property taxes, software and hardware maintenance and bad debt expense also contributed to the higher selling, general and administrative expenses. Partially offsetting these additional costs were declines in travel, advertising and mine management expenses. Selling, general and administrative costs for the remainder of 2001 are expected to remain consistent or decline slightly from second quarter 2001 levels due to the reduction in force.

Selling, general and administrative expenses were \$707 million in the six months ended June 30, 2001, a 46% increase over the respective period of 2000. This increase is primarily attributable to the factors identified above. Increases in cash and non-cash compensation, facility related expenses and bad debt expenses were partially offset by declines in travel expenses and mine management fees.

Restructuring Charges of \$40 million were recorded in the second quarter of 2001. The Company announced that due to the duration and severity of the economic slowdown for the telecommunications industry, it was reducing its revenue and EBITDA forecasts for 2001 and 2002. In conjunction with this revised revenue outlook, the Company also announced that it would be necessary to reduce operating expenses in an effort to be in a position to benefit when the economy recovers. As a result of this action, the Company is reducing its global work force by approximately 1,400 employees, primarily in the communications business. The restructuring charge is comprised of \$35 million for staff reduction costs and \$5 million for real estate lease termination costs. The Company had previously recorded a \$10 million charge for a workforce realignment action taken in the first quarter. In total, the Company has paid \$11 million in severance and fringe benefit costs as of June 30, 2001 for both of these actions. The remaining cash expenditures relating to the workforce reduction and the lease terminations are expected to be substantially paid by the end of 2001.

Impairments of \$61 million were recorded in the three month period ending June 30, 2001. As part of the restructuring announcement, the Company also announced that it was reducing and reprioritizing capital expenditures. The capital reprioritization resulted in certain telecommunications assets being identified as excess or impaired. As a result, the Company recorded a non-cash impairment charge of \$61 million representing the excess of the carrying value over the fair value of these assets. The value of the excess equipment was based on recent cash sales of similar equipment. The impaired assets were written-off, as the Company does not expect to utilize them to generate future cash flows.

EBITDA, as defined by the Company, consists of earnings (losses) before interest, income taxes, depreciation, amortization, non-cash operating expenses (including stock-based compensation and impairment charges) and other non-operating income or expenses. The Company excludes non-cash compensation due to its adoption of the expense recognition provisions of SFAS No. 123. EBITDA declined to a loss of \$122 million in the second quarter of 2001 from a \$120 million loss for the same period in 2000. EBITDA for the six months ended June 30, 2001 was a loss of \$236 million as compared to \$261 million loss for the same period in 2000. Excluding the two restructuring charges recorded in the first and second quarter of 2001, EBITDA would have been losses of \$82 million and \$186 million for the three and six months ended June 30, 2001, respectively. These improvements were predominantly due to the higher margins earned by the communications business.

Adjusted EBITDA, as defined by the Company, is EBITDA as defined above plus the change in cash deferred revenue and excluding the non-cash cost of goods sold associated with certain capacity sales and dark fiber contracts. For the quarter ended June 30, 2001, Adjusted EBITDA was \$238 million compared to \$29 million for the same period in 2000. For the six months ended June 30, 2001, Adjusted EBITDA was \$478 million compared to loss of \$82 million for the same period in 2000. These increases can be attributed to increases in cash deferred revenue and increased pre-June 30, 1999 dark fiber revenue recognized in 2001.



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

Interest Income was \$47 million for the second quarter of 2001 and \$104 million for the second quarter of 2000. The decrease is primarily attributable to the average cash and marketable securities balance declining from \$7.1 billion during the three month period ending June 30, 2000 to \$3.6 billion for the three month period ended June 30, 2001. In February 2000, the Company raised approximately \$5.5 billion in cash through debt and equity offerings. The Company has subsequently utilized these proceeds to fund its business plan. In addition, the weighted average interest rate on the portfolio decreased by approximately 60 basis points for the three months ended June 30, 2001 from the same period in 2000. Interest income for the six months ending June 30, 2001 and 2000 was \$106 million and \$168 million, respectively. The decrease is again attributable to a decline in the average portfolio balance and an approximately 10 basis point decline in the weighted average interest rate earned on the portfolio. Pending utilization of the cash, cash equivalents and marketable securities, the Company invests the funds primarily in government and government agency securities. The investment strategy will provide lower yields on the funds, but is expected to reduce the risk to principal in the short term prior to using the funds in implementing the Company's business plan.

Interest Expense, net increased by \$93 million to \$174 million in the second quarter of 2001 compared to the respective period in 2000. Interest expense increased due to the commercial mortgages entered into the latter half of 2000 and the additional credit facility draws in the first quarter of 2001. The amortization of the related debt issuance costs also contributed to the increased interest expense in 2001. Additionally, the increase can be attributed to a decrease in the amount of interest capitalized in the second quarter of 2001 as compared to the same period in 2000. The Company completed a significant portion of the network by the end of 2000, therefore reducing the amount of interest capitalization. Capitalized interest was \$14 million in the second quarter of 2001 and \$90 million in the second quarter of 2000.

Interest expense, net for the first six months of 2001 was \$312 million as compared to \$131 million for the same period in 2000. In addition to the explanations provided above, interest expense increased in the six months ended June 30, 2001 as compared to the respective period in 2000 due to the debt offerings completed in late February 2000. Capitalized interest was \$57 million in the six months ended June 30, 2001 and \$157 million for the same period in 2000.

Equity in Earnings (Losses) of Unconsolidated Subsidiaries was \$4 million in the second quarter of 2001, compared to loss of (\$61) million for the same period in 2000. The equity losses in 2000 are predominantly attributable to RCN Corporation, Inc. ("RCN"). RCN is a facilities-based provider of communications services to the residential markets primarily on the East and West coasts as well as in Chicago and the largest regional Internet service provider in the Northeast. RCN is incurring significant costs in developing its business plan. The Company's proportionate share of RCN's losses exceeded the remaining carrying value of Level 3's investment in RCN during the fourth quarter of 2000. Level 3 does not have additional financial commitments to RCN; therefore it only recognizes equity losses equal to its investment in RCN. The Company will not record any equity in RCN's future profits, if any, until unrecorded equity losses have been offset. The Company, as of June 30, 2001, had unrecorded equity losses attributable to RCN of \$296 million. Since RCN did not become profitable in the second quarter of 2001, the Company did not record any previously unrecorded losses attributable to RCN. Additionally, the Company recorded \$4 million and \$2 million of equity earnings for the three month periods ended June 30, 2001 and 2000, respectively, related to the investment in Commonwealth Telephone Enterprises, Inc.

