

# LEVEL 3 COMMUNICATIONS INC

## FORM 10-Q (Quarterly Report)

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Address	1025 ELDORADO BOULEVARD BLDG 2000 BROOMFIELD, CO 80021
Telephone	7208881000
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Sector	Services
Fiscal Year	12/31

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

**FORM 10-Q**

(Mark One)

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

For the Quarterly Period Ended September 30, 2012

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)

**80021-8869**

(Zip Code)

**(720) 888-1000**

(Registrant's telephone number,  
including area code)

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

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

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

Large accelerated filer ☒

Accelerated filer ☐

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

Smaller reporting company ☐

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

The number of shares outstanding of each class of the issuer's common stock, as of November 2, 2012:

Common Stock: 217,902,512 shares

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LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

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**Part I - Financial Information**
**Item 1. Financial Statements**

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

(dollars in millions, except per share data)	Three Months Ended		Nine Months Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
Revenue	\$ 1,590	\$ 927	\$ 4,762	\$ 2,754
Costs and Expenses Exclusive of Depreciation and Amortization shown separately below:				
Cost of Revenue	642	342	1,947	1,046
Depreciation and Amortization	185	203	563	612
Selling, General and Administrative	619	375	1,851	1,089
Restructuring Charges	6	—	14	—
Total Costs and Expenses	1,452	920	4,375	2,747
Operating Income	138	7	387	7
Other Income (Expense):				
Interest income	—	—	2	—
Interest expense	(188)	(178)	(558)	(495)
Loss on extinguishment of debt, net	(49)	(30)	(110)	(73)
Other, net	(54)	(1)	(52)	5
Total Other Expense	(291)	(209)	(718)	(563)
Loss Before Income Taxes	(153)	(202)	(331)	(556)
Income Tax Expense	(13)	(6)	(35)	(36)
Loss from Continuing Operations	(166)	(208)	(366)	(592)
Income (Loss) from Discontinued Operations, Net	—	1	—	(1)
Net Loss	\$ (166)	\$ (207)	\$ (366)	\$ (593)
Basic and Diluted Loss per Share *				
Loss per Share from Continuing Operations	\$ (0.76)	\$ (1.76)	\$ (1.71)	\$ (5.17)
Income (Loss) per Share from Discontinued Operations	—	0.01	—	(0.01)
Net Loss per Share	\$ (0.76)	\$ (1.75)	\$ (1.71)	\$ (5.18)
Shares Used to Compute Basic and Diluted Loss per Share * (in thousands)	217,301	118,067	214,498	114,585

\*Adjusted to give effect to the 1 for 15 reverse stock split that became effective on October 19, 2011. See Note 1 - Organization and Summary of Significant Accounting Policies.

See accompanying notes to consolidated financial statements.

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

(dollars in millions)	Three Months Ended		Nine Months Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
Net Loss	\$ (166)	\$ (207)	\$ (366)	\$ (593)
Other Comprehensive Income (Loss) Before Income Taxes:				
Foreign Currency Translation	48	(40)	16	10
Holding Gain on Interest Rate Swaps, including Reclassification Gains	74	2	90	10
Other, net	—	14	2	13
Other Comprehensive Income (Loss), Before Income Taxes	122	(24)	108	33
Income Tax Related to Items of Other Comprehensive Income (Loss)	—	—	—	—
Other Comprehensive Income (Loss), Net of Income Taxes	122	(24)	108	33
Comprehensive Loss	<u>\$ (44)</u>	<u>\$ (231)</u>	<u>\$ (258)</u>	<u>\$ (560)</u>

See accompanying notes to consolidated financial statements.

**LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES**  
**Supplementary Stockholders' Equity Information**  
**Accumulated Other Comprehensive Income (Loss)**  
**For the nine months ended September 30, 2012**  
**(unaudited)**

<b>(dollars in millions)</b>	<b>Net Foreign Currency Translation Adjustment</b>	<b>Unrealized Holding Gain (Loss) on Interest Rate Swaps</b>	<b>Other</b>	<b>Total</b>
Balance at December 31, 2011	\$ 39	\$ (90)	\$ (29)	\$ (80)
Change	16	90	2	108
Balance at September 30, 2012	<u>\$ 55</u>	<u>\$ —</u>	<u>\$ (27)</u>	<u>\$ 28</u>

See accompanying notes to consolidated financial statements.

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

(dollars in millions, except share data)	September 30, 2012	December 31, 2011
<b>Assets:</b>		
<b>Current Assets:</b>		
Cash and cash equivalents	\$ 793	\$ 918
Restricted cash and securities	8	10
Receivables, less allowances for doubtful accounts of \$27 and \$21, respectively	748	648
Other	186	131
<b>Total Current Assets</b>	<b>1,735</b>	<b>1,707</b>
Property, Plant and Equipment, net of accumulated depreciation of \$8,183 and \$7,678, respectively	8,191	8,136
Restricted Cash and Securities	39	51
Goodwill	2,565	2,541
Other Intangibles, net	287	358
Other Assets, net	399	395
<b>Total Assets</b>	<b>\$ 13,216</b>	<b>\$ 13,188</b>
<b>Liabilities and Stockholders' Equity</b>		
<b>Current Liabilities:</b>		
Accounts payable	\$ 719	\$ 747
Current portion of long-term debt	213	65
Accrued payroll and employee benefits	163	209
Accrued interest	166	216
Current portion of deferred revenue	260	264
Other	122	157
<b>Total Current Liabilities</b>	<b>1,643</b>	<b>1,658</b>
Long-Term Debt, less current portion	8,496	8,385
Deferred Revenue, less current portion	841	885
Other Liabilities	1,032	1,067
<b>Total Liabilities</b>	<b>12,012</b>	<b>11,995</b>
<b>Commitments and Contingencies</b>		
<b>Stockholders' Equity:</b>		
Preferred stock, \$.01 par value, authorized 10,000,000 shares: no shares issued or outstanding	—	—
Common stock, \$.01 par value, authorized 343,333,333 shares at September 30, 2012 and 293,333,333 at December 31, 2011: 217,710,720 issued and outstanding at September 30, 2012 and 207,913,428 issued and outstanding at December 31, 2011	2	2
Additional paid-in capital	13,975	13,706
Accumulated other comprehensive income (loss)	28	(80)
Accumulated deficit	(12,801)	(12,435)
<b>Total Stockholders' Equity</b>	<b>1,204</b>	<b>1,193</b>
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$ 13,216</b>	<b>\$ 13,188</b>

See accompanying notes to consolidated financial statements.

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

(dollars in millions)	Nine Months Ended	
	September 30, 2012	September 30, 2011
Cash Flows from Operating Activities:		
Net loss	\$ (366)	\$ (593)
Loss from discontinued operations	—	1
Loss from continuing operations	(366)	(592)
Adjustments to reconcile loss from continuing operations to net cash provided by operating activities of continuing operations:		
Depreciation and amortization	563	612
Non-cash compensation expense attributable to stock awards	102	68
Loss on extinguishments of debt, net	110	73
Loss on interest rate swaps	60	—
Accretion of debt discount and amortization of debt issuance costs	33	45
Accrued interest on long-term debt, net	(47)	36
Deferred income taxes	18	34
Gain on sale of property, plant and equipment and other assets	—	(2)
Other, net	(16)	(6)
Changes in working capital items:		
Receivables	(120)	(70)
Other current assets	(28)	(12)
Payables	(42)	10
Deferred revenue	(45)	(6)
Other current liabilities	(44)	9
Net Cash Provided by Operating Activities of Continuing Operations	178	199
Cash Flows from Investing Activities:		
Capital expenditures	(545)	(346)
Decrease (increase) in restricted cash and securities, net	15	(63)
Proceeds from the sale of property, plant and equipment and other assets	5	4
Other	(13)	—
Net Cash Used in Investing Activities of Continuing Operations	(538)	(405)
Cash Flows from Financing Activities:		
Long-term debt borrowings, net of issuance costs	3,317	765
Payments on and repurchases of long-term debt, including current portion and refinancing costs	(3,088)	(711)
Proceeds from stock options exercised	5	—
Net Cash Provided by Financing Activities of Continuing Operations	234	54
Discontinued Operations:		
Net cash used in investing activities	—	(4)
Net Cash Used in Discontinued Operations	—	(4)
Effect of Exchange Rates on Cash and Cash Equivalents	1	1
Net Change in Cash and Cash Equivalents	(125)	(155)
Cash and Cash Equivalents at Beginning of Period	918	616
Cash and Cash Equivalents at End of Period	\$ 793	\$ 461

Supplemental Disclosure of Cash Flow Information:

Cash interest paid	\$ 572	\$ 414
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Income taxes paid, net of refunds	\$	25	\$	1
Non-cash Financing Activities:				
Long-term debt conversion into equity	\$	100	\$	128
Premium on long-term debt conversion into equity	\$	39	\$	—
Accrued interest conversion into equity	\$	2	\$	—
Long-term debt issued and proceeds placed into escrow	\$	—	\$	1,200
Long-term debt issued in exchange transaction	\$	—	\$	300
Long-term debt retired in exchange transaction	\$	—	\$	295

See accompanying notes to consolidated financial statements.

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

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

*Description of Business*

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

On October 4, 2011, a subsidiary of Level 3 completed its amalgamation with Global Crossing Limited ("Global Crossing"), which thereby became a wholly owned indirect subsidiary of the Company through a tax free, stock for stock transaction (the "Amalgamation"). See Note 2 - Events Associated with the Amalgamation of Global Crossing.

Until November 2011, the Company also was engaged in coal mining through its two 50% owned joint-venture surface mines, one each in Montana and Wyoming. The Company completed the sale of its coal mining business on November 14, 2011. See Note 4 - Dispositions.

*Principles of Consolidation and Basis of Presentation*

The consolidated financial statements include the accounts of Level 3 Communications, Inc. and subsidiaries in which it has a controlling interest. Prior to the disposition of the coal mining business during the fourth quarter of 2011, the Company's 50% owned mining joint ventures were consolidated on a pro rata basis. All significant intercompany accounts and transactions have been eliminated. The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP").

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

The accompanying consolidated balance sheet as of December 31, 2011, which was derived from audited consolidated financial statements, and the unaudited interim consolidated financial statements as of September 30, 2012 and for the three and nine months ended September 30, 2012 and 2011 have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") for quarterly reports on Form 10-Q and do not include all of the information and note disclosures required by GAAP for complete financial statements. These financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto included in the Company's Form 10-K, as amended, for the year ended December 31, 2011. In the opinion of the Company's management, these financial statements contain all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of financial position, results of operations and cash flows at the dates and for the interim periods presented herein. The results of operations for an interim period are not necessarily indicative of the results of operations expected for a full fiscal year.

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

Effective after the close of trading on October 19, 2011, the Company completed a 1 for 15 reverse stock split as previously approved by the Company's stockholders. Proportional adjustments were made to the Company's outstanding convertible debt, warrants, equity awards and to its equity compensation plans to reflect the reverse stock split. No fractional shares were issued in connection with the reverse stock split, as stockholders who would otherwise hold a fractional share of common stock received a cash payment in lieu of that fractional share. All references herein to common stock and per share data have been retrospectively adjusted to reflect the reverse stock split.

### *Reclassifications*

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

### *Recently Issued Accounting Pronouncements*

In July 2012, the Financial Accounting Standards Board ("FASB") issued guidance that allows companies to consider qualitative factors when testing indefinite-lived intangible assets for impairment. Current GAAP requires an entity to perform a two step test in which the first step involves estimating the fair value of indefinite-lived intangible assets and comparing it to the carrying value. The recently issued guidance allows an entity to assess qualitative factors to determine whether it is more likely than not that the fair value exceeds the carrying value prior to performing the two step evaluation required as part of the quantitative assessment. If it is determined that it is unlikely that the carrying value exceeds the fair value, then the entity is no longer required to complete the two step indefinite-lived intangible assets impairment evaluation, or the quantitative assessment. The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, with early adoption permitted.

## **(2) Events Associated with the Amalgamation of Global Crossing**

On October 4, 2011, a subsidiary of Level 3 completed its amalgamation with Global Crossing, which became a wholly owned indirect subsidiary of the Company through a tax free, stock for stock transaction. As a result of the Amalgamation, (i) each issued and outstanding common share of Global Crossing was exchanged for 16 shares of Level 3 common stock (unadjusted for the 1 for 15 reverse stock split completed on October 19, 2011), including the associated rights under the Company's Rights Agreement with Wells Fargo Bank, N.A., as rights agent (the "Amalgamation Consideration") and (ii) each issued and outstanding share of Global Crossing's 2% cumulative senior convertible preferred stock was exchanged for the Amalgamation Consideration, plus an amount equal to the aggregate accrued and unpaid dividends thereon. In addition, (i) the outstanding vested options to purchase Global Crossing common shares were modified into vested options to purchase a number of shares of Level 3's common stock equal to 16 times the number of Global Crossing common shares covered by such Global Crossing options, and (ii) the issued and outstanding restricted stock units covering Global Crossing common shares, to the extent applicable in accordance with their terms, vested and settled for a number of shares of Level 3's common stock equal to 16 times the number of Global Crossing common shares covered by such restricted stock units.

In connection with the closing of the Amalgamation, Level 3 Financing, Inc. ("Level 3 Financing") amended its existing credit agreement to incur an additional \$650 million of borrowings through an additional tranche (the "Tranche B II Term Loan."). In addition, the \$1.2 billion of proceeds from the initial and additional issuance of 8.125% Senior Notes due 2019 in June and July 2011 (see Note 8 — Long-Term Debt) by an indirect wholly owned subsidiary were deposited into an escrow account. On October 4, 2011, following the consummation of the Amalgamation and the satisfaction of certain escrow release conditions, the 8.125% Senior Notes were assumed by Level 3 Financing (the "Notes Assumption"), and the funds were released from the escrow account. The net aggregate proceeds from the Tranche B II Term Loan and 8.125% Senior Notes were used to refinance certain existing indebtedness of Global Crossing in connection with the closing of the Amalgamation and for general corporate purposes.

As a result of the Amalgamation, the Company issued approximately 88.53 million shares of common stock, adjusted for the October 19, 2011 1 for 15 reverse stock split, to former holders of Global Crossing common shares and Global Crossing's 2% cumulative senior convertible preferred stock, and Level 3 caused the refinancing of approximately \$1.36 billion of Global Crossing's outstanding consolidated debt.

Based on (i) the number of Level 3 shares issued ( 88.53 million as adjusted for the 1 for 15 reverse stock split completed on October 19, 2011), (ii) the closing stock price of Level 3 common stock as of October 3, 2011 ( \$21.15 as adjusted for the 1 for 15 reverse stock split completed on October 19, 2011), and (iii) the debt of Global Crossing refinanced ( \$1.36 billion ), the Company determined that the aggregate consideration for acquisition accounting, including assumed debt, approximated \$3.4 billion . The restricted stock units covering Global Crossing common

shares settled for Level 3 shares of common stock were reduced in settlement of employee income and payroll tax withholding obligations and the corresponding amounts of approximately \$81 million were paid in cash. The premium paid by Level 3 in this transaction is attributable to strategic benefits, including a significantly expanded IP/optical network with global reach including South America, Asia and the Pacific region, an improved credit profile and reduced financial leverage attributed to enhanced financial and operational scale, and the opportunity for investment and network expansion. The Company has a comprehensive portfolio of voice, video and data services, which operates on a unique global services platform anchored by subsea and terrestrial fiber optic networks in North America, Europe and Latin America. The goodwill associated with this transaction is not expected to be deductible for income tax purposes.

The combined results of operations of Level 3 and Global Crossing are included in the Company's consolidated results of operations beginning in October 2011. The assets acquired and liabilities assumed of Global Crossing were recognized at their acquisition date fair value. The purchase price allocation of acquired assets and assumed liabilities, including the assignment of goodwill to reporting units was completed in October 2012. The following is the final allocation of the purchase price.

	<b>Purchase Price Allocation</b>	
	<b>(dollars in millions)</b>	
<b>Assets:</b>		
Cash, Cash Equivalents, and Restricted Cash	\$	226
Property, Plant, and Equipment		3,098
Goodwill		1,123
Identifiable Intangibles		106
Other Assets		651
<b>Total Assets</b>		<b>5,204</b>
<b>Liabilities:</b>		
Long-term Debt		(1,554)
Other Liabilities		(1,688)
<b>Total Liabilities</b>		<b>(3,242)</b>
<b>Total Estimated Consideration</b>	<b>\$</b>	<b>1,962</b>

Level 3 entered into certain transactions with Global Crossing prior to completing the Amalgamation, whereby Level 3 received cash for communications services to be provided in the future, which it accounted for as deferred revenue. As a result of the Amalgamation, Level 3 could no longer amortize this deferred revenue into earnings and accordingly, reduced the purchase price applied to the net assets acquired in the Amalgamation by \$77 million, the amount of the unamortized deferred revenue as of the acquisition date.

As a result of refinements to the preliminary purchase price allocation that were made during the nine months ended September 30, 2012, there were changes to the initial amount of goodwill determined in the fourth quarter of 2011, which have been reflected in the above table. The refinements were primarily a result of changes in the purchase price allocation for estimated tax valuation allowances and reserves. These changes are the result of additional information obtained since the filing of the Company's Form 10-K for the year ended December 31, 2011. The effect of the adjustments did not result in a material change to previously reported amounts.

The following unaudited pro forma financial information presents the combined results of Level 3 and Global Crossing as if the completion of the Amalgamation had occurred as of January 1, 2010.

(dollars in millions, except per share data)	Three Months Ended September 30, 2011		Nine Months Ended September 30, 2011	
Total Revenue	\$	1,606	\$	4,739
Net Loss	\$	(224)	\$	(652)
Net Loss per share	\$	(1.08)	\$	(3.21)

These results include certain adjustments, primarily due to a net decrease in depreciation and amortization expense due to the Company, in connection with the Amalgamation, increasing the estimated useful lives of the acquired conduit, fiber and certain transmission equipment while increasing the fair value of tangible and intangible assets, decreases in interest expense due to Level 3's issuance of incremental debt in order to redeem and refinance Global Crossing debt that had higher interest rates than the incremental financing, and to eliminate historical transactions between Level 3 and Global Crossing. The unaudited pro forma financial information is not intended to represent or be indicative of the actual results of operations of Level 3 that would have been reported had the Amalgamation been completed on January 1, 2010, nor is it representative of future operating results of the Company. The unaudited pro forma information does not include any operating efficiencies or cost savings that Level 3 may achieve with respect to combining the companies.

Acquisition related costs include transaction costs such as legal, accounting, valuation, and other professional services as well as integration costs such as severance and retention. Acquisition related costs have been recorded in selling, general and administrative expense and restructuring charges in the Company's consolidated statements of operations during the period that such costs were incurred. Since the acquisition date, Level 3 incurred total acquisition related transaction costs of approximately \$49 million through September 30, 2012, which is unchanged from December 31, 2011. Since the acquisition date, Level 3 incurred total acquisition related integration costs of approximately \$82 million through September 30, 2012. In addition, Level 3 expects to incur additional integration related costs through the remainder of 2012.

In April 2011, Level 3 adopted a Stockholder Rights Plan to protect its U.S. federal net operating loss carryforwards from certain Internal Revenue Code Section 382 limitations. On May 24, 2012, the stockholders of the Company ratified such adoption. This plan was designed to deter trading that would result in a change of control (as defined in that Code Section), and therefore protect the Company's ability to use its historical U.S. federal net operating loss carryforwards in the future.

### (3) Loss Per Share

The Company computes basic net loss per share by dividing net loss for the period by the weighted average number of shares of common stock outstanding during the period. Diluted net loss per share is computed by dividing net loss for the period by the weighted average number of shares of common stock outstanding during the period and including the dilutive effect of common stock that would be issued assuming conversion or exercise of outstanding convertible notes, stock based compensation awards and other dilutive securities. The effect of approximately 35 million and 47 million shares issuable pursuant to the various series of convertible notes outstanding at September 30, 2012 and September 30, 2011, respectively, have not been included in the computation of diluted loss per share because their inclusion would have been anti-dilutive to the computation. In addition, the effect of the approximately 7 million and 3 million stock options, outperform stock options, restricted stock units and warrants outstanding at September 30, 2012 and September 30, 2011, respectively, have not been included in the computation of diluted loss per share because their inclusion would have been anti-dilutive to the computation.

**(4) Dispositions**

Level 3, through its two 50% owned joint-venture surface mines, one each in Montana and Wyoming, sold coal primarily through long-term contracts with public utilities. In November 2011, Level 3 completed the sale of its coal mining business to Ambre Energy Limited as part of its long-term strategy to focus on core business operations. As a result of the transaction, all of the assets and liabilities associated with the coal mining business have been removed from Level 3's balance sheet and the Company recognized a gain on the transaction of approximately \$72 million, which was included in the consolidated statements of operations within "Income from Discontinued Operations" in the fourth quarter of 2011. The financial results of the coal mining business were included in the Company's consolidated results of operations through the date of sale, and the three and nine month periods ended September 30, 2011 have been revised to reflect the presentation within discontinued operations.

The following amounts relate to the operations of the coal business and were derived from historical financial information and have been segregated from continuing operations and reported as discontinued operations in the Consolidated Statements of Operations (dollars in millions):

	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011
Revenue	\$ 20	\$ 54
Cost of Revenue	18	52
Depreciation and Amortization	1	3
Selling, General, and Administrative	—	—
Total Costs and Expenses	19	55
Operating Income (Loss)	1	(1)
Total Other Expense	—	—
Income (Loss) From Discontinued Operations, Net	\$ 1	\$ (1)

## (5) Acquired Intangible Assets

Identifiable acquisition-related intangible assets as of September 30, 2012 and December 31, 2011 were as follows (dollars in millions):

	Gross Carrying Amount	Accumulated Amortization	Net
<b>September 30, 2012</b>			
<i>Finite-Lived Intangible Assets:</i>			
Customer Contracts and Relationships	\$ 776	\$ (620)	\$ 156
Trademarks	55	(14)	41
Patents and Developed Technology	158	(100)	58
	989	(734)	255
<i>Indefinite-Lived Intangible Assets:</i>			
Vyvx Trade Name	32	—	32
	<u>\$ 1,021</u>	<u>\$ (734)</u>	<u>\$ 287</u>
<b>December 31, 2011</b>			
<i>Finite-Lived Intangible Assets:</i>			
Customer Contracts and Relationships	\$ 776	\$ (571)	\$ 205
Trademarks	55	(3)	52
Patents and Developed Technology	158	(89)	69
	989	(663)	326
<i>Indefinite-Lived Intangible Assets:</i>			
Vyvx Trade Name	32	—	32
	<u>\$ 1,021</u>	<u>\$ (663)</u>	<u>\$ 358</u>

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

Acquired finite-lived intangible asset amortization expense was \$21 million and \$71 million for the three and nine months ended September 30, 2012 and \$23 million and \$72 million for the three and nine months ended September 30, 2011 .

At September 30, 2012 , the weighted average remaining useful lives of the Company's acquired finite-lived intangible assets was 3.2 years for customer contracts and relationships, 4.2 years for patents and developed technology and 3 years for trademarks.

As of September 30, 2012, estimated amortization expense for the Company's finite-lived acquisition-related intangible assets over the next five years and thereafter is as follows (dollars in millions):

2012 (remaining three months)	\$	18
2013		73
2014		62
2015		45
2016		28
2017		13
Thereafter		16
	\$	<u>255</u>

## (6) Fair Value of Financial Instruments

The Company's financial instruments consist of cash and cash equivalents, restricted cash and securities, accounts receivable, accounts payable, capital leases, other liabilities, interest rate swaps and long-term debt (including the current portion) as of September 30, 2012 and December 31, 2011. The carrying values of cash and cash equivalents, restricted cash and securities, accounts receivable, accounts payable, capital leases and other liabilities approximated their fair values at September 30, 2012 and December 31, 2011. The interest rate swaps are recorded in the consolidated balance sheets at fair value. See Note 7 - Derivative Financial Instruments and Note 8 - Long-Term Debt. The carrying value of the Company's long-term debt, including the current portion, reflects the original amounts borrowed net of unamortized discounts and premiums and was \$8.7 billion and \$8.5 billion as of September 30, 2012 and December 31, 2011, respectively.

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

### *Fair Value Hierarchy*

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

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

*Level 2* —Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets with insufficient volume or infrequent transactions (less active markets); or model-derived valuations in which all significant inputs are observable or can be derived principally from or corroborated by observable market data for substantially the full term of the assets or liabilities.

*Level 3* —Unobservable inputs to the valuation methodology that are significant to the measurement of fair value of assets or liabilities.



The table below presents the fair values for each class of Level 3's liabilities as well as the input levels used to determine these fair values as of September 30, 2012 and December 31, 2011:

	Total Carrying Value in Consolidated Balance Sheet		Fair Value Measurement Using			
			Quoted Prices in Active Markets for Identical Assets (Level 1)		Significant Other Observable Inputs (Level 2)	
	September 30, 2012	December 31, 2011	September 30, 2012	December 31, 2011	September 30, 2012	December 31, 2011
(dollars in millions)						
<i>Liabilities Recorded at Fair Value in the Financial Statements:</i>						
<i>Derivatives:</i>						
Interest Rate Swap Liabilities (included in other non-current liabilities)	\$ 63	\$ 90	\$ —	\$ —	\$ 63	\$ 90
Total Derivative Liabilities Recorded at Fair Value in the Financial Statements	\$ 63	\$ 90	\$ —	\$ —	\$ 63	\$ 90
<i>Liabilities Not Recorded at Fair Value in the Financial Statements:</i>						
<i>Long-term Debt, including the current portion:</i>						
Term Loans	\$ 2,574	\$ 2,567	\$ 2,627	\$ 2,518	\$ —	\$ —
Senior Notes	5,183	4,716	5,590	4,822	—	—
Convertible Notes	845	939	291	247	763	834
Commercial Mortgage	—	65	—	—	—	73
Capital Leases and Other	107	163	—	—	107	163
Total Long-term Debt, including the current portion:	\$ 8,709	\$ 8,450	\$ 8,508	\$ 7,587	\$ 870	\$ 1,070

The Company does not have any assets or liabilities measured using significant unobservable inputs (Level 3).

#### *Derivatives*

The fair value of interest rate swaps are estimated in accordance with the GAAP Fair Value Measurements and Disclosures guidance using discounted cash flow techniques that use observable market inputs, such as LIBOR-based forward yield curves, forward rates, and the specific swap rate stated in each of the swap agreements.

#### *Term Loans*

The fair value of the Term Loans was approximately \$2.6 billion and \$2.5 billion at September 30, 2012 and December 31, 2011, respectively. The fair value of each loan is based on the September 30, 2012 and December 31, 2011 trading quotes as provided by large financial institutions that trade in the Company's Term Loans. The pricing quotes provided by these market participants incorporate LIBOR curve expectations, interest spread, corporate and

loan credit ratings, maturity date (March 2014, February 2016, September 2018 and August 2019) and liquidity, among other loan characteristics and relative value across other instruments of similar terms. The interest spreads for the \$1.4 billion Tranche A Term Loan was LIBOR plus 2.25% (aggregate principal value) and is LIBOR plus 4.25% with a LIBOR floor of 1.5% for the Tranche B II and Tranche B III Term Loans, respectively. The interest spreads are LIBOR plus 3.25% for the Tranche B 2016 Term Loan and LIBOR plus 3.75% for the Tranche B 2019 Term Loan, with the LIBOR floor set at a minimum of 1.5% on both loans.