Equity in earnings of Commonwealth was \$2 million for the six months ended June 30, 2001. Equity losses and earnings attributable to RCN and Commonwealth during the six months ended June 30, 2000, were losses of (\$120) million and earnings of \$4 million, respectively.

Gain on Equity Investee Stock Transactions was \$57 million and \$95 million for the three and six months ended June 30, 2000, respectively. Specifically, RCN issued stock for certain transactions, which diluted the Company's ownership interest. The pre-tax gains resulted from the increase in the Company's proportionate share of RCN's net assets related to these transactions. The Company did not record any gains on equity investee stock transactions during 2001 due to the suspended equity losses attributable to RCN.

Other, net decreased to a \$11 million loss in the second quarter of 2001 from a \$3 million loss in the same period of 2000 and from a loss of \$3 million for the six month period ended June 30, 2000 to a loss of \$37 million the same period in 2001. These declines are primarily attributable to the other-than temporary changes in the value of investments of \$9 million and \$37 million recorded in the three and six month periods ended June 30, 2001, respectively. Additionally, the Company recorded a loss of \$15 million in the first quarter of 2001 related to losses on certain asset disposals. These losses were partially offset by \$14 million of realized gains from the sale of marketable securities denominated in foreign currency.

Income Tax Benefit for the first and second quarter of 2001 was zero as a result of the Company exhausting the taxable income in the carryback period in 2000, and that it is unable to determine when the tax benefits attributable to the net operating losses will be realizable. The tax benefit for 2000 differs from the statutory rate due to the limited availability of taxable income in the carryback period for which current year losses can be offset. In 2000, Level 3 recognized a portion of the expected annual benefit equal to the ratio of pre-tax loss for the period to the total estimated loss for the year.

### **Financial Condition -- June 30, 2001**

The Company's working capital decreased from \$3.1 billion at December 31, 2000 to \$2.0 billion at June 30, 2001 due primarily to the use of available funds in payment of selling, general and administrative expenses, interest expense and construction of the Level 3 network. Proceeds from the Senior Secured Credit Facility borrowings increased working capital.

Cash provided by operations decreased from \$467 million in the six months ended June 30, 2000 to \$402 million in the same period of 2001. Excluding income tax refunds of \$43 million in 2001 and \$245 million in 2000, cash flows from operations actually increased from \$222 million in 2000 to \$359 million in 2001. An increase in revenue and deferred revenue and fluctuations in components of working capital, particularly accounts receivable, are primarily responsible for the increase in cash flow from operations.

Investing activities include using the proceeds from the first quarter Senior Secured Credit Facility draws and cash on hand to purchase \$1.1 billion of marketable securities and complete approximately \$2.0 billion of capital expenditures, primarily for the communications network. The Company also realized \$2.1 billion of proceeds from the sales and maturities of marketable securities and \$17 million of proceeds from the sale of construction equipment.

Financing sources in 2001 consisted primarily of the net proceeds of \$636 million from the first quarter 2001 Senior Secured Credit Facility draws. The Company also repaid long-term debt of \$3 million during the six months ended June 30, 2001 primarily attributable to capitalized leases and non-recourse debt at CPTC.

### **Liquidity and Capital Resources**

The Company is a facilities-based provider (that is, a provider that owns or leases a substantial portion of the property, plant and equipment necessary to provide its services) of a broad range of integrated communications services. The Company has created, through a combination of construction, purchase and leasing of facilities and other assets, an advanced, international, end-to-end, facilities-based communications network. The Company has designed its network based on Internet Protocol technology in order to leverage the efficiencies of this technology to provide lower cost communications services.

The continued development of the communications business will require significant expenditures. These expenditures may result in substantial negative operating cash flow and substantial net operating losses for the Company for the foreseeable future. Although the Company believes that its cost estimates and build-out schedule are reasonable, the actual construction costs or the timing of the expenditures may deviate from current estimates. The Company's capital expenditures in connection with its business plan were approximately \$2.0 billion during the first half of 2001. The majority of the spending was for construction of the U.S. and European intercity networks, certain local networks in the U.S. and Europe, and the transoceanic cable network. Through June 30, 2001, the total cost of the Level 3 network by region, including intercity and metropolitan networks, optronic and other transmission equipment, transmission facilities including gateway facilities and the regions allocated portion of undersea cables was \$8.8 billion for North America, \$1.7 billion for Europe and \$0.4 billion for Asia. Total capital expenditures for 2001 are expected to be approximately \$3.0 billion. The cash and marketable securities already on hand and the undrawn commitments of \$650 million at June 30, 2001 under the expanded Senior Secured Credit Facility, provided Level 3 with approximately \$3.8 billion of funds available at the end of the second quarter 2001. The Company's current liquidity, cash flows from committed contracts for communications services and dark fiber IRUs and anticipated future cash flows from operations should be sufficient to fund the currently committed portions of the business plan through early 2004.

The Company currently estimates that the implementation of the business plan from its inception through free cash flow breakeven will require approximately \$13 billion to \$14 billion on a cumulative basis. The Company also currently estimates that its operations will reach free cash flow breakeven in early 2004. The Company's successful debt and equity offerings have given the Company the ability to implement the committed portions of the business plan. However, if additional opportunities should present themselves, the Company may be required to secure additional financing in the future. In order to pursue these possible opportunities and provide additional flexibility to fund its business plan, in January 2001 the Company filed a "universal" shelf registration statement for an additional \$3 billion of common stock, preferred stock, debt securities, warrants, stock purchase agreements and depository shares. This shelf filing, in combination with the remaining availability under a previously existing universal shelf registration statement, will allow Level 3 to offer an aggregate of up to \$3.156 billion of additional securities to fund its business plan.

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

In connection with implementing the business plan, management will continue reviewing the existing businesses of the Company to determine how those businesses will complement the Company's focus on communications and information services. If it is decided that an existing business is not compatible with the communications business and if a suitable buyer can be found, the Company may dispose of that business.