On August 6, 2012, the Tranche A Term Loan was refinanced. See Note 8 - Long-Term Debt for details.

The Term Loans are secured by a pledge of the equity interests in certain U.S.-based subsidiaries of Level 3 Financing; 65% of the equity interests in each of Level 3 Financing's Canadian subsidiary and its Bermuda subsidiary that indirectly owns Global Crossing's non-U.S. subsidiaries; and liens on the assets of Level 3 Communications, Inc. and certain U.S.-based subsidiaries of Level 3 Financing. In addition, Level 3 Communications, Inc. and certain U.S.-based subsidiaries of Level 3 Financing have provided full and unconditional guarantees of the obligations under the Term Loans. However, the Tranche B 2016 Term Loan and the Tranche B 2019 Term Loan have not yet been guaranteed by Level 3 Communications, LLC, an indirect, wholly owned subsidiary of the Company, and certain of its domestic subsidiaries due to the need for regulatory approvals, which are being sought.

#### *Senior Notes*

The estimated fair value of the Company's Senior Notes approximated \$5.6 billion and \$4.8 billion at September 30, 2012 and December 31, 2011, respectively, based on market prices. The fair value of each instrument was based on the September 30, 2012 and December 31, 2011 trading quotes as provided by large financial institutions that trade in the Company's securities. The pricing quotes provided by these market participants incorporate spreads to the Treasury curve, security coupon (which ranges from LIBOR plus 3.75% to 11.875%), corporate and security credit ratings, maturity date (ranging from 2014 to 2020) and liquidity, among other security characteristics and relative value at both the borrower entity level and across other securities of similar terms.

The 11.875% Senior Notes due 2019 and the 8.875% Senior Notes due 2019 were issued by the Company and are not guaranteed by any of the Company's subsidiaries. The remaining Senior Notes are obligations of Level 3 Financing, Inc. and are all fully and unconditionally guaranteed by Level 3 Communications, Inc. and, other than the 7% Senior Notes due 2020, by Level 3 Communications, LLC. Regulatory approval is being sought to enable Level 3 Communications, LLC to guarantee the 7% Senior Notes due 2020.

#### *Convertible Notes*

The estimated fair value of the Company's actively traded 6.5% Convertible Senior Notes due 2016 was approximately \$291 million at September 30, 2012 and \$247 million at December 31, 2011. The fair value of the Company's actively traded Convertible Notes is based on the trading quotes as of September 30, 2012 and December 31, 2011 provided by large financial institutions that trade in the Company's securities. The estimated fair value of the Company's Convertible Notes that are not actively traded, such as the 7% Convertible Senior Notes due 2015, the 7% Convertible Senior Notes due 2015, Series B, and the 15% Convertible Senior Notes due 2013, approximated \$763 million at September 30, 2012 and \$834 million at December 31, 2011. A portion of the Company's 15% Convertible Senior Notes due 2013 were exchanged for equity during the first quarter of 2012, as discussed in Note 8 - Long-Term Debt. To estimate the fair value of the Convertible Notes that are not actively traded, Level 3 used a Black-Scholes valuation model and an income approach using discounted cash flows. The most significant inputs affecting the valuation are the pricing quotes provided by market participants that incorporate spreads to the Treasury curve, security coupon (ranging from 7% to 15%), convertible optionality, corporate and security credit ratings, maturity date (ranging from 2013 to 2015), liquidity, and other equity option inputs, such as the risk-free rate, underlying stock price, strike price of the embedded derivative, estimated volatility and maturity inputs for the option component and for the bond component, among other security characteristics and relative value at both the borrower entity level and across other securities with similar terms. The fair value of each instrument is obtained by adding together the value derived by discounting the security's coupon or interest payment using a risk-

adjusted discount rate and the value calculated from the embedded equity option based on the estimated volatility of the Company's stock price, conversion rate of the particular Convertible Note, remaining time to maturity, and risk-free rate. The Convertible Notes are unsecured obligations of Level 3 Communications, Inc. No subsidiary of Level 3 Communications, Inc. has provided a guarantee of the Convertible Notes.

### *Commercial Mortgage*

During the third quarter of 2012, the outstanding principal of the Commercial Mortgage was fully repaid. See Note 8 - Long Term Debt for additional information. The fair value of the Commercial Mortgage was approximately \$73 million at December 31, 2011 as compared to the carrying amount of \$65 million. The Commercial Mortgage was not actively traded and its fair value was estimated by management using a valuation model based on an income approach. The significant inputs used to estimate fair value of this debt instrument using discounted cash flows included the anticipated scheduled mortgage payments and observable market yields on other actively traded debt of similar characteristics and collateral type.

Prior to its repayment, the Commercial Mortgage was a secured obligation of HQ Realty, Inc., a wholly owned subsidiary of the Company. HQ Realty, Inc.'s obligations under the Commercial Mortgage were secured by a first priority lien on the Company's headquarters campus located at 1025 Eldorado Boulevard, Broomfield, Colorado 80021 and certain HQ Realty, Inc. restricted cash and reserve accounts.

### **(7) Derivative Financial Instruments**

The Company has floating rate long-term debt (see Note 8 - Long-Term Debt). Such debt exposes the Company to variability in interest payments due to changes in interest rates. If interest rates increase, interest expense increases. Conversely, if interest rates decrease, interest expense also decreases. The Company uses derivative financial instruments, primarily interest rate swaps, in an attempt to manage its exposure to fluctuations in interest rate movements. The Company's primary objective in managing interest rate risk is to decrease the volatility of its earnings and cash flows affected by changes in the underlying rates. To achieve this objective, the Company enters into financial derivatives, primarily interest rate swap agreements, the values of which change in the opposite direction of the anticipated future cash flows. The Company does not use derivative financial instruments for speculative purposes. See Note 8 - Long-Term Debt.

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

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

As a result of the refinancing of the Tranche A Term Loan on August 6, 2012, the two interest rate swap agreements maturing in early 2014 that had effectively hedged changes in the interest rate on a portion of the Tranche A Term Loan were deemed "ineffective" under GAAP. The Company recognized a non-cash loss on the agreements of approximately \$60 million (excluding accrued interest) in the third quarter of 2012, which represented the cumulative loss recorded in AOCI at the date the instruments ceased to qualify as hedges. After August 6, 2012, the Company will reflect the change in the fair value of the swaps in Other Income in its

Consolidated Statement of Operations until maturity of the swaps in early 2014. For both the three and nine months ended September 30, 2012, the Company recognized \$3 million of Other Income in the Company's Consolidated Statement of Operations.

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

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

Derivatives designated as hedging instruments	Liability Derivatives			
	September 30, 2012		December 31, 2011	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Cash flow hedging contracts	Other noncurrent liabilities	\$ —	Other noncurrent liabilities	\$ 90

The amount of gains (losses) recognized in Other Comprehensive Loss consists of the following (dollars in millions):

Derivatives designated as hedging instruments	2012	2011
Cash flow hedging contracts		
Three Months Ended September 30,	\$ 74	\$ 2
Nine Months Ended September 30,	\$ 90	\$ 10

The amount of gains (losses) reclassified from AOCI to Income/Loss (effective portions) consists of the following (dollars in millions):

Derivatives designated as hedging instruments	Income Statement Location	2012	2011
Cash flow hedging contracts:			
Three Months Ended September 30,	Interest Expense	\$ (4)	\$ (12)
Nine Months Ended September 30,	Interest Expense	\$ (26)	\$ (35)

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

## (8) Long-Term Debt

As of September 30, 2012 and December 31, 2011, long-term debt was as follows:

(dollars in millions)	September 30, 2012	December 31, 2011
Senior Secured Term Loan*	\$ 2,615	\$ 2,600
Senior Notes due 2014 (9.25%)	—	807
Floating Rate Senior Notes due 2015 (4.469% as of September 30, 2012 and 4.202% as of December 31, 2011)	300	300
Senior Notes due 2017 (8.75%)	—	700
Senior Notes due 2018 (10.0%)	640	640
Senior Notes due 2019 (11.875%)	605	605
Senior Notes due 2019 (9.375%)	500	500
Senior Notes due 2019 (8.125%)	1,200	1,200
Senior Notes due 2019 (8.875%)	300	—
Senior Notes due 2020 (8.625%)	900	—
Senior Notes due 2020 (7%)	775	—
Convertible Senior Notes due 2013 (15.0%)	172	272
Convertible Senior Notes due 2015 (7.0%)	200	200
Convertible Senior Notes due 2015 Series B (7.0%)	275	275
Convertible Senior Notes due 2016 (6.5%)	201	201
Commercial Mortgage due 2015 (9.86%)	—	65
Capital Leases	92	131
Other	15	32
<b>Total Debt Obligations</b>	<b>8,790</b>	<b>8,528</b>
Unamortized (Discount) Premium:		
Discount on Senior Secured Term Loan	(41)	(33)
Premium on Senior Notes due 2014 (9.25%)	—	3
Discount on Senior Notes due 2018 (10.0%)	(10)	(11)
Discount on Senior Notes due 2019 (11.875%)	(10)	(10)
Discount on Senior Notes due 2019 (9.375%)	(9)	(9)
Discount on Senior Notes due 2019 (8.125%)	(8)	(9)
Discount on Convertible Senior Notes due 2015 (7.0%)	(2)	(2)
Discount due to embedded derivative contracts	(1)	(7)
<b>Total Unamortized (Discount) Premium</b>	<b>(81)</b>	<b>(78)</b>
Carrying Value of Debt	8,709	8,450
Less current portion	(213)	(65)
<b>Long-term Debt, less current portion</b>	<b>\$ 8,496</b>	<b>\$ 8,385</b>

\* The \$1.4 billion Tranche A Term Loan due 2014 had an effective interest rate of 2.65% as of December 31, 2011, excluding the effect of the \$1 billion notional amount interest rate swaps. The \$650 million Tranche B II Term Loan due 2018 and the \$550 million Tranche B III Term Loan due 2018 had an interest rate of 5.75% as of September 30, 2012 and December 31, 2011. The \$600 million Tranche B 2016 Term Loan and the \$815 million Tranche B 2019 Loan had interest rates of 4.75% and 5.25% , respectively, as of September 30, 2012 .

## ***2012 Debt Issuances, Related Redemptions, and Registrations***

### ***Senior Secured Tranche B 2016 and Tranche B 2019 Term Loans***

On August 6, 2012, Level 3 Financing, Inc. refinanced its existing \$1.4 billion Tranche A Term Loan under its existing senior secured credit facility through the creation of new term loans in the aggregate principal amount of \$1.415 billion (the "New Term Loans"). The New Term Loans were borrowed pursuant to an amended and restated credit agreement, which reflects the amendments approved by the lenders. The New Term Loans consist of: (a) a \$600 million senior secured term loan which matures on February 1, 2016 (the "Tranche B 2016 Loan"), and (b) a \$815 million senior secured term loan which matures on August 1, 2019 (the "Tranche B 2019 Loan"). The interest rates on the loans are LIBOR plus 3.25% for the Tranche B 2016 Loan and LIBOR plus 3.75% for the Tranche B 2019 Loan, with LIBOR set at a minimum of 1.5% on both loans. The Tranche B 2016 Loan and the Tranche B 2019 Loan were priced at 99.5% and 99.0% of par, respectively.

The Company used the net proceeds from the New Term Loans, along with cash on hand, to repay Level 3 Financing, Inc.'s \$1.4 billion Tranche A Term Loan under the existing credit agreement maturing in March 2014 and used remaining net proceeds to repay \$15 million in principal amount plus premium for existing vendor financing obligations. The Company recognized a loss on the extinguishment of debt of \$9 million in the third quarter of 2012 as a result of refinancing the \$1.4 billion Tranche A Term Loan and repayment of existing vendor financing obligations. In addition, in connection with the refinancing of the Tranche A Term Loan, the Company recognized a \$60 million non-cash loss on two interest rate swap agreements that had previously hedged changes in the interest rate on \$1 billion notional amount of floating rate debt. See Note 7 - Derivative Financial Instruments.

The net discounts for the Tranche B 2016 Loan and the Tranche B 2019 Loan of approximately \$3 million and \$8 million, respectively, are reflected as a reduction in long-term debt and are being amortized as interest expense over the terms of the Tranche B 2016 Loan and Tranche B 2019 Loan using the effective interest method. Debt issuance costs for the Tranche B 2016 Loan and the Tranche B 2019 Loan of approximately \$9 million and \$12 million, respectively, were capitalized and are being amortized as interest expense using the effective interest method over the respective terms of those term loans.

### ***7% Senior Notes due 2020***

On August 6, 2012, Level 3 Financing, Inc. completed the offering of \$775 million aggregate principal amount of its 7% Senior Notes due 2020 (the "7% Senior Notes"). Debt issuance costs of approximately \$15 million were capitalized and are being amortized as interest expense over the term of the 7% Senior Notes. The net proceeds from the offering of the notes, along with cash on hand were used to redeem all of the outstanding 8.75% Senior Notes due 2017 issued by Level 3 Financing, Inc., including the payment of accrued interest and applicable premiums, and in connection with that redemption, the indenture relating to the 8.75% Senior Notes due 2017 was discharged. The Company recognized a loss on extinguishment of debt of \$40 million in the third quarter of 2012 as a result of the redemption of the 8.75% Senior Notes due 2017.

The 7% Senior Notes were priced at 100% of their principal amount and will mature on June 1, 2020. Interest on the notes will accrue from August 6, 2012 and will be payable on June 1 and December 1 of each year, beginning on December 1, 2012. The notes are senior unsecured obligations of Level 3 Financing, Inc., ranking equal in right of payment with all other senior unsecured obligations of Level 3 Financing, Inc. The 7% Senior Notes are guaranteed on an unsecured basis by Level 3 Communications, Inc., and subject to receipt of applicable regulatory approvals will be guaranteed on an unsecured basis by Level 3 Communications, LLC.