On July 26, 2001, Level 3 announced that it had amended its Senior Secured Credit Facility to permit the Company to acquire certain of its outstanding indebtedness in exchange for shares of common stock. At the date of this announcement, various issuances of Level 3's outstanding senior notes, senior discount notes and convertible subordinated notes were trading at discounts to their respective face or accreted amounts. In order to reduce future cash interest payments, as well as future amounts due at maturity, Level 3 may exchange shares of Level 3 common stock for these outstanding debt securities in open market or privately negotiated transactions. The amounts involved in any such transactions, individually or in the aggregate, may be material and could result in significant non-operating income to the Company.

## Market Risk

Level 3 is subject to market risks arising from changes in interest rates, equity prices and foreign exchange rates. The Company's exposure to interest rate risk increased due to the \$1.375 billion Senior Secured Credit Facility entered into by the Company in September 1999, the additional \$400 million added to the Senior Secured Credit Facility during the first quarter of 2001 and the commercial mortgages entered into in 2000. As of June 30, 2001, the Company had borrowed \$1.125 billion under the Senior Secured Credit Facility and \$233 million under the commercial mortgages. Amounts drawn on the debt instruments bear interest at the alternate base rate or LIBOR rate plus applicable margins. As the alternate base rate and LIBOR rate fluctuate, so too will the interest expense on amounts borrowed under the credit facility and mortgages. The weighted average interest rate based on outstanding amounts under these variable rate instruments of \$1.358 billion at June 30, 2001, was approximately 7.3%. A hypothetical increase in the variable portion of the weighted average rate by 1% (i.e. a weighted average rate of 8.3%), would increase annual interest expense of the Company by approximately \$14 million. In an effort to reduce the risk of increased interest rates related to the Lehman commercial mortgage, in January 2001 the Company entered into an interest rate cap agreement. The terms of the agreement provide that the net interest expense related to the Lehman commercial mortgage will not exceed 8% plus the original spread. The agreement therefore caps the LIBOR portion of the interest rate at 8%. At June 30, 2001, the Company had \$6.5 billion of fixed rate debt bearing interest ranging from 6% to 12.875%. A decline in interest rates in the future will not benefit the Company due to the terms and conditions of the loan agreements require the Company to repurchase the debt at specified premiums. The Company may reduce its exposure to interest rate risk by, as outlined above, acquiring certain outstanding indebtedness in exchange for shares of common stock. The Company continues to evaluate other alternatives to limit interest rate risk.

Level 3 continues to hold positions in certain publicly traded entities, primarily Commonwealth Telephone and RCN. The Company accounts for these two investments using the equity method. The market value of these investments was approximately \$598 million at June 30, 2001, which is significantly higher than their carrying value of \$107 million. The Company does not currently have plans to dispose of these investments, however, if any such transaction occurred, the value received for the investments would be affected by the market value of the underlying stock at the time of any such transaction. A 20% decrease in the price of Commonwealth Telephone and RCN stock would result in approximately a \$120 million decrease in fair value of these investments. The Company does not currently utilize financial instruments to minimize its exposure to price fluctuations in equity securities.

The Company's business plan includes developing and constructing networks in Europe and Asia. As of June 30, 2001, the Company had invested significant amounts of capital in both regions and will continue to expand its presence in Europe and Asia throughout 2001. The Company issued 800 million in Senior Euro Notes in February 2000 as an economic hedge against its net investment in its European subsidiaries. Due to the historically low exchange rates involving the U.S. Dollar and the Euro during the fourth quarter of 2000, Level 3 elected to set aside, and continues to hold, the remaining Euros received from the debt offerings and purchase on the spot market the Euros required to fund its current European investing and operating activities. Other than the issuance of the Euro denominated debt and the purchase of the Euros on the spot market, the Company has not made significant use of financial instruments to minimize its exposure to foreign currency fluctuations. The Company continues to analyze risk management strategies to reduce foreign currency exchange risk.

The change in interest rates and equity security prices is based on hypothetical movements and are not necessarily indicative of the actual results that may occur. Future earnings and losses will be affected by actual fluctuations in interest rates, equity prices and foreign currency rates.

# LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

## PART II - OTHER INFORMATION

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

At the annual meeting of stockholders held on May 23, 2001 the following matters were submitted to a vote:

1. To reelect the five Class I Directors to the Board of Directors of Level 3 for a three-year term until the 2004 Annual Meeting of Stockholders:

	In Favor	Withheld
Walter Scott, Jr.	297,326,681	559,556
James Q. Crowe	295,264,543	2,621,694
Charles C. Miller, III	293,628,586	4,259,651
Mogens C. Bay	297,390,160	496,077
Colin V.K. Williams	293,189,004	4,697,233

2. In their discretion, the proxies are authorized to vote upon such other business as may properly come before the meeting or any adjournments or postponements thereof:

Affirmative votes:	278,441,343
Negative votes:	11,896,944

### Item 6. Exhibits and Reports on Form 8-K

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

Exhibit  
Number

3 Amended and Restate By-laws.

(b) On April 18, 2001, the Company filed a Current Report on Form 8-K related to financial results for the three months ended March 31, 2001 and revised financial projections.

On June 18, 2001, the Company filed a Current Report on Form 8-K related to revised financial projections and disclosing an open letter to stockholders from James Q. Crowe, Level 3's Chief Executive Officer, addressing Level 3 stock transactions of certain executives of the Company.

## **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 10, 2001*

*\s\ Eric J. Mortensen  
Eric J. Mortensen  
Vice President, Controller  
and Principal Accounting Officer*

**AMENDED AND RESTATED**  
**BY-LAWS**  
**OF**  
**LEVEL 3 COMMUNICATIONS, INC.**

**ARTICLE I.**  
**OFFICES**

**SECTION 1.1. REGISTERED OFFICE AND AGENT.** The registered office of Level 3 Communications, Inc.(the "Corporation") is at 1209 Orange Street, Wilmington, New Castle County, Delaware 19801. The registered agent at that address is The Corporation Trust Company.

**SECTION 1.2. OTHER OFFICES.** The Corporation may have other offices from time to time as the directors may designate or as the business may require.

**ARTICLE II.**  
**STOCKHOLDERS**

**SECTION 2.1. ANNUAL MEETINGS.** The annual meeting of stockholders shall be held at such place, date, and time as is designated by the Board of Directors. At this meeting, directors shall be elected and any other proper business may be transacted.

**SECTION 2.2. SPECIAL MEETINGS.** Special meetings of the stockholders of the Corporation may be called for any purpose or purposes by the Chairman of the Board, the Chief Executive Officer, the President or by a majority of the directors. Business transacted at any special meeting of stockholders shall be limited to the purposes stated in the notice of the meeting.

**SECTION 2.3. PLACE OF MEETINGS.** Meetings of stockholders shall be held at such place, either within or without the State of Delaware, as shall be designated by those calling the meeting.

**SECTION 2.4. NOTICES OF MEETINGS.** A written notice shall be given to each stockholder entitled to vote at the meeting not less than 10 nor more than 60 days before each annual or special meeting. The notice shall state the place, date, and hour of the meeting. The notice of a special meeting shall state the purposes for which the meeting has been called. Written notices may be given by either personal delivery or mail. If mailed, notice is given when deposited in the United States mail, postage prepaid directed to the stockholder at his address as it appears on the records of the Corporation. No notice is required to be given to a stockholder to whom notices of two consecutive annual meetings (and any other written notice sent between those meetings) have been mailed addressed to that person at his address as shown on the corporate records and have been returned undeliverable.

**SECTION 2.5. WAIVER OF NOTICE.** A written waiver, signed by a stockholder, whether before or after an annual or special meeting, shall be equivalent to the

giving of such notice. Attendance by a stockholder, without objection to the notice, whether in person or by proxy, at an annual or special meeting shall constitute waiver of notice of such meeting.

**SECTION 2.6. VOTING LIST.** At least ten days before each stockholders' meeting, the Secretary shall prepare a complete list of stockholders entitled to vote at such meeting. Arranged in alphabetical order, the list shall show the name, address, and number of shares of each stockholder entitled to vote. For at least 10 days before the meeting, the list shall be open to the examination of any stockholder, for any purpose germane to the meeting, during ordinary business hours, at (1) the meeting place, or (2) at another place within the city of the meeting which shall be specified in the notice of the meeting. The list shall also be available at the meeting for inspection by any stockholder present.

**SECTION 2.7. RECORD DATE.** The Board of Directors may fix a record date to determine which stockholders are entitled to: (a) notice of a stockholders' meeting; (b) vote at a stockholders' meeting; (c) receive payment for a dividend; (d) receive a distribution or allotment of rights; (e) exercise any rights in respect of any change, conversion, or exchange of stock; or (f) notice for the purpose of any other lawful action. The record date shall not be less than 10 nor more than 60 days before any such action. A determination of stockholders of record entitled to notice of or to vote at a meeting of stockholders shall apply to any adjournment of the meeting; provided, however, that the Board of Directors may fix a new record date for the adjourned meeting.

**SECTION 2.8. PROXY.** Each stockholder eligible to vote may authorize another person or persons to act for him by proxy. No proxy shall be valid after three years from its date, unless the proxy provides for a longer period.

**SECTION 2.9. VOTING RIGHTS.** Unless otherwise provided in the Second Restated Certificate of Incorporation, each stockholder eligible to vote shall have one vote for each share of capital stock held by such stockholder.

**SECTION 2.10. QUORUM AND REQUIRED VOTE.** A majority of the shares entitled to vote, present in person or represented by proxy, shall constitute a quorum at a meeting of stockholders. Unless otherwise required by the Second Restated Certificate of Incorporation or by statute, the affirmative vote of the majority of shares present in person or represented by proxy at the meeting and entitled to vote on the subject matter shall be the act of the stockholders. However, if less than a quorum but more than one-third of all shares eligible to vote is present at a scheduled meeting, a majority of the shares present may adjourn the scheduled meeting.

**SECTION 2.11. ADJOURNED MEETINGS.** No new notice is required if the time and place of the adjourned meeting is announced at the meeting at which the adjournment is taken and if the adjournment is for not more than 30 days. At an adjourned meeting, the stockholders may transact any business which might have been transacted at the original meeting.



**SECTION 2.12. NO ACTION WITHOUT A MEETING.** Any action required or permitted at a stockholders' meeting may be taken only upon the vote of the stockholders at an annual or special meeting duly noticed and called, and may not be taken by a written consent of the stockholders.

**SECTION 2.13. CONDUCT OF MEETINGS.**

(a) The Chief Executive Officer of the Corporation shall preside at each meeting of the stockholders. In the absence of the Chief Executive Officer, the meeting shall be chaired by an other officer of the Corporation in accordance with the following order: Chairman of the Board, Vice Chairman, President, any Executive Vice President, any Senior Vice President and any Vice President. In the absence of any of such officers, the meeting shall be chaired by a person chosen by a majority in interest of the stockholders present in person or represented by proxy and entitled to vote thereat, who shall act as chairman. The Secretary or in his or her absence an Assistant Secretary or a person whom the chairman of the meeting shall appoint shall act as secretary of the meeting and keep a record of the proceedings thereof.

(b) The Board of Directors shall be entitled to make such rules or regulations for the conduct of meeting of stockholders as it shall deem necessary, appropriate or convenient. Subject to such rules and regulations of the Board of Directors, if any, the chairman of the meeting shall have the right and authority to prescribe such rules, regulations and procedures and to do all such acts as, in the judgment of the chairman, are necessary, appropriate or convenient for the proper conduct of the meeting including, without limitation, establishing an agenda or order of business for the meeting, rules and procedures for maintaining order at the meeting and the safety of those present, limitations on participation in such meeting to stockholders of record of the Corporation and their duly authorized and constituted proxies, and such other persons as the chairman shall permit, restrictions on entry to the meeting after the time fixed for the commencement thereof, limitations on the time allotted to questions or comment by participants and regulation of the opening and closing of the ballot. Unless, and to the extent, determined by the Board of Directors or the chairman of the meeting, meetings of stockholders shall not be required to be held in accordance with rules of parliamentary procedure.

**SECTION 2.14. ADVANCE NOTIFICATION OF BUSINESS TO BE TRANSACTED AT STOCKHOLDER MEETINGS.**

(a) No business may be transacted at an annual meeting of stockholders, other than business that is either (a) specified in the notice of meeting (or any supplement thereto) given by or at the direction of the Board of Directors (or any duly authorized committee thereof), (b) otherwise properly brought before the annual meeting by or at the direction of the Board of Directors (or any duly authorized committee thereof) or (c) otherwise properly brought before the annual meeting by any stockholder of the Corporation (i) who is a stockholder of record on the date of the giving of the notice provided for in this section and on the record date for the determination of stockholders entitled to vote at such annual meeting and (ii) who complies with the notice procedures set forth in this section.