The 7% Senior Notes are subject to redemption at the option of Level 3 Financing, Inc. in whole or in part, at any time before June 1, 2016 at the redemption price equal to 100% of their principal amount, plus a make-whole premium and accrued and unpaid interest. On or after June 1, 2016, Level 3 Financing may redeem all or part of the 7% Senior Notes, upon not less than 30 nor more than 60 days' prior notice, at the redemption prices set forth below (expressed as a percentage of principal amount), plus accrued and unpaid interest thereon (if any) to, but not including, the redemption date (subject to the right of holders of record on the relevant record date to receive interest due on the relevant interest payment date), if redeemed during the twelve months beginning June 1, of the years indicated below:

Year	Redemption Price
2016	103.500%
2017	101.750%
2018	100.000%

In addition, at any time or from time to time on or prior to June 1, 2015, Level 3 Financing may redeem up to 35% of the original aggregate principal amount of the 7% Senior Notes (including any additional 7% Senior Notes) at a redemption price equal to 107% of the principal amount of the 7% Senior Notes so redeemed, plus accrued and unpaid interest thereon (if any) to the redemption date (subject to the right of holders of record on the relevant record date to receive interest due on the relevant interest payment date), with the net cash proceeds contributed to the capital of Level 3 Financing of one or more private placements to persons other than affiliates of Level 3 or underwritten public offerings of common stock of Level 3 resulting, in each case, in gross proceeds of at least \$100 million in aggregate; provided, however, that at least 65% of the original aggregate principal amount of the 7% Senior Notes (including any additional 7% Senior Notes) would remain outstanding immediately after giving effect to such redemption. Any such redemption shall be made within 90 days of such private placement or public offering upon not less than 30 nor more than 60 days' prior notice.

The 7% Senior Notes are not registered under the Securities Act of 1933 or any state securities laws and, unless so registered, may not be offered or sold except pursuant to an applicable exemption from the registration requirements of the Securities Act of 1933 and applicable state securities laws. In connection with the offering, the Company and Level 3 Financing, Inc. entered into a registration rights agreement pursuant to which Level 3 and Level 3 Financing, Inc. agreed to file a registration statement to exchange the offered notes with new notes that are substantially identical in all material respects, and to use commercially reasonable efforts to cause the registration statement to be declared effective no later than 270 days after the issuance of the 7% Senior Notes.

#### *8.875% Senior Notes due 2019*

On August 1, 2012, Level 3 Communications, Inc. completed the offering of \$300 million aggregate principal amount of its 8.875% Senior Notes due 2019 (the "8.875% Senior Notes"). Debt issuance costs of approximately \$7 million were capitalized and are being amortized as interest expense using the effective interest method over the term of the 8.875% Senior Notes. The net proceeds from the offering of the notes will be used for general corporate purposes, including the potential repurchase, redemption, repayment or refinancing of the Company's and its subsidiaries' existing indebtedness from time to time.

The 8.875% Senior Notes were priced at 100% of their principal amount and will mature on June 1, 2019. Interest on the notes will accrue from August 1, 2012 and will be payable on June 1 and December 1 of each year, beginning on December 1, 2012. The notes are senior unsecured obligations of Level 3 Communications, Inc., ranking equal in right of payment with all other senior unsecured obligations of Level 3. The notes will not be guaranteed by any of the Company's subsidiaries.



The 8.875% Senior Notes are subject to redemption at the option of Level 3 in whole or in part, at any time before June 1, 2015 at the redemption price equal to 100% of their principal amount, plus a make-whole premium and accrued and unpaid interest. On and after June 1, 2015, Level 3 may redeem all or part of the 8.875% Senior Notes, upon not less than 30 nor more than 60 days' prior notice, at the redemption prices set forth below (expressed as a percentage of principal amount), plus accrued and unpaid interest thereon (if any) to, but not including, the redemption date (subject to the right of holders of record on the relevant record date to receive interest due on the relevant interest payment date), if redeemed during the twelve months beginning June 1, of the years indicated below:

Year	Redemption Price
2015	104.438%
2016	102.219%
2017	100.000%

In addition, at any time or from time to time on or prior to June 1, 2015, Level 3 may redeem up to 35% of the original aggregate principal amount of the 8.875% Senior Notes (including any additional 8.875% Senior Notes) at a redemption price equal to 108.875% of the principal amount of the 8.875% Senior Notes so redeemed, plus accrued and unpaid interest thereon (if any) to the redemption date (subject to the right of holders of record on the relevant record date to receive interest due on the relevant interest payment date), with the net cash proceeds contributed to the capital of Level 3 of one or more private placements to persons other than affiliates of Level 3 or underwritten public offerings of common stock of Level 3 resulting, in each case, in gross proceeds of at least \$100 million in aggregate; provided, however, that at least 65% of the original aggregate principal amount of the 8.875% Senior Notes (including any additional 8.875% Senior Notes) would remain outstanding immediately after giving effect to such redemption. Any such redemption shall be made within 90 days of such private placement or public offering upon not less than 30 nor more than 60 days' prior notice.

The 8.875% Senior Notes are not registered under the Securities Act of 1933 or any state securities laws and, unless so registered, may not be offered or sold except pursuant to an applicable exemption from the registration requirements of the Securities Act of 1933 and applicable state securities laws. In connection with the offering, Level 3 entered into a registration rights agreement pursuant to which Level 3 agreed to file a registration statement to exchange the offered notes with new notes that are substantially identical in all material respects, and to use commercially reasonable efforts to cause the registration statement to be declared effective no later than 270 days after the issuance of the offered notes.

#### *8.125% Senior Notes due 2019*

The 8.125% Senior Notes due 2019 issued by Level 3 Financing, Inc. were not originally registered under the Securities Act of 1933, as amended. During the second quarter of 2012, all of the originally placed notes were exchanged for a new issue of 8.125% Senior Notes due 2019 with identical terms and conditions, other than those related to registration rights, in a registered exchange offer and now are freely tradeable. The 8.125% Senior Notes became fully and unconditionally guaranteed by Level 3 Communications, LLC during the first quarter of 2012.

#### *8.625% Senior Notes due 2020*

On January 13, 2012, Level 3 Financing completed the offering of \$900 million aggregate principal amount of its 8.625% Senior Notes due 2020 (the "8.625% Senior Notes"). Debt issuance costs of approximately \$20 million were capitalized and are being amortized as interest expense using the effective interest method over the term of the 8.625% Senior Notes. In February 2012, a portion of the net proceeds from the offering of the 8.625% Senior Notes were used to redeem all of Level 3 Financing's outstanding 9.25% Senior Notes due 2014 in aggregate principal amount of \$807 million. The Company recognized a loss on extinguishment of debt of \$22 million in the first quarter of 2012 as a result of the redemption of the 9.25% Senior Notes due 2014.



The remaining net proceeds constitute purchase money indebtedness under the existing senior secured credit agreement and indentures of the Company and Level 3 Financing and are being used solely to fund the cost of construction, installation, acquisition, lease, development or improvement of any Telecommunications/IS assets (as defined in the existing senior secured credit agreement and indentures of Level 3), including cash purchase price of any past, pending or future acquisitions.

The 8.625% Senior Notes will mature on July 15, 2020. Interest on the notes will accrue from January 13, 2012 and will be payable on January 15 and July 15 of each year, beginning on July 15, 2012. The notes are fully and unconditionally guaranteed on an unsubordinated and unsecured basis by the Company and became fully and unconditionally guaranteed by Level 3 Communications, LLC in the second quarter of 2012. The notes are unsecured, unsubordinated obligations of Level 3 Financing, ranking equal in right of payment with all existing and future unsubordinated indebtedness of Level 3 Financing, and are senior in right of payment to all existing and future indebtedness of Level 3 Financing expressly subordinated in right of payment to the notes.

The 8.625% Senior Notes are subject to redemption at the option of Level 3 Financing in whole or in part, at any time before January 15, 2016 at the redemption price equal to 100% of their principal amount, plus a make-whole premium and accrued and unpaid interest. On and after January 15, 2016, Level 3 Financing may redeem all or part of the 8.625% Senior Notes, upon not less than 30 nor more than 60 days' prior notice, at the redemption prices set forth below (expressed as a percentage of principal amount), plus accrued and unpaid interest thereon (if any) to, but not including, the redemption date (subject to the right of holders of record on the relevant record date to receive interest due on the relevant interest payment date), if redeemed during the twelve months beginning January 15, of the years indicated below:

Year	Redemption Price
2016	104.313%
2017	102.156%
2018	100.000%

In addition, at any time or from time to time on or prior to January 15, 2015, Level 3 Financing may redeem up to 35% of the original aggregate principal amount of the 8.625% Senior Notes (including any additional 8.625% Senior Notes) at a redemption price equal to 108.625% of the principal amount of the 8.625% Senior Notes so redeemed, plus accrued and unpaid interest thereon (if any) to the redemption date (subject to the right of holders of record on the relevant record date to receive interest due on the relevant interest payment date), with the net cash proceeds contributed to the capital of Level 3 Financing of one or more private placements to persons other than affiliates of Level 3 or underwritten public offerings of common stock of Level 3 resulting, in each case, in gross proceeds of at least \$100 million in aggregate; provided, however, that at least 65% of the original aggregate principal amount of the 8.625% Senior Notes (including any additional 8.625% Senior Notes) would remain outstanding immediately after giving effect to such redemption. Any such redemption shall be made within 90 days of such private placement or public offering upon not less than 30 nor more than 60 days' prior notice.

The 8.625% Senior Notes due 2020 issued by Level 3 Financing, Inc. were not originally registered under the Securities Act of 1933, as amended. During the second quarter of 2012, all of the originally placed notes were exchanged for a new issue of 8.625% Senior Notes due 2020 with identical terms and conditions, other than those related to registration rights, in a registered exchange offer and are now freely tradeable. The 8.625% Senior Notes became fully and unconditionally guaranteed by Level 3 Communications, LLC during the second quarter of 2012.

#### *Commercial Mortgage due 2015*

During the third quarter of 2012, the outstanding principal of the Commercial Mortgage due 2015 was fully repaid along with accrued interest.

## 2012 Debt Exchange

On March 13, 2012, the Company entered into an exchange agreement for a portion of its 15% Convertible Senior Notes due 2013. Pursuant to the agreement, the holder of approximately \$100 million aggregate principal amount of Level 3's outstanding 15% Convertible Senior Notes due 2013 agreed to exchange that debt for approximately 3.7 million shares of Level 3's common stock into which the notes were convertible plus an additional 1.7 million shares for a total of approximately 5.4 million shares. The consideration was based on the market price for these notes which included an inducement premium and included a payment for accrued and unpaid interest from January 15, 2012 through March 15, 2012 of approximately \$2 million. This transaction did not include the payment by the Company of any cash. The Company recognized a loss on inducement included in loss on extinguishment of debt of \$39 million in the first quarter of 2012 as a result of the exchange of the 15% Convertible Senior Notes due 2013.

## Long-Term Debt Maturities

Aggregate future contractual maturities of long-term debt and capital leases (excluding issue discounts, premiums and fair value adjustments) were as follows as of September 30, 2012 (dollars in millions):

2012 (remaining three months)	\$	11
2013		210
2014		16
2015		782
2016		807
2017		6
Thereafter		6,958
	\$	<u>8,790</u>

## (9) Stock-Based Compensation

The following table summarizes non-cash compensation expense and capitalized non-cash compensation for three and nine months ended September 30, 2012 and 2011 (dollars in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
OSO	\$ 4	\$ 3	\$ 10	\$ 7
Restricted Stock Units and Shares	21	11	39	18
401(k) Match Expense	5	3	18	10
Restricted Stock Unit Bonus Grant	20	9	36	33
	50	26	103	68
Capitalized Noncash Compensation	(1)	—	(1)	—
	<u>\$ 49</u>	<u>\$ 26</u>	<u>\$ 102</u>	<u>\$ 68</u>

The Company capitalizes non-cash compensation for those employees directly involved in the construction of the network, installation of services for customers or development of business support systems. As of September 30, 2012, there were approximately 2 million outperform stock options ("OSOs") outstanding. As of September 30, 2012, there were approximately 5 million nonvested restricted stock and restricted stock units ("RSUs") outstanding. In addition, as of September 30, 2012, there were approximately seventy-eight thousand non-qualified stock options outstanding.

During 2012, the Company adopted cash and share-based incentive and retention plans to encourage certain levels of management to remain employed with the Company and to award the achievement of established performance criteria. The non-cash compensation expense for the awards is included in the restricted stock units and shares information above.

## (10) Segment Information

Accounting guidance for the disclosures about segments of an enterprise 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. As a result of the integration of Global Crossing (see Note 2 - Events Associated with the Amalgamation of Global Crossing) and the sale of the coal business during the fourth quarter of 2011, the Company reorganized its management reporting structure to reflect the way in which it allocates resources and assesses performance. As a result of these changes, the Company is now comprised of one reportable segment for financial reporting purposes, representing its communications services business. The prior year reportable segment information has been revised to conform with this presentation.

The data presented in the following table includes information for the three and nine months ended September 30, 2012 and September 30, 2011. Information related to the acquired business is included from the date of acquisition.

Total revenue consists of:

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

The following table provides revenue (dollars in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Core Network Services	\$ 1,395	\$ 758	\$ 4,163	\$ 2,231
Wholesale Voice Services and Other	195	169	599	523
	<u>\$ 1,590</u>	<u>\$ 927</u>	<u>\$ 4,762</u>	<u>\$ 2,754</u>

The prior year's revenue by service offering has been revised to conform to the current year's presentation.