(b) In addition to any other applicable requirements for business to be properly brought before an annual meeting by a stockholder, such stockholder must have given timely notice thereof in proper written form to the Secretary.

(c) To be timely, a stockholder's notice to the Secretary must be delivered to or mailed and received at the principal executive office of the Corporation not less than 60 days nor more than 90 days prior to the anniversary date of the immediately preceding annual meeting of stockholders; provided, however, that in the event that the annual meeting is called for a date that is not within 30 days before or after such anniversary date, notice by the stockholder in order to be timely must be so received not later than the close of business on the tenth day following the day on which such notice of the date of the annual meeting was mailed or public disclosure of the date of the annual meeting was made, whichever first occurs.

(d) To be in proper written form, a stockholder's notice to the Secretary must set forth as to each matter such stockholder proposes to bring before the annual meeting (i) a brief description of the business desired to be brought before the annual meeting and the reasons for conducting such business at the annual meeting, (ii) the name and record address of such stockholder, (iii) the class or series and number of shares of capital stock of the Corporation which are owned beneficially or of record by such stockholder, (iv) a description of all arrangements or understandings between such stockholder and any other person or persons (including their names and addresses) in connection with the proposal of such business by such stockholder and any material interest of such stockholder in such business and (v) a representation that such stockholder intends to appear in person or by proxy at the annual meeting to bring such business before the meeting.

(e) No business shall be conducted at the annual meeting of stockholders except business brought before the annual meeting in accordance with the procedures set forth in this section; provided, however, that, once business has been properly brought before the annual meeting in accordance with such procedures, nothing in this section shall be deemed to preclude discussion by any stockholder of any such business. If the chairman of an annual meeting determines that business was not properly brought before the annual meeting in accordance with the foregoing procedures, the chairman shall declare to the meeting that the business was not properly brought before the meeting and such business shall not be transacted.

### **ARTICLE III. DIRECTORS**

**SECTION 3.1. GENERAL POWERS.** The business and affairs of this Corporation shall be managed by its Board of Directors.

**SECTION 3.2. NUMBER AND QUALIFICATIONS.** The Board of Directors shall fix, by resolution from time to time, the number of directors which shall constitute the whole Board of Directors; provided, however, that such number shall be no fewer than six and no more than fifteen. Directors need not be stockholders.

**SECTION 3.3. ELECTION AND TERM.** Upon the original filing of the Second Restated Certificate of Incorporation (the "Effective Time"), the Board of Directors shall be

divided into three classes to be designated as Class I, Class II and Class III. The Board of Directors, by resolution, shall designate the class in which each of the directors then in office shall serve upon such classification. The terms of office of the classes of directors so designated by the Board of Directors shall expire at the times of the annual meetings of the stockholders as follows:

Class I on the first annual meeting of stockholders following the Effective Time, Class II on the second annual meeting following the Effective Time and Class III on the third annual meeting following the Effective Time, or thereafter in each case when their respective successors are elected and qualified. At each subsequent annual election, the directors chosen to succeed those whose terms are expiring shall be identified as being of the same class as the directors whom they succeed, and shall be elected for a term expiring at the time of the third succeeding annual meeting of stockholders, or thereafter in each case when their respective successors are elected and qualified. The number of directorships shall be apportioned among the classes so as to maintain the classes as nearly equal in number as possible.

**SECTION 3.4. VACANCIES.** Vacancies, however resulting, and newly created directorships resulting from any increase in the authorized number of directors may be filled by a majority of the directors then in office, although less than a quorum, or by a sole remaining director. Any director elected to fill such a vacancy or newly created directorship shall hold office for a term that shall coincide with the term of the class to which such director shall have been elected.

**SECTION 3.5. REMOVAL.** Subject to any rights of the holders of any series of Preferred Stock to elect additional directors under specified circumstances, any director, or the entire Board of Directors, may be removed from office at any time, but only for cause and only by the affirmative vote of the holders of at least sixty-six and two-thirds percent (66 2/3%) of the outstanding stock entitled to vote thereon.

**SECTION 3.6. ANNUAL MEETINGS.** The Board of Directors may provide by resolution for the time and place of annual meetings of the Board of Directors, without notice other than such resolution.

**SECTION 3.7. REGULAR MEETINGS.** The Board of Directors may provide by resolution for the time and place of regular meetings of the Board of Directors, without notice other than such resolution.

**SECTION 3.8. SPECIAL MEETINGS.** Special meetings of the Board of Directors shall be called by the Chairman of the Board, the Chief Executive Officer, the President or by a majority of the directors. The person(s) calling the meeting may fix the specific time and place of the meeting.

**SECTION 3.9. NOTICE OF MEETING.** Notice of any special meeting of the Board of Directors shall be given to each director at his business or residence in writing or by telegram or by telephone communication or by facsimile transmission. If mailed, such notice shall be deemed adequately delivered when deposited in the United States mails so addressed, with postage thereon prepaid, at least five days before such meeting. If by telegram, such notice shall be deemed adequately delivered when the telegram is delivered to the telegraph company at least twenty-four hours before such meeting. If by telephone, the notice shall be given at least

twelve hours prior to the time set for the meeting. If by facsimile transmission, the notice shall be deemed adequately delivered if transmitted at least twenty-four hours before such meeting. Neither the business to be transacted at, nor the purpose of, any regular or special meeting of the Board of Directors need be specified in the notice of such meeting, except for amendments to these By-laws as provided under Article IX hereof. A meeting of the Board of Directors may be held at any time without notice if all the directors are present or if those not present waive notice of the meeting in writing, either before or after such meeting.

**SECTION 3.10. WAIVER OF NOTICE.** A written waiver, signed by the director, whether before or after the meeting of the Board of Directors, shall be equivalent to the giving of such notice. Attendance by a director, without objection to the notice, at a meeting of the Board of Directors shall constitute waiver of notice of such meeting.

**SECTION 3.11. TELEPHONE PARTICIPATION.** Directors may participate in a meeting of the Board of Directors by means of conference telephone or similar communications equipment if all persons participating in the meeting can hear each other. Participation in a meeting of this kind shall constitute presence in person at the meeting.