## (11) Commitments, Contingencies and Other Items

The Company is subject to various legal proceedings and other contingent liabilities that individually or in the aggregate could materially affect its financial condition, future results of operations or cash flows. Amounts accrued for such contingencies aggregate to \$296 million and are included in "Other" current liabilities and "Other Liabilities" in the Company's consolidated balance sheet as of September 30, 2012. The establishment of an accrual does not mean that actual funds have been set aside to satisfy a given contingency. Thus, the resolution of a particular contingency for the amount accrued may have no effect on the Company's results of operations but could materially adversely affect its cash flows for the affected period.

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

Below is a description of material legal proceedings and other contingencies pending at September 30, 2012. Although the Company believes it has accrued for these matters in accordance with the accounting guidance for contingencies, contingencies are inherently unpredictable and it is possible that results of operations or cash flows could be materially and adversely affected in any particular period by unfavorable developments in, or resolution or disposition of, one or more of these matters. For those contingencies in respect of which the Company believes that it is reasonably possible that a loss may result that is materially in excess of the accrual (if any) established for the matter, the Company has below either provided an estimate of such possible loss or range of loss or included a statement that such an estimate cannot be made. In addition to the contingencies described below, the Company is party to many other legal proceedings and contingencies the resolution of which is not expected to materially affect its financial condition or future results of operations beyond the amounts accrued.

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

The Company is party to a number of purported class action lawsuits involving its right to install fiber optic cable network in railroad right-of-ways adjacent to plaintiffs' land. In general, the Company obtained the rights to construct its networks from railroads, utilities, and others, and has installed its networks along the rights-of-way so granted. Plaintiffs in the purported class actions assert that they are the owners of lands over which the its fiber optic cable networks pass, and that the railroads, utilities, and others who granted the Company the right to construct and maintain its network did not have the legal authority to do so. The complaints seek damages on theories of trespass, unjust enrichment and slander of title and property, as well as punitive damages. The Company has also received, and may in the future receive, claims and demands related to rights-of-way issues similar to the issues in these cases that may be based on similar or different legal theories. The Company has defeated motions for class certification in a number of these actions but expects that, absent settlement of these actions, plaintiffs in the pending lawsuits will continue to seek certification of statewide or multi-state classes. The only lawsuit in which a class was certified against the Company, absent an agreed upon settlement, occurred in *Koyle, et. al. v. Level 3 Communications, Inc., et. al.*, a purported two state class action filed in the United States District Court for the District of Idaho. The *Koyle* lawsuit has been dismissed pursuant to a settlement reached in November 2010 as described further below.

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

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

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

### *Derivative Action*

In March 2009, Level 3 Communications, Inc., as a nominal defendant, certain of its directors and its current officers, and a former officer, were named as defendants in purported stockholder derivative actions in the District Court, Broomfield County, Colorado, which were consolidated as *In re Level 3 Communications, Inc. Derivative Litigation (Lead Case No. 2009CV59)* (the “State Derivative Action”). The plaintiffs in the action alleged that during the period specified in the complaints the named defendants failed to disclose material adverse facts about the Company's integration activities, business and operations. The complaint sought damages on behalf of the Company based on purported breaches of fiduciary duties for disseminating false and misleading statements and failing to maintain internal controls; unjust enrichment; abuse of control; gross mismanagement; waste of corporate assets; and, with respect to certain defendants, breach of fiduciary duties in connection with the resignation of Kevin O'Hara. The plaintiffs undertook further assessment of the State Derivative Action following the final dismissal of a related securities class action lawsuit which was based upon similar allegations, and determined not to pursue the action further. The plaintiffs filed a motion for voluntary dismissal and the action was dismissed by the court on June 26, 2012.

### *Peruvian Tax Litigation*

Beginning in 2005, one of the Company's Peruvian subsidiaries received a number of assessments for tax, penalty and interest for calendar years 2001 and 2002. Peruvian tax authorities (SUNAT) took the position that the Peruvian subsidiary incorrectly documented its importations resulting in additional income tax withholding and value-added taxes (VAT). The total amount of the asserted claims, including potential interest and penalties, was \$26 million, consisting of \$3 million for income tax withholding in connection with the import of services for calendar years 2001 and 2002, \$7 million for VAT in connection with the import of services for calendar years 2001 and 2002, and \$16 million in connection with the disallowance of VAT credits for periods beginning in 2005. Due to accrued interest and foreign exchange effects, and taking into account the developments described below, the total amount of exposure has increased to \$94 million.

The Company challenged the tax assessments during 2005 by filing administrative claims before SUNAT. During August 2006 and June 2007, SUNAT rejected the Company's administrative claims, thereby confirming the assessments. Appeals were filed in September 2006 and July 2007 in the Tax Court, which is the highest administrative authority. In October 2011, the Tax Court issued a ruling regarding VAT, associated penalties and penalties associated with withholding taxes, adjudicating the central issue underlying the assessments in the government's favor, while confirming the assessment in part and denying a portion of the assessment on procedural grounds. Other than an immaterial amount, all assessed items dismissed by the Tax Court in this ruling remain open for reassessment by SUNAT. While this Tax Court ruling applies only to 2002, the Company believes the Tax Court will issue a similar ruling with respect to 2001, and all material amounts likely to be waived due to procedural defects similarly remain open for reassessment.

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

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

### *Employee Severance and Contractor Termination Disputes*

A number of former employees and third-party contractors have asserted a variety of claims in litigation against certain Latin American subsidiaries of the Company for separation pay, severance, commissions, pension benefits, unpaid vacation pay, breach of employment contracts, unpaid performance bonuses, property damages, moral damages and related statutory penalties, fines, costs and expenses (including accrued interest, attorneys fees and statutorily mandated inflation adjustments) as a result of their separation from the Company or termination of service relationships. The Company is vigorously defending itself against the asserted claims, which aggregate to approximately \$42 million .

### *Brazilian Tax Claims*

In December 2004, March 2009 and April 2009, the São Paulo state tax authorities issued tax assessments against one of the Company's Brazilian subsidiaries for the Tax on Distribution of Goods and Services ("ICMS") with respect to revenues from leasing movable properties (in the case of the December 2004 and March 2009 assessments) and revenues from the provision of internet access services (in the case of the April 2009 assessment), by treating such activities as the provision of communications services, to which the ICMS tax applies. In September 2002, July 2009 and May 2012, the Rio de Janeiro state tax authorities issued tax assessments to the same Brazilian subsidiary on similar issues. The Company has filed objections to these assessments, arguing that the lease of assets and the provision of internet access are not communication services subject to ICMS. The objections to the December 2004 and September 2002 assessments have been rejected by the respective state administrative courts, and the Company has appealed those decisions to the judicial courts. The objections to the March, April and July 2009 and May 2012 assessments are still pending final administrative decisions.

The Company is vigorously contesting all such assessments in both states, and in particular, views the assessment of ICMS on revenues from leasing movable properties to be without merit. Nevertheless, the Company believes that it is reasonably possible that these assessments could result in a loss of up to \$57 million in excess of the accruals established for these matters.

### *Customer Bankruptcy Claim*

During 2007, one of the Company's U.S. subsidiaries commenced default and disconnect procedures against a customer for breach of a sales contract for termination of international and domestic wireless and wireline phone service based on the nature of the customer's traffic, which rendered the contract highly unprofitable to the Company. After the process was begun, the customer filed for bankruptcy protection, thereby barring the Company from taking further disconnection actions against it. The Company commenced an adversary proceeding in the bankruptcy court, asserting a claim for damages for the customer's alleged breaches of the contract and for a declaration that, as a result of these breaches, the customer was prohibited from assuming the contract in its reorganization proceedings.

The customer filed several counterclaims against the Company alleging various breaches of contract for attempting improperly to terminate service, for improperly blocking international traffic, for violations of the Communications Act of 1934 and for related tort-based claims. The Company notified the customer that the Company would be raising its rates for certain of the services and filed a motion with the bankruptcy court seeking additional adequate assurance for the rate change, or an order allowing the Company to terminate the customer's service. The customer amended its counter claims to assert claims for breach of contract based upon the rate increase. On July 3, 2008, the Court issued an opinion holding that the agreement did not permit the Company to increase the rates in the manner it did and that the Company: (a) breached the sales contract in so doing; and (b) was therefore not entitled to additional adequate assurance or an order terminating service. The Court did, however, permit the Company to amend its complaint to plead a rescission claim (which was filed on July 14, 2008) and to assert other defenses.

The Court dismissed the customer's bankruptcy case by order dated November 25, 2009, and retained the adversary proceeding (including the customer's counterclaim). On December 26, 2009, the Company terminated

service to the customer. The Company amended its complaint to include allegations relating to the manipulation of traffic data, so called “ANI stripping,” and the customer filed an amended answer, affirmative defenses and counterclaims.

On January 14, 2011, the Company filed a motion for summary judgment asserting that the customer was not entitled to recover any damages (other than those based on rescission-type theories) by reason of a limitation of liability provision in the contract and applicable law. On July 22, 2011, the Court issued its decision on the motion. Although the Court held that the limitation of liability provision of the contract was valid and enforceable and barred the customer from pursuing all forms of lost profit damages, the Court refused to exclude the customer's claim for general damages at that point, and permitted that issue to proceed.

After discovery in the action concluded, the Court ordered trial to proceed in three separate phases. Trial of the first set of issues commenced on November 14, 2011. After the Court heard testimony from four witnesses, the matter was adjourned until January 23, 2012, at which time further testimony was taken for three days. The customer's most recent damage estimate ranged from approximately \$150 million to approximately \$450 million. While the final outcome of this matter was uncertain, the Company believed Global Crossing had good defenses that would have limited substantially the amount of damages recoverable by the customer, including defenses based upon the limitation of liability provisions in the contract. However, the precise effect of the application of these defenses was unclear, and the Company therefore elected to settle the case for an amount approximately equal to the accrual that the Company had established for the matter. The settlement agreement was entered into by the parties effective on April 11, 2012, and the parties filed a stipulation with the Court on April 13, 2012, pursuant to which the case was dismissed with prejudice and payment was rendered during the second quarter of 2012.

### ***Letters of Credit***

It is customary for Level 3 to use various financial instruments in the normal course of business. These instruments include letters of credit. Letters of credit are conditional commitments issued on behalf of Level 3 in accordance with specified terms and conditions. As of September 30, 2012 and December 31, 2011, Level 3 had outstanding letters of credit of approximately \$32 million and \$33 million, respectively, of which \$30 million and \$29 million, are collateralized by cash, that is reflected on the consolidated balance sheets as restricted cash. The Company does not believe it is reasonable to estimate the fair value of the letters of credit and does not believe exposure to loss is reasonably possible nor material.

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

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

In conjunction with the registration of the Senior Notes, the accompanying condensed consolidating financial information has been prepared and presented pursuant to SEC Regulation S-X Rule 3-10 “Financial statements of guarantors and affiliates whose securities collateralize an issue registered or being registered.”

The operating activities of the separate legal entities included in the Company's consolidated financial statements are interdependent. The accompanying condensed consolidating financial information presents the results of operations, financial position and cash flows of each legal entity and, on an aggregate basis, the other non-guarantor subsidiaries based on amounts incurred by such entities, and is not intended to present the operating results of those legal entities on a stand-alone basis. Level 3 Communications, LLC leases equipment and certain facilities from other wholly owned subsidiaries of Level 3 Communications, Inc. These transactions are eliminated in the consolidated results of the Company.



**Condensed Consolidating Statements of Comprehensive Income (Loss)**  
**For the three months ended September 30, 2012**

	Level 3 Communications, Inc	Level 3 Financing, Inc	Level 3 Communications, LLC	Other Non- Guarantor Subsidiaries	Eliminations	Total
(dollars in millions)						
Revenue	\$ —	\$ —	\$ 672	\$ 981	\$ (63)	\$ 1,590
Costs and Expense:						
Cost of Revenue	—	—	256	447	(61)	642
Depreciation and Amortization	—	—	63	122	—	185
Selling, General and Administrative	1	1	406	213	(2)	619
Restructuring Charges	—	—	4	2	—	6
Total Costs and Expenses	1	1	729	784	(63)	1,452
Operating Income (Loss)	(1)	(1)	(57)	197	—	138
Other Income (Expense):						
Interest income	—	—	—	—	—	—
Interest expense	(43)	(137)	(1)	(7)	—	(188)
Interest income (expense) affiliates, net	244	400	(561)	(83)	—	—
Equity in net earnings (losses) of subsidiaries	(365)	(516)	40	—	841	—
Other income (expense), net	—	(111)	3	5	—	(103)
Total Other Expense	(164)	(364)	(519)	(85)	841	(291)
Income (Loss) before Income Taxes	(165)	(365)	(576)	112	841	(153)
Income Tax Expense	(1)	—	(1)	(11)	—	(13)
Net Income (Loss)	(166)	(365)	(577)	101	841	(166)
Other Comprehensive Income, Net of Income Taxes	122	122	—	48	(170)	122
Comprehensive Income (Loss)	\$ (44)	\$ (243)	\$ (577)	\$ 149	\$ 671	\$ (44)



**Condensed Consolidating Statements of Comprehensive Income (Loss)**  
**For the nine months ended September 30, 2012**

	Level 3 Communications, Inc	Level 3 Financing, Inc	Level 3 Communications, LLC	Other Non- Guarantor Subsidiaries	Eliminations	Total
	(dollars in millions)					
Revenue	\$ —	\$ —	\$ 1,957	\$ 2,995	\$ (190)	\$ 4,762
Costs and Expense:						
Cost of Revenue	—	—	736	1,393	(182)	1,947
Depreciation and Amortization	—	—	196	367	—	563
Selling, General and Administrative	2	1	1,197	659	(8)	1,851
Restructuring Charges	—	—	10	4	—	14
Total Costs and Expenses	2	1	2,139	2,423	(190)	4,375
Operating Income (Loss)	(2)	(1)	(182)	572	—	387
Other Income (Expense):						
Interest income	—	—	1	1	—	2
Interest expense	(123)	(410)	(2)	(23)	—	(558)
Interest income (expense) affiliates, net	734	1,202	(1,678)	(258)	—	—
Equity in net earnings (losses) of subsidiaries	(935)	(1,593)	101	—	2,427	—
Other income (expense), net	(39)	(133)	6	4	—	(162)
Total Other Expense	(363)	(934)	(1,572)	(276)	2,427	(718)
Income (Loss) before Income Taxes	(365)	(935)	(1,754)	296	2,427	(331)
Income Tax Expense	(1)	—	(3)	(31)	—	(35)
Net Income (Loss)	(366)	(935)	(1,757)	265	2,427	(366)
Other Comprehensive Income, Net of Income Taxes	108	108	—	18	(126)	108
Comprehensive Income (Loss)	\$ (258)	\$ (827)	\$ (1,757)	\$ 283	\$ 2,301	\$ (258)

**Condensed Consolidating Statements of Comprehensive Income (Loss)**  
**For the three months ended September 30, 2011**

	Level 3 Communications, Inc	Level 3 Financing, Inc	Level 3 Communications, LLC	Other Non- Guarantor Subsidiaries	Eliminations	Total
(dollars in millions)						
Revenue	\$ —	\$ —	\$ 605	\$ 379	\$ (57)	\$ 927
Costs and Expense:						
Cost of Revenue	—	—	222	174	(54)	342
Depreciation and Amortization	—	—	102	101	—	203
Selling, General and Administrative	—	—	328	50	(3)	375
Restructuring Charges	—	—	—	—	—	—
Total Costs and Expenses	—	—	652	325	(57)	920
Operating Income (Loss)	—	—	(47)	54	—	7
Other Income (Expense):						
Interest income	—	—	—	—	—	—
Interest expense	(51)	(99)	—	(28)	—	(178)
Interest income (expense) affiliates, net	212	350	(514)	(48)	—	—
Equity in net earnings (losses) of subsidiaries	(338)	(589)	29	—	898	—
Other income (expense), net	(30)	—	2	(3)	—	(31)
Total Other Expense	(207)	(338)	(483)	(79)	898	(209)
Loss before Income Taxes	(207)	(338)	(530)	(25)	898	(202)
Income Tax Expense	—	—	(1)	(5)	—	(6)
Loss from Continuing Operations	(207)	(338)	(531)	(30)	898	(208)
Income From Discontinued Operations, Net	—	—	—	1	—	1
Net Loss	(207)	(338)	(531)	(29)	898	(207)
Other Comprehensive Loss, Net of Income Taxes	(24)	(24)	—	(26)	50	(24)
Comprehensive Loss	<u>\$ (231)</u>	<u>\$ (362)</u>	<u>\$ (531)</u>	<u>\$ (55)</u>	<u>\$ 948</u>	<u>\$ (231)</u>

**Condensed Consolidating Statements of Comprehensive Income (Loss)**  
**For the nine months ended September 30, 2011**

	Level 3 Communications, Inc	Level 3 Financing, Inc	Level 3 Communications, LLC	Other Non- Guarantor Subsidiaries	Eliminations	Total
(dollars in millions)						
Revenue	\$ —	\$ —	\$ 1,741	\$ 1,182	\$ (169)	\$ 2,754
Costs and Expense:						
Cost of Revenue	—	—	658	548	(160)	1,046
Depreciation and Amortization	—	—	309	303	—	612
Selling, General and Administrative	1	—	941	156	(9)	1,089
Restructuring Charges	—	—	—	—	—	—
Total Costs and Expenses	1	—	1,908	1,007	(169)	2,747
Operating Income (Loss)	(1)	—	(167)	175	—	7
Other Income (Expense):						
Interest income	—	—	—	—	—	—
Interest expense	(163)	(296)	(2)	(34)	—	(495)
Interest income (expense) affiliates, net	633	1,069	(1,545)	(157)	—	—
Equity in net earnings (losses) of subsidiaries	(1,011)	(1,761)	107	—	2,665	—
Other income (expense), net	(51)	(23)	8	(2)	—	(68)
Total Other Expense	(592)	(1,011)	(1,432)	(193)	2,665	(563)
Loss before Income Taxes	(593)	(1,011)	(1,599)	(18)	2,665	(556)
Income Tax Expense	—	—	(21)	(15)	—	(36)
Loss from Continuing Operations	(593)	(1,011)	(1,620)	(33)	2,665	(592)
Loss From Discontinued Operations, Net	—	—	—	(1)	—	(1)
Net Loss	(593)	(1,011)	(1,620)	(34)	2,665	(593)
Other Comprehensive Income, Net of Income Taxes	33	33	—	23	(56)	33
Comprehensive Loss	<u>\$ (560)</u>	<u>\$ (978)</u>	<u>\$ (1,620)</u>	<u>\$ (11)</u>	<u>\$ 2,609</u>	<u>\$ (560)</u>

# **Condensed Consolidating Balance Sheets** **September 30, 2012**

	Level 3 Communications, Inc	Level 3 Financing, Inc	Level 3 Communications, LLC	Other Non- Guarantor Subsidiaries	Eliminations	Total
(dollars in millions)						
<b>Assets</b>						
<b>Current Assets:</b>						
Cash and cash equivalents \$	296	\$ 5	\$ 215	\$ 277	\$ —	\$ 793
Restricted cash and securities	—	—	1	7	—	8
Receivables, less allowances for doubtful accounts	—	—	103	645	—	748
Due from (to) affiliates	14,188	15,405	(29,446)	(147)	—	—
Other	7	34	55	90	—	186
<b>Total Current Assets</b>	<b>14,491</b>	<b>15,444</b>	<b>(29,072)</b>	<b>872</b>	<b>—</b>	<b>1,735</b>
Property, Plant, and Equipment, net	—	—	2,893	5,298	—	8,191
Restricted Cash and Securities	15	—	18	6	—	39
Goodwill and Other Intangibles, net	—	—	438	2,414	—	2,852
Investment in Subsidiaries	(11,505)	(19,998)	3,267	—	28,236	—
Other Assets, net	17	115	11	256	—	399
<b>Total Assets</b>	<b>\$ 3,018</b>	<b>\$ (4,439)</b>	<b>\$ (22,445)</b>	<b>\$ 8,846</b>	<b>\$ 28,236</b>	<b>\$ 13,216</b>
<b>Liabilities and Stockholders' Equity (Deficit)</b>						
<b>Current Liabilities:</b>						
Accounts payable \$	1	\$ 2	\$ 32	\$ 684	\$ —	\$ 719
Current portion of long-term debt	175	—	2	36	—	213
Accrued payroll and employee benefits	—	—	121	42	—	163
Accrued interest	54	112	—	—	—	166
Current portion of deferred revenue	—	—	102	158	—	260
Other	1	1	24	96	—	122
<b>Total Current Liabilities</b>	<b>231</b>	<b>115</b>	<b>281</b>	<b>1,016</b>	<b>—</b>	<b>1,643</b>
Long-Term Debt, less current portion	1,569	6,862	20	45	—	8,496
Deferred Revenue, less current portion	—	—	593	248	—	841
Other Liabilities	14	92	141	785	—	1,032
<b>Commitments and Contingencies</b>						
Stockholders' Equity (Deficit)	1,204	(11,508)	(23,480)	6,752	28,236	1,204
<b>Total Liabilities and Stockholders' Equity (Deficit)</b>	<b>\$ 3,018</b>	<b>\$ (4,439)</b>	<b>\$ (22,445)</b>	<b>\$ 8,846</b>	<b>\$ 28,236</b>	<b>\$ 13,216</b>

# **Condensed Consolidating Balance Sheets** **December 31, 2011**

	Level 3 Communications, Inc	Level 3 Financing, Inc	Level 3 Communications, LLC	Other Non- Guarantor Subsidiaries	Eliminations	Total
(dollars in millions)						
<b>Assets</b>						
<b>Current Assets:</b>						
Cash and cash equivalents	\$ 2	\$ 6	\$ 618	\$ 292	\$ —	\$ 918
Restricted cash and securities	—	—	1	9	—	10
Receivables, less allowances for doubtful accounts	—	—	59	589	—	648
Due from (to) affiliates	13,472	14,584	(28,092)	36	—	—
Other	3	16	48	64	—	131
<b>Total Current Assets</b>	<b>13,477</b>	<b>14,606</b>	<b>(27,366)</b>	<b>990</b>	<b>—</b>	<b>1,707</b>
Property, Plant, and Equipment, net	—	—	2,823	5,313	—	8,136
Restricted Cash and Securities	18	—	19	14	—	51
Goodwill and Other Intangibles, net	—	—	481	2,418	—	2,899
Investment in Subsidiaries	(10,718)	(18,467)	3,412	—	25,773	—
Other Assets, net	13	109	6	267	—	395
<b>Total Assets</b>	<b>\$ 2,790</b>	<b>\$ (3,752)</b>	<b>\$ (20,625)</b>	<b>\$ 9,002</b>	<b>\$ 25,773</b>	<b>\$ 13,188</b>
<b>Liabilities and Stockholders' Equity (Deficit)</b>						
<b>Current Liabilities:</b>						
Accounts payable	\$ —	\$ —	\$ 37	\$ 710	\$ —	\$ 747
Current portion of long-term debt	—	—	2	63	—	65
Accrued payroll and employee benefits	—	—	116	93	—	209
Accrued interest	50	165	—	1	—	216
Current portion of deferred revenue	—	—	107	157	—	264
Other	—	1	52	104	—	157
<b>Total Current Liabilities</b>	<b>50</b>	<b>166</b>	<b>314</b>	<b>1,128</b>	<b>—</b>	<b>1,658</b>
Long-Term Debt, less current portion	1,533	6,688	22	142	—	8,385
Deferred Revenue, less current portion	—	—	612	273	—	885
Other Liabilities	14	116	146	791	—	1,067
<b>Commitments and Contingencies</b>						
Stockholders' Equity (Deficit)	1,193	(10,722)	(21,719)	6,668	25,773	1,193
<b>Total Liabilities and Stockholders' Equity (Deficit)</b>	<b>\$ 2,790</b>	<b>\$ (3,752)</b>	<b>\$ (20,625)</b>	<b>\$ 9,002</b>	<b>\$ 25,773</b>	<b>\$ 13,188</b>

**Condensed Consolidating Statements of Cash Flows**  
**For the nine months ended September 30, 2012**

	Level 3 Communications, Inc	Level 3 Financing, Inc	Level 3 Communications, LLC	Other Non- Guarantor Subsidiaries	Eliminations	Total
	(dollars in millions)					
Net Cash Provided by (Used in) Operating Activities	\$ (48)	\$ (442)	\$ 80	\$ 588	\$ —	\$ 178
Cash Flows from Investing Activities:						
Capital Expenditures	—	—	(199)	(346)	—	(545)
Decrease in restricted cash and securities, net	3	—	1	11	—	15
Proceeds from sale of property, plant, and equipment and other assets	—	—	—	5	—	5
Other	—	—	—	(13)	—	(13)
Net Cash Provided by (Used in) Investing Activities	3	—	(198)	(343)	—	(538)
Cash Flows from Financing Activities:						
Long-term debt borrowings, net of issuance costs	293	3,024	—	—	—	3,317
Payments on and repurchases of long-term debt, including current portion and refinancing costs	—	(2,960)	—	(128)	—	(3,088)
Proceeds from stock options exercised	5	—	—	—	—	5
Increase (decrease) due from affiliates, net	41	377	(285)	(133)	—	—
Net Cash Provided by (Used in) Financing Activities	339	441	(285)	(261)	—	234
Effect of Exchange Rates on Cash and Cash Equivalents	—	—	—	1	—	1
Net Change in Cash and Cash Equivalents	294	(1)	(403)	(15)	—	(125)
Cash and Cash Equivalents at Beginning of Period	2	6	618	292	—	918
Cash and Cash Equivalents at End of Period	\$ 296	\$ 5	\$ 215	\$ 277	\$ —	\$ 793

**Condensed Consolidating Statements of Cash Flows**  
**For the nine months ended September 30, 2011**

	Level 3 Communications, Inc	Level 3 Financing, Inc	Level 3 Communications, LLC	Other Non- Guarantor Subsidiaries	Eliminations	Total
	(dollars in millions)					
Net Cash Provided by (Used in) Operating Activities of Continuing Operations	\$ (129)	\$ (279)	\$ 153	\$ 454	\$ —	\$ 199
Cash Flows from Investing Activities:						
Capital Expenditures	—	—	(146)	(200)	—	(346)
Increase in restricted cash and securities, net	—	—	—	(63)	—	(63)
Proceeds from sale of property, plant, and equipment and other assets	—	—	1	3	—	4
Net Cash Used in Investing Activities of Continuing Operations	—	—	(145)	(260)	—	(405)
Cash Flows from Financing Activities:						
Long-term debt borrowings, net of issuance costs	292	474	—	(1)	—	765
Payments on and repurchases of long-term debt, including current portion and refinancing costs	(245)	(463)	—	(3)	—	(711)
Increase (decrease) due from affiliates, net	(47)	267	(29)	(191)	—	—
Net Cash Provided by (Used in) Financing Activities of Continuing Operations	—	278	(29)	(195)	—	54
Net Cash Used in Discontinued Operations	—	—	—	(4)	—	(4)
Effect of Exchange Rates on Cash and Cash Equivalents	—	—	—	1	—	1
Net Change in Cash and Cash Equivalents	(129)	(1)	(21)	(4)	—	(155)
Cash and Cash Equivalents at Beginning of Period	173	7	350	86	—	616
Cash and Cash Equivalents at End of Period	\$ 44	\$ 6	\$ 329	\$ 82	\$ —	\$ 461

### **(13) Subsequent Events**

In October 2012, Level 3 Financing, Inc. refinanced its existing \$650 million Tranche B II and \$550 million Tranche B III Term Loans under its existing senior secured credit facility through the creation of a new term loan in the aggregate principal amount of \$1.2 billion (the "Tranche B-II 2019 Term Loan"). The new Tranche B-II 2019 Term Loan was borrowed pursuant to an amended and restated credit agreement. The new Tranche B-II 2019 Term Loan consists of a \$1.2 billion senior secured term loan which matures on August 1, 2019. The interest rate on the loan is LIBOR plus 3.25% , with LIBOR set at a minimum of 1.5% . The Tranche B-II 2019 Term Loan was priced at par. The Company used the net proceeds from the Tranche B-II 2019 Term Loan, along with cash on hand, to repay Level 3 Financing, Inc.'s \$650 million Tranche B II and \$550 million Tranche B III Term Loans under the existing credit agreement maturing in September 2018. The Company expects to recognize a loss on the extinguishment of debt of approximately \$50 million in the fourth quarter of 2012 as a result of this transaction.