**SECTION 3.12. QUORUM AND VOTING.** A majority of the whole Board of Directors shall constitute a quorum for the transaction of business. The vote of the majority of the directors present at a meeting at which a quorum is present shall be the act of the Board of Directors unless the vote of a greater number is required by statute, the Second Restated Certificate of Incorporation, or these By-laws.

**SECTION 3.13. ACTION WITHOUT A MEETING.** Any action that may be taken at a meeting of the directors may be taken without a meeting if a consent in writing, setting forth the action taken, is signed by all directors.

**SECTION 3.14. COMPENSATION.** By resolution of the Board of Directors, a director may be paid a fixed sum, and any expenses, for attendance at a meeting of the Board of Directors. No such payment shall preclude a director from receiving compensation for serving the Corporation in any other capacity.

**SECTION 3.15. NOMINATION OF DIRECTORS.**

(a) Only persons who are nominated in accordance with the following procedures shall be eligible for election as directors of the Corporation. Nominations of persons for election to the Board of Directors may be made at any annual meeting of stockholders, or at any special meeting of stockholders called for the purpose of electing directors, (a) by or at the direction of the Board of Directors (or any duly authorized committee thereof) or (b) by any stockholder of the Corporation (i) who is a stockholder of record on the date of the giving of the notice provided for in this section and on the record date for the determination of stockholders entitled to vote at such meeting and (ii) who complies with the notice procedures set forth in this section.

(b) In addition to any other applicable requirements, for a nomination to be made by a stockholder, such stockholder must have given timely notice thereof in proper written form to the Secretary of the Corporation.

(c) To be timely, a stockholder's notice to the Secretary must be delivered to or mailed and received at the principal executive office of the Corporation

(a) in the case of an annual meeting, not less than 60 days nor more than 90 days prior to the anniversary date of the immediately preceding annual meeting of stockholders; provided, however, that in the event that the annual meeting is called for a date that is not within 30 days before or after such anniversary date, notice by the stockholder in order to be timely must be so received not later than the close of business on the tenth day following the day on which such notice of the date of the annual meeting was mailed or public disclosure of the date of the annual meeting was made, whichever first occurs and (b) in the case of a special meeting of stockholders called for the purpose of electing directors, not later than the close of business on the tenth day following the day on which notice of the date of the special meeting was mailed or public disclosure of the date of the special meeting was made, whichever first occurs.

(d) To be in proper written form, a stockholder's notice to the Secretary must set forth (a) as to each person whom the stockholder proposes to nominate for election as a director (i) the name, age, business address and residence address of the person, (ii) the principal occupation or employment of the person, (iii) the class or series and number of shares of capital stock of the Corporation which are owned beneficially or of record by the person and (iv) any other information relating to the person that would be required to be disclosed in a proxy statement or other filings required to be made in connection with solicitation of proxies for election of directors pursuant to Section 14 of the Securities Exchange Act of 1934 (the "Exchange Act"), and the rules and regulations promulgated thereunder, and (b) as to the stockholder giving the notice (i) the name and record address of such stockholder, (ii) the class or series and number of shares of capital stock of the Corporation which are owned beneficially or of record by such stockholder, (iii) a description of all arrangements or understandings between such stockholder and each proposed nominee and any other person or persons (including their names and addresses) pursuant to which the nominations(s) are to be made by such stockholder, (iv) a representation that such stockholder intends to appear in person or by proxy at the meeting to nominate the persons named in its notice and (v) any other information relating to such stockholder that would be required to be disclosed in a proxy statement or other filings required to be made in connection with solicitation of proxies for election of directors pursuant to Section 14 of the Exchange Act and the rules and regulations promulgated thereunder. Such notice must be accompanied by a written consent of each proposed nominee to being named as a nominee and to serve as a director if elected.

(e) No person shall be eligible for election as a director of the Corporation unless nominated in accordance with the procedures set forth in this section. If the chairman of the meeting determines that a nomination was not made in accordance with the foregoing procedures, the chairman shall declare to the meeting that the nomination was defective and such defective nomination shall be disregarded.

#### **ARTICLE IV. BOARD COMMITTEES**

**SECTION 4.1. FORMATION OF COMMITTEES.** The Board of Directors by resolution may create committees, each consisting of two or more directors, which committees shall hold office for such time and have such powers and perform such duties as may from time

to time be assigned to them by the Board of Directors. Three committees have previously been formed: the executive committee, the compensation committee and the audit committee.

**SECTION 4.2. EXECUTIVE COMMITTEE.** The executive committee shall have all the powers of the Board of Directors in the management of the normal and ordinary business and affairs of the Corporation at all times when the Board of Directors is not in session. The executive committee shall have the following specific powers to:

(a) review and approve business plans of subsidiaries and make recommendations concerning such plans to the appropriate subsidiary board of directors; and

(b) delegate authority to one or more persons to act on behalf of the Corporation or its subsidiaries, whether pursuant to a power of attorney or otherwise, and to establish policies regarding such delegations of authority.

**SECTION 4.3. COMPENSATION COMMITTEE.** The compensation committee shall have the duties to recommend to the Board of Directors:

(a) the base salary or wage ranges of all employees; (b) the amounts and forms of compensation, including fringe benefits and bonuses, as well as stock options and incentive compensation rights that apply or may apply to employees; (c) the adoption and implementation of any new or modified forms of compensation; (d) the suspension, elimination or restriction of any presently existing forms of compensation; and (e) plans concerning the orderly succession of officers and key management personnel.

**SECTION 4.4. AUDIT COMMITTEE.** None of the members of the audit committee shall be directly involved in the supervision or management of the financial affairs of this Corporation or any of its subsidiaries.

(a) The books, records, and accounts of the Corporation may be audited periodically by independent public accountants. In connection with the audit process, the audit committee shall have the duties outlined in its written charter as in effect from time to time and as approved by the Board of Directors.

(b) The audit committee shall meet periodically with the staff responsible for the Corporation's financial and accounting matters to review and discuss the scope of internal accounting procedures and controls then in effect and the extent to which any recommendations made by the independent public accountants or any internal auditors have been implemented.

(c) The audit committee shall direct and supervise any investigation into any matter brought to its attention within the scope of its duties which it believes is necessary. The audit committee may retain outside consultants in connection with any such investigation.

(d) The audit committee shall monitor business practices of the Corporation as set forth in the written policies of the Corporation, such as compliance with antitrust policies and other policies, as directed by the Board of Directors.