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

The following discussion should be read in conjunction with the Level 3 Communications, Inc. and its subsidiaries ("Level 3" or the "Company") consolidated financial statements (including the notes thereto), included elsewhere herein and the Company's Form 10-K, as amended, for the year ended December 31, 2011 filed with the Securities and Exchange Commission.

This document contains forward looking statements and information that are based on the beliefs of management as well as assumptions made by and information currently available to the Company. When used in this document, the words "anticipate", "believe", "plan", "estimate" and "expect" and similar expressions, as they relate to the Company or its management, are intended to identify forward-looking statements. Such statements reflect the current views of the Company with respect to future events and are subject to certain risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described in this document. For a more detailed description of these risks and factors, please see the Company's Form 10-K, as amended, for the year ended December 31, 2011 filed with the Securities and Exchange Commission and Item 1A in Part II of this Form 10-Q.

### **Executive Summary**

#### *Overview*

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

On October 4, 2011, a wholly owned subsidiary of Level 3 completed its amalgamation with Global Crossing and the amalgamated entity became an indirect wholly owned subsidiary of the Company through a tax free, stock for stock transaction (the "Amalgamation"). In addition, after the close of business on October 19, 2011, Level 3 completed a 1 for 15 reverse stock split as previously approved by the Company's stockholders in connection with its announcement to transfer the listing of its common stock to the New York Stock Exchange on October 20, 2011. The reverse stock split automatically combined every fifteen shares of issued and outstanding Level 3 common stock into one share of common stock without any change in the par value per share. All share and per share references for all periods presented have been adjusted to give effect to the reverse stock split.

Level 3, through its two 50% owned joint-venture surface mines, one each in Montana and Wyoming, sold coal primarily through long-term contracts with public utilities. In November 2011, Level 3 completed the sale of its coal mining business to Ambre Energy Limited as part of its long-term strategy to focus on core business operations. As a result of the transaction, all of the assets and liabilities associated with the coal mining business have been removed from Level 3's balance sheet. The financial results of the coal mining business are included in the Company's consolidated results of operations through the date of sale, and all periods presented have been revised to reflect the presentation within discontinued operations.

#### *Business Strategy and Objectives*

The Company pursues the strategies discussed in Item 1. Business, "Business Overview and Strategy" as discussed in its Form 10-K, as amended, for the year ended December 31, 2011. In particular, with respect to strategic financial objectives, the Company focuses its attention on the following:

- growing Core Network Services revenue by increasing sales;
- continually improving the customer experience to increase customer retention and reduce customer churn;
- completing the integration of acquired businesses;

- reducing network costs and operating expenses;
- achieving sustainable generation of positive cash flows from operations in excess of capital expenditures;
- continuing to show improvement in Adjusted EBITDA (as defined in this Item below) as a percentage of revenue;
- concentrating its capital expenditures on those technologies and assets that enable the Company to develop its Core Network Services;
- managing Wholesale Voice Services for margin contribution; and
- refinancing its future debt maturities.

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

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

The Company has also been focused on improving its liquidity, financial condition, and extending the maturity dates of certain debt.

In October 2012, Level 3 Financing, Inc. refinanced its existing \$650 million Tranche B II and \$550 million Tranche B III Term Loans under its existing senior secured credit facility through the creation of a new term loan in the aggregate principal amount of \$1.2 billion (the "Tranche B-II 2019 Term Loan"). The Company used the net proceeds from the Tranche B-II 2019 Term Loan, along with cash on hand, to repay Level 3 Financing, Inc.'s \$650 million Tranche B II and \$550 million Tranche B III Term Loans under the existing credit agreement maturing in September 2018. See Note 13 - Subsequent Events in the notes to the consolidated financial statements for additional information.

In September 2012, the Company fully repaid the outstanding principal of its Commercial Mortgage due 2015 along with accrued interest which was approximately \$63 million. See Note 8 - Long-Term Debt in the notes to the consolidated financial statements for additional information.

In August 2012, the Company completed the offering of \$300 million aggregate principal amount of its 8.875% Senior Notes due 2019 in a private offering. The net proceeds from the offering of the notes will be used for general corporate purposes, including the potential repurchase, redemption, repayment or refinancing of the Company's and its subsidiaries' existing indebtedness from time to time. See Note 8 - Long-Term Debt in the notes to the consolidated financial statements for additional information.

Also in August 2012, Level 3 Financing, Inc. completed the offering of \$775 million aggregate principal amount of its 7% Senior Notes due 2020 in a private offering. The net proceeds from the offering of the notes, along with cash on hand, were used to redeem all of the Company's outstanding 8.75% Senior Notes due 2017, including the payment of accrued interest and applicable premiums. See Note 8 - Long-Term Debt in the notes to the consolidated financial statements for additional information.

Level 3 Financing, Inc. refinanced its existing \$1.4 billion Tranche A Term Loan under its existing senior secured credit facility through the creation of new term loans in the aggregate principal amount of \$1.415 billion (the "New Term Loans") in August 2012. The Company used the net proceeds from the New Term Loans, along with cash on hand, to repay Level 3 Financing, Inc.'s \$1.4 billion Tranche A Term Loan under the existing credit agreement maturing in March 2014 and used remaining net proceeds to repay \$15 million in principal amount plus premium for existing vendor financing obligations. See Note 8 - Long-Term Debt in the notes to the consolidated financial statements for additional information.

In March 2012, the Company exchanged approximately \$100 million aggregate principal amount of its outstanding 15% Convertible Senior Notes due 2013 for approximately 3.7 million shares of Level 3's common stock into which the notes were convertible plus an additional 1.7 million shares for a total of approximately 5.4 million shares. See Note 8 - Long-Term Debt in the notes to the consolidated financial statements for additional information.

In January 2012, Level 3 Financing, Inc. issued \$900 million aggregate principal amount of its 8.625% Senior Notes due 2020 in a private transaction. A portion of the net proceeds from the offering were used in February 2012 to redeem all of Level 3 Financing's outstanding 9.25% Senior Notes due 2014 in aggregate principal amount of \$807 million. See Note 8 - Long-Term Debt in the notes to the consolidated financial statements for additional information.

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

### *Revenue and Service Offering*

(dollars in millions)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Core Network Services:				
North America - Wholesale Channel	\$ 381	\$ 334	\$ 1,144	\$ 993
North America - Enterprise Channel	627	341	1,858	995
EMEA - Wholesale Channel	89	51	272	152
EMEA - Enterprise Channel	80	31	240	87
EMEA - U.K. Government Channel	41	—	131	—
Latin America - Wholesale Channel	36	1	103	3
Latin America - Enterprise Channel	141	—	415	1
Total Core Network Services	\$ 1,395	\$ 758	\$ 4,163	\$ 2,231
Wholesale Voice Services and Other	195	169	599	523
Total Revenue	\$ 1,590	\$ 927	\$ 4,762	\$ 2,754

Total revenue consists of:

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

Core Network Services revenue represents higher margin services and Wholesale Voice Services and Other revenue represents lower margin services. Core Network Services revenue requires different levels of investment and focus and provides different contributions to the Company's operating results than Wholesale Voice Services and

Other revenue. Management of Level 3 believes that growth in revenue from its Core Network Services is critical to the long-term success of its business. The Company also believes it must continue to effectively manage gross margin contribution from the Wholesale Voice Services component and the positive cash flows from the Other revenue component of Wholesale Voice Services and Other revenue. The Company believes that trends in its communications business are best gauged by analyzing revenue changes in Core Network Services.

### *Core Network Services*

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

Colocation and data center services allow customers to place their network equipment and servers in suitable environments maintained by the Company with high-speed links providing on net access to more than 45 countries. These services are secure, redundant and flexible to fit the varying needs of the Company's customers. Services include hosting network equipment used to transport high speed data and voice over Level 3's global network; providing managed IT services (hosting), installation, maintenance, storage and monitoring of enterprise services; and providing comprehensive IT outsource solutions.

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

The Company believes that one of the largest sources of future incremental demand for the Company's Core Network Services will be from customers that are seeking to distribute their feature rich content or video over the Internet. Revenue growth in this area is dependent on the continued increase in demand from customers and the pricing environment. An increase in the reliability and security of information transmitted over the Internet and declines in the cost to transmit data have resulted in increased utilization of e-commerce or web based services by businesses. Although the pricing for data services is currently relatively stable, the IP market is generally characterized by price compression and high unit growth rates depending upon the type of service. The Company experienced price compression in the high-speed IP and voice services markets in 2011, which has continued in 2012.

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

- The enterprise channel includes large, multi-national enterprises requiring large amounts of bandwidth to support their business operations, such as financial services companies, healthcare companies, content providers, and portal and search engine companies. It also includes medium enterprises and regional service providers who buy services regionally or locally, as well as government markets, including the U.S. federal government, the systems integrators supporting the U.S. federal government, U.S. state and local

governments, academic consortia, and certain academic institutions. Included in the enterprise channel, but broken out separately in the table above, is the U.K. government channel, which includes revenue primarily from the government sector in the U.K.

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

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

#### *Wholesale Voice Services and Other*

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

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

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

For a detailed description of the Company's broad range of communications services, please see Item 1. Business - "Our Services Offerings" of the Company's Form 10-K, as amended, for the year ended December 31, 2011 filed with the Securities and Exchange Commission.

### ***Hurricane Sandy***

Level 3's business has been affected by Hurricane Sandy in the Northeast region of the United States during the fourth quarter of 2012. Level 3 continues to address issues affecting its network and to restore services to customers affected by the storm. In addition, revenue from Level 3's usage-based services may be adversely affected by storm-related business interruptions affecting its customers. The timing of the installation of services ordered by customers and Level 3's resulting revenue may also be adversely affected by limitations on the ability of third party access providers to provision services in the region on a timely basis. It is not possible at this time to estimate the effect that the storm may have on Level 3's operating results in the fourth quarter of 2012. Based on information that is available to management on the date of this report, Level 3 does not expect that the direct and indirect effects that the storm has on its operating results in the fourth quarter of 2012 will be significant; however, it is possible that this expectation could change once additional information regarding the effect of the storm damage is available.

### ***Critical Accounting Policies***

Refer to Item 7 of the Company's Form 10-K, as amended, for the year ended December 31, 2011 for a description of the Company's critical accounting policies.

**Results of Operations for the Three and Nine Months Ended September 30, 2012 and 2011:**

(dollars in millions)	Three Months Ended September 30,			Nine Months Ended September 30,		
	2012	2011	Change %	2012	2011	Change %
Revenue	\$ 1,590	\$ 927	72 %	\$ 4,762	\$ 2,754	73 %
Cost of Revenue	642	342	88 %	1,947	1,046	86 %
Depreciation and Amortization	185	203	(9)%	563	612	(8)%
Selling, General and Administrative	619	375	65 %	1,851	1,089	70 %
Restructuring Charges	6	—	NM	14	—	NM
Total Costs and Expenses	1,452	920	58 %	4,375	2,747	59 %
Operating Income	138	7	NM	387	7	NM
Other Income (Expense):						
Interest income	—	—	NM	2	—	NM
Interest expense	(188)	(178)	6 %	(558)	(495)	13 %
Loss on extinguishment of debt, net	(49)	(30)	63 %	(110)	(73)	51 %
Other, net	(54)	(1)	NM	(52)	5	NM
Total Other Expense	(291)	(209)	39 %	(718)	(563)	28 %
Loss Before Income Taxes	(153)	(202)	(24)%	(331)	(556)	(40)%
Income Tax Expense	(13)	(6)	117 %	(35)	(36)	(3)%
Loss from Continuing Operations	(166)	(208)	(20)%	(366)	(592)	(38)%
Income (Loss ) from Discontinued Operations, Net	—	1	(100)%	—	(1)	(100)%
Net Loss	<u>\$ (166)</u>	<u>\$ (207)</u>	<u>(20)%</u>	<u>\$ (366)</u>	<u>\$ (593)</u>	<u>(38)%</u>

NM — Not meaningful

## Discussion of all significant variances:

### Total Revenue by Service Offering

(dollars in millions)	Three Months Ended September 30,			Nine Months Ended September 30,		
	2012	2011	Change %	2012	2011	Change %
Core Network Services	\$ 1,395	\$ 758	84%	\$ 4,163	\$ 2,231	87%
Wholesale Voice Services and Other	195	169	15%	599	523	15%
Total Revenue	<u>\$ 1,590</u>	<u>\$ 927</u>	72%	<u>\$ 4,762</u>	<u>\$ 2,754</u>	73%

**Revenue** increased 72% to \$1.590 billion in the three months ended September 30, 2012 from \$927 million in the same period of 2011 and increased 73% to \$ 4.762 billion in the nine months ended September 30, 2012 from \$ 2.754 billion in the same period of 2011. The increase is primarily driven by the additional revenue associated with the Global Crossing acquisition completed in the fourth quarter of 2011. Excluding revenue from the Global Crossing acquisition, revenue from enterprise customers contributed to the growth in Core Network Services revenue.