**SECTION 4.5. LIMITATIONS ON POWERS.** Limitations on the powers of committees of the Board of Directors shall be governed by Section 141(c)(2) of the Delaware

General Corporation Law. In addition, no committee shall act contrary to a fundamental policy or method of conducting the business of the Corporation. No committee shall have the specific powers conferred upon any other committee by these By-laws.

SECTION 4.6. GENERAL. Any committee member may be removed by the Board of Directors at any time without cause. The Board of Directors may designate a chairman of a committee. The following provisions of the By-laws, which are applicable to the Board of Directors, shall also govern each Board of Directors committee: Section 3.4 (vacancies), Section 3.10 (waiver of notice), Section 3.11 (telephone participation), Section 3.12 (quorum and voting), and Section 3.13 (action without a meeting). Each committee may adopt its own rules of procedure and such rules may govern the call, time, place, and notice of meetings. Each committee may keep appropriate minutes of such proceedings and shall report all significant actions at regular meetings of the Board of Directors.

## **ARTICLE V. OFFICERS**

SECTION 5.1. NUMBER. The officers of the Corporation shall include a President and a Secretary. The Board of Directors may elect additional officers and appoint agents as it determines necessary. Any two or more offices may be held by the same person, except the offices of President and Secretary. The Board of Directors in its discretion may also elect one or more Chairman of the Board and one or more Vice Chairman.

SECTION 5.2. ELECTION AND QUALIFICATION. The President and Secretary shall be elected at the annual meeting of the Board of Directors. Other officers may be elected by the Board of Directors from time to time. The Chairman of the Board, if any, the Chief Executive Officer, any Vice Chairman, and the President shall be directors of the Corporation, and should any one of them cease to be a director, he shall IP SO FACTO cease to be such officer.

SECTION 5.3. TERM. Each officer shall hold office until his successor is elected and qualified or until his earlier resignation or removal. Any officer may resign at any time upon written notice to the Corporation.

SECTION 5.4. REMOVAL. Any officer elected by the Board of Directors may be removed by a majority of the members of the whole Board of Directors whenever, in their judgment, the best interest of the Corporation would be served thereby. No elected officer shall have any contractual rights against the Corporation for compensation by virtue of such election beyond the date of the election of his successor, his death, his resignation or his removal, whichever event shall first occur, except as otherwise provided in an employment contract or under an employee deferred compensation plan.

SECTION 5.5. VACANCY. Any vacancy in any office from any cause may be filled for the unexpired portion of the term by the Board of Directors.

SECTION 5.6. CHAIRMAN OF THE BOARD. The Chairman of the Board shall be a director and shall preside at all meetings of the Board of Directors at which he shall be

present, and shall have such power and perform such duties as may from time to time be assigned to him by the Board of Directors.

**SECTION 5.7. VICE CHAIRMAN OF THE BOARD.** Any Vice Chairman of the Board shall be a director and shall preside at all meetings of the Board of Directors at which a Chairman shall not be present, and shall have such power and perform such duties as may from time to time be assigned to him by the Board of Directors.

**SECTION 5.8. CHIEF EXECUTIVE OFFICER.** The Chief Executive Officer shall, when present, preside at all meetings of the stockholders, and, in the absence of the Chairman of the Board and any Vice Chairman of the Board, or upon motion of the Board of Directors, at meetings of the Board of Directors. He shall have power to call special meetings of the stockholders, of the Board of Directors or of the Executive Committee at any time. He shall be the chief executive officer of the Corporation, and shall have the general direction of the business, affairs and property of the Corporation, and of its several officers and shall have and exercise all such powers and discharge such duties as usually pertain thereto.

**SECTION 5.9. PRESIDENT.** The President shall be the chief operating officer of the Corporation and shall have and exercise all such powers and discharge such duties as usually pertain to the office of President. In the absence of the Chief Executive Officer, the Chairman of the Board and any Vice Chairman, the President, when present, will preside at all meetings of the stockholders, and, in the absence of the Chairman of the Board, any Vice Chairman of the Board and the Chief Executive Officer, at meetings of the Board of Directors. He shall have power to call special meetings of the stockholders, of the Board of Directors or of the Executive Committee at any time.

**SECTION 5.10. VICE-PRESIDENTS.** The Vice-Presidents, if any, or any of them, shall, subject to the direction of the Board of Directors, at the request of the Chief Executive Officer of the President or in his absence, or in case of his inability to perform his duties from any cause, perform the duties of the President, and, when so acting, shall have all the powers of, and be subject to all restrictions upon, the President. The Vice-Presidents shall also perform such other duties as may be assigned to them by the Board of Directors, and the Board of Directors may determine the order of priority among them.

**SECTION 5.11. SECRETARY.** The Secretary shall perform such duties as are incident to the office of Secretary, or as may from time to time be assigned to him by the Board of Directors, or as are prescribed by these By-laws.

**SECTION 5.12.. TREASURER.** The Treasurer shall perform such duties and have powers as are usually incident to the office of Treasurer or which may be assigned to him by the Board of Directors.

**SECTION 5.13. COMPENSATION.** The compensation of all officers shall be fixed by the Board of Directors. An officer who is also a director may be compensated in both capacities.



SECTION 5.14. BONDING. Any officer, agent or employee of the Corporation, if so required by the Board of Directors, shall be bonded for the faithful performance of his duties, with such penalties, conditions and security as the Board of Directors may require.

## **ARTICLE VI. STOCK**

SECTION 6.1. STOCK CERTIFICATES. The directors shall determine the form of certificates which represent ownership of shares of the Corporation. Each certificate shall contain the holder's name and the number of shares issued. Each certificate shall be signed by the President or any Vice President and the Secretary or the Assistant Secretary. Each certificate shall be impressed with the corporate seal. Each certificate shall be consecutively numbered. The name and address of the person to whom the shares are issued, with the number of shares and date of issue, shall be entered in the stock ledger of the Corporation.

SECTION 6.2. TRANSFER OF STOCK. Transfers of shares shall be made only on the stock transfer books of the Corporation. On surrender to the Corporation of a stock certificate properly endorsed by the holder of record or accompanied by a proper evidence of authority to transfer, a new certificate shall be issued to the person entitled. However, the requirements of any applicable stock transfer restriction agreement must also be satisfied. The old certificate shall be canceled and the transaction recorded in the stock ledger.

SECTION 6.3. LOST CERTIFICATES. The Corporation shall issue a new stock certificate in place of a certificate previously issued, if the holder: (a) claims by affidavit that the certificate has been lost, destroyed, or stolen; and (b) gives the Corporation a bond or other indemnity as the directors determine appropriate.

SECTION 6.4. REGISTERED STOCKHOLDERS. The person in whose name shares are registered in the Corporation's stock ledger shall be deemed by the Corporation to be the owner of those shares for all purposes. The Corporation shall not be required to recognize any equitable or other claim or interest in such shares by any other person, whether or not it has actual or other notice of such claim.

## **ARTICLE VII. MISCELLANEOUS**

SECTION 7.1. SEAL. The corporate seal shall contain the name of the Corporation as well as the words "Corporate Seal" and "Delaware".

SECTION 7.2. FISCAL YEAR. The fiscal year of the Corporation shall be determined by resolution of the Board of Directors.

SECTION 7.3. CONTRACTS, ETC. The directors shall determine by resolution which persons shall be empowered to sign contracts, bids, proposals, certificates and other instruments of the Corporation. Such authority may be general or confined to specific instances.

**SECTION 7.4. CHECKS, ETC.** All checks or demands for money and notes of the Corporation shall be signed by such officer or officers or such other person or persons as the Board of Directors may from time to time designate.

**SECTION 7.5. DIVIDENDS.** Dividends upon the capital stock of the Corporation, subject to the provisions of the Second Restated Certificate of Incorporation, may be declared by the Board of Directors or a committee of the Board of Directors at any regular or special meeting, pursuant to law. Dividends may be paid in cash, in property or in shares of the capital stock.

**SECTION 7.6. RESERVES.** Before payment of any dividend there may be set aside out of any funds of the Corporation available for dividends such sum or sums as the directors from time to time, in their absolute discretion, determine proper as a reserve fund to meet contingencies, or for repairing or maintaining any property of the Corporation or for such other purpose as the directors shall think conducive to the interest of the Corporation, and the directors may abolish any such reserve in the manner in which it was created.

**SECTION 7.7. VOTING STOCK OF OTHER CORPORATIONS.** Except as otherwise ordered by the Board of Directors, the Chairman of the Board or the Chief Executive Officer or the President shall have full power on behalf of the Corporation to attend and to act and to vote at any meeting of the stockholders of any other corporation of which the Corporation is a stockholder and to execute a proxy to any other person to represent the Corporation at any such meeting.

## **ARTICLE VIII. INDEMNIFICATION**

**SECTION 8.1. NON-DERIVATIVE SUITS.** The Corporation shall indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or complete action, suit or proceeding, whether civil, criminal, administrative, or investigative (other than an action by or in the right of the Corporation), by reason of the fact that he is or was a director, officer, employee or agent of the Corporation, or is or was serving at the request of the Corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by him in connection with such action, suit or proceeding if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the Corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe his conduct was unlawful. The termination of any action, suit or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, shall not, of itself, create a presumption that the person did not act in good faith and in a manner which he reasonably believed to be in or not opposed to the best interests of the Corporation, and, with respect to any criminal action or proceeding, had reasonable cause to believe his conduct was unlawful.

**SECTION 8.2. DERIVATIVE SUITS.** The Corporation shall indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action or suit by or in the right of the Corporation to procure a judgment in its favor

by reason of the fact that he is or was a director, officer, employee or agent of the Corporation, or is or was serving at the request of the Corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against expenses (including attorneys' fees) actually and reasonably incurred by him in connection with the defense or settlement of such action or suit if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interest of the Corporation and except that no indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable to the Corporation unless and only to the extent that the Court of Chancery or the court in which such action or suit was brought shall determine upon application that, despite the adjudication of liability but in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses which the Court of Chancery or such other court shall deem proper.

**SECTION 8.3. EXTENT OF INDEMNIFICATION.** To the extent that a director, officer, employee or agent of the Corporation has been successful on the merits or otherwise in defense of any action, suit or proceeding referred to in Section 8.1 or 8.2 above, or in defense of any claim, issue or matter therein, he shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by him in connection therewith.

**SECTION 8.4. APPROVAL OF INDEMNIFICATION.** Any indemnification under Section 8.1 or 8.2 above (unless ordered by a court) shall be made by the Corporation only as authorized in the specific case upon a determination that indemnification of the director, officer, employee or agent is proper in the circumstances because he has met the applicable standard of conduct set forth in Section 8.1 or 8.2 above. Such determination shall be made (1) by the Board of Directors by a majority vote of a quorum consisting of directors who were not parties to such action, suit or proceeding, (2) if such a quorum is not obtainable, or, even if obtainable, a quorum of disinterested directors so directs, by independent legal counsel in a written opinion or (3) by the affirmative vote of the holders of 51% of the outstanding shares of Common Stock of the Corporation.

**SECTION 8.5. ADVANCES.** Expenses (including attorneys' fees) incurred in defending a civil, criminal, administrative or investigative action, suit or proceeding shall be paid by the Corporation in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of the director, officer, employee or agent to repay such amount, if it shall ultimately be determined that he is not entitled to be indemnified by the Corporation as authorized in this Article VIII.

**SECTION 8.6. NON-EXCLUSIVITY.** The indemnification and advancement of expenses provided by, or granted pursuant to, this Article VIII shall not be deemed exclusive of any other rights to which any person seeking indemnification may be entitled under any By-law, agreement, vote of stockholders or disinterested director or otherwise, both as to action in his official capacity and as to action in another capacity while holding such office, and shall continue as to a person who has ceased to be a director, officer, employee or agent and shall inure to the benefit of the heirs, executors and administrators of such person.

**SECTION 8.7. INSURANCE.** The Corporation shall have power to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or

agent of the Corporation, or is or was serving at the request of the Corporation as director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against him and incurred by him in any such capacity or arising out of his status as such, whether or not the Corporation would have the power to indemnify him against such liability under the provisions of this Section 8.7 or under the provisions of any applicable law or regulation.

## **ARTICLE IX. AMENDMENTS**

SECTION 9.1. These By-laws may be repealed, altered, amended or rescinded and new by-laws may be adopted by the majority vote of the Board of Directors or by the affirmative vote of sixty-six and two-thirds percent (66-2/3%) of the outstanding stock entitled to vote thereon.

Dated: May 23, 2001

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**End of Filing**

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