The Company experienced growth in each of its service offerings during the three and nine months ended September 30, 2012 compared to the same periods in 2011 as a result of the Global Crossing acquisition. Excluding revenue from the Global Crossing acquisition, revenue growth in IP and data services and voice services during the three and nine months ended September 30, 2012 was driven primarily by end customer demand for content delivery over the internet and enterprise bandwidth, as well as increased usage for voice services. Growth in transport and fiber services and colocation and data center services was more modest during the three and nine months ended September 30, 2012.

Core Network Services revenue increased in the North America, EMEA and Latin America regions during the three and nine months ended September 30, 2012 compared to the same periods of 2011 primarily as a result of the Global Crossing acquisition. Excluding revenue from the Global Crossing acquisition, revenue increased in the North America region during the three and nine months ended September 30, 2012 compared to the same periods of 2011.

Wholesale Voice Services and Other revenue increased in the three and nine months ended September 30, 2012 compared to the same periods in 2011 as a result of the Global Crossing acquisition. Excluding revenue from the Global Crossing acquisition, Wholesale Voice Services and Other revenue decreased in the three and nine months ended September 30, 2012 due to declines in usage. The Company continues to manage its combined wholesale voice services platform for margin growth, and expects continued volatility in revenue as a result of this strategy. In addition, the Company expects managed modem and SBC Contract Services revenue to continue to decline due to an increase in the number of subscribers migrating to broadband services and as a result of the migration of the SBC traffic to the AT&T network, respectively.

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

Cost of revenue as a percentage of total revenue was 40% and 41% for the three and nine months ended September 30, 2012 compared to 37% and 38% in the same periods of the prior year. The increase is due to inclusion of costs associated with the Global Crossing business, which has lower gross margins, in the current year periods compared to the same periods of 2011. This increase was partially offset by an improving gross margin mix from higher margin on-net Core Network Services and a decrease in lower margin Wholesale Voice Services and Other. Additionally, the Company continues to implement initiatives to reduce both fixed and variable network expenses.



**Depreciation and Amortization** expense decreased 9% to \$185 million in the three months ended September 30, 2012 from \$203 million in the same period in 2011 and decreased 8% to \$ 563 million in the nine months ended September 30, 2012 from \$ 612 million in the same period in 2011. The decrease is attributable to a change in the estimated useful lives of certain of the Company's property, plant and equipment that resulted in a reduction of depreciation expense in the three and nine months ended September 30, 2012 compared to the same periods of 2011. The change in accounting estimate was applied on a prospective basis effective October 1, 2011 as required under the accounting standard related to changes in accounting estimates. This decrease was partially offset by additional depreciation and amortization as a result of the Global Crossing acquisition and property, plant and equipment additions since September 30, 2011.

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

SG&A expenses increased 65% to \$619 million in the three months ended September 30, 2012 compared to \$375 million in the same period of 2011 and increased 70% to \$ 1.851 billion in the nine months ended September 30, 2012 from \$ 1.089 billion in the same period in 2011. The increase is primarily due to SG&A expenses associated with the Global Crossing acquisition, including integration costs of approximately \$ 18 million and \$ 50 million for the three and nine months ended September 30, 2012 , higher employee compensation and related costs as the Company continued to increase its sales, support and customer service delivery headcount, and merit increases effective in the first quarter of 2012. These increases were partially offset by cost synergies achieved as a result of the Global Crossing acquisition in the three and nine months ended September 30, 2012 .

Also included in SG&A expenses in the three and nine months ended September 30, 2012 were \$ 49 million and \$ 102 million , respectively, and in the three and nine months ended September 30, 2011 , \$ 26 million and \$ 68 million , respectively, of non-cash, stock-based compensation expenses related to grants of outperform stock options, restricted stock units, accruals for the Company's discretionary bonus, incentive and retention plans and shares issued for the Company's matching contribution for the 401(k) plan.

**Restructuring Charges** in the three and nine months ended September 30, 2012 were \$6 million and \$ 14 million , respectively, compared to less than \$1 million in the same periods of 2011. The increase in the three and nine months ended September 30, 2012 compared to the same periods of 2011 was primarily due to reductions in headcount associated with the Global Crossing acquisition, as the Company had not initiated any significant new workforce reduction plans in 2011.

The Company may initiate additional restructuring activities in future periods in connection with the efforts to optimize its cost structure or in connection with the Amalgamation of Global Crossing. Additional restructuring activities could result in additional headcount reductions and related charges.

**Adjusted EBITDA** , as defined by the Company, is net income (loss) from the consolidated statements of operations before (1) income tax benefit (expense), (2) total other income (expense), (3) non-cash impairment charges included within restructuring charges, (4) depreciation and amortization expense, (5) non-cash stock compensation expense included within selling, general and administrative expenses and (6) discontinued operations.

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

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

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

The following information provides a reconciliation of Net Loss to Adjusted EBITDA as defined by the Company (dollars in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net Loss	\$ (166)	\$ (207)	\$ (366)	\$ (593)
Income Tax Expense	13	6	35	36
Total Other Expense	291	209	718	563
Depreciation and Amortization Expense	185	203	563	612
Non-Cash Compensation Expense	49	26	102	68
Discontinued Operations of Coal Mining Business	—	(1)	—	1
Adjusted EBITDA	<u>\$ 372</u>	<u>\$ 236</u>	<u>\$ 1,052</u>	<u>\$ 687</u>

Consolidated Adjusted EBITDA was \$372 million in the three months ended September 30, 2012 compared to \$236 million in the same period of 2011 and was \$1.052 billion in the nine months ended September 30, 2012 compared to \$687 million in the same period of 2011. The increase in Adjusted EBITDA in the three and nine months ended September 30, 2012 is primarily attributable to Adjusted EBITDA associated with the Global Crossing acquisition and growth in the Company's higher incremental margin Core Network Services revenue and continued improvements in cost of revenue.

**Interest Expense** increased 6% to \$ 188 million in the three months ended September 30, 2012 from \$ 178 million in the same period of 2011 and increased 13% to \$ 558 million in the nine months ended September 30, 2012 from \$ 495 million in the same period of 2011. Interest expense increased as a result of higher average debt balance for 2012 compared to 2011, including financing associated with the Global Crossing acquisition, partially offset by lower cost of borrowing on refinanced debt.

The Company expects annual interest expense in 2012 to be approximately \$ 740 million based on the Company's outstanding debt as of September 30, 2012, and taking into consideration the current interest rates on the Company's variable rate debt and the October 2012 incurrence of the \$1.2 billion Tranche B-II 2019 Term Loan under the amended and restated credit agreement (along with the repayment of the existing \$650 million Tranche B II and \$550 million Tranche B III Term Loans). See Note 8 - Long-Term Debt and Note 13 - Subsequent Events of the Notes to Consolidated Financial Statements for more details regarding the Company's financing activities.

**Loss on Extinguishment of Debt, net** was \$49 million and \$ 110 million in the three and nine months ended September 30, 2012 , compared to a loss of \$ 30 million and \$ 73 million in the three and nine months ended September 30, 2011 . The loss recorded during 2012 was related to a charge of approximately \$9 million related to the refinancing of the \$1.4 billion Tranche A Term Loan in August 2012 and the repayment of existing vendor financing obligations, a charge of approximately \$40 million as a result of the redemption of the 8.75% Senior Notes due 2017 in August 2012, a charge of approximately \$22 million related to the redemption of the 9.25% Senior Notes due 2014 in February 2012 and a charge of approximately \$39 million as a result of the exchange of a portion of the 15% Convertible Senior Notes due 2013 for approximately 5.4 million shares of Level 3 stock in March 2012. The loss recorded during 2011 was related to a charge of approximately \$29 million recognized for the July 2011 conversion of the 15% Convertible Senior Notes due 2013, a charge of less than \$1 million for the 3.5% Senior Notes due 2012 repurchased in August 2011, a \$23 million charge recognized for the portion of the 9.25% Senior Notes due 2014 redeemed in April 2011 and a \$20 million charge recorded in the first quarter of 2011 resulting from the redemption of the 5.25% Convertible Senior Notes due 2011 in February 2011 and the exchange of the 9% Convertible Senior Discount Notes due 2013 in January 2011. See Note 8 - Long-Term Debt, of the Notes to the Consolidated Financial Statements for more details regarding the Company's financing activities.

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

**Other, net** was \$ 54 million and \$ 52 million of expense in the three and nine months ended September 30, 2012 , respectively compared to \$ 1 million of expense and \$ 5 million of income in the same periods of the prior year. Other, net is primarily comprised of foreign currency gains and losses, gains and losses on the sale of non-operating assets and other income. Other, net in the three and nine months ended September 30, 2012 was driven by a non-cash loss on the Company's interest rate swaps agreements of approximately \$60 million that were deemed "ineffective" under GAAP in connection with the refinancing of the \$1.4 billion Tranche A Term Loan. See Note 8 - Long-Term Debt, of the Notes to the Consolidated Financial Statements for more details regarding the Company's financing activities.

**Income Tax Expense** was \$ 13 million and \$ 35 million in the three and nine months ended September 30, 2012 compared to \$ 6 million and \$ 36 million in the same periods of 2011. The income tax expense in 2012 was primarily related to income taxes for Latin American entities acquired as part of the Global Crossing acquisition. The income tax expense during the nine months ended September 30, 2011 is primarily related to an out of period adjustment due to taxable temporary differences associated with certain indefinite-lived intangible assets that the Company is unable to offset with deductible temporary differences.

The Company also incurs income tax expense attributable to income in various Level 3 subsidiaries that are required to file state or foreign income tax returns on a separate legal entity basis. The Company also recognizes accrued interest and penalties in income tax expense related to uncertain tax benefits.

**Income (Loss) from Discontinued Operations** was income of \$ 1 million and a loss of \$1 million in the three and nine months ended September 30, 2011 , respectively. Level 3 sold its coal mining business in the fourth quarter of 2011, and accordingly, reflected the coal mining business as discontinued operations in 2011.

## Financial Condition — For the nine months ended September 30, 2012 and 2011

Cash flows provided by operating activities, investing activities and financing activities for the nine months ended September 30, 2012 and 2011, respectively, are summarized as follows:

(dollars in millions)	Nine Months Ended September 30,		
	2012	2011	Change
Net Cash Provided by Operating Activities of Continuing Operations	\$ 178	\$ 199	\$ (21)
Net Cash Used in Investing Activities of Continuing Operations	(538)	(405)	(133)
Net Cash Provided by Financing Activities of Continuing Operations	234	54	180
Net Cash Used in Discontinued Operations	—	(4)	4
Effect of Exchange Rates on Cash and Cash Equivalents	1	1	—
Net Change in Cash and Cash Equivalents	<u>\$ (125)</u>	<u>\$ (155)</u>	<u>\$ 30</u>

### *Operating Activities of Continuing Operations*

Cash provided by operating activities of continuing operations decreased to \$ 178 million in the nine months ended September 30, 2012 compared with \$ 199 million in the same period in 2011 primarily due to higher interest paid and an increase in the use of cash for working capital items.

### *Investing Activities of Continuing Operations*

Cash used in investing activities of continuing operations increased in the nine months ended September 30, 2012 compared to the same period of 2011 primarily as a result of additional capital expenditures, which totaled \$ 545 million in the nine months ended September 30, 2012 compared to \$ 346 million in the same period of the prior year. The increase was primarily driven by the inclusion of Global Crossing in the Company's results since the acquisition date. The increase was partially offset by a decrease of \$15 million in restricted cash and securities, net in the nine months ended September 30, 2012 compared to a \$63 million increase in the same period in 2011.

### *Financing Activities of Continuing Operations*

Cash provided by financing activities of continuing operations increased in the nine months ended September 30, 2012 compared to the same period of 2011 as a result of greater borrowings net of payments on and repurchases of debt and capital leases during 2012. See Note 8 - Long-Term Debt of the Notes to the Consolidated Financial Statements for more details regarding the Company's debt transactions during 2012.

### *Cash Flows of Discontinued Operations*

Net cash used in discontinued operations was \$ 4 million in the nine months ended September 30, 2011 . The Company completed the sale of its coal mining business on November 14, 2011.

## Liquidity and Capital Resources

The Company incurred a net loss of \$ 366 million in the nine months ended September 30, 2012 and \$ 593 million in the same period of 2011. In connection with its continuing operations, the Company used \$545 million for capital expenditures and \$234 million of cash was provided by financing activities in the nine months ended September 30, 2012 . This compares to \$346 million of cash used for capital expenditures and \$54 million of cash flows provided by financing activities in the same period of the prior year.

Net cash interest payments are expected to increase to approximately \$ 695 million in 2012 from the \$ 576 million made in 2011 based on forecasted interest rates on the Company's variable rate debt outstanding as of September 30, 2012 and the October 2012 incurrence of the \$1.2 billion Tranche B-II 2019 Term Loan under the



amended and restated credit agreement (along with the repayment of the existing \$650 million Tranche B II and \$550 million Tranche B III Term Loans).

Capital expenditures for 2012 are expected to remain relatively consistent as a percentage of revenue with 2011, as the Company invests in base capital expenditures (estimated capital required to keep the network operating efficiently and support new service development) with the remaining capital expenditures expected to be partly success-based, which is tied to a specific customer revenue opportunity, and partly project-based where capital is used to expand the network based on the Company's expectation that the project will eventually lead to incremental revenue. As of September 30, 2012, the Company had debt contractual obligations, including capital lease and commercial mortgage obligations, and excluding interest, premium and discounts on debt issuance and fair value adjustments, of \$ 11 million that mature in the remainder of 2012, \$ 210 million in 2013 and \$ 16 million in 2014.

In October 2012, Level 3 Financing, Inc. refinanced its existing \$650 million Tranche B II and \$550 million Tranche B III Term Loans under its existing senior secured credit facility through the creation of a new Tranche B-II 2019 Term Loan in the aggregate principal amount of \$1.2 billion. The Company used the net proceeds from the Tranche B-II 2019 Term Loan, along with cash on hand, to repay Level 3 Financing, Inc.'s \$650 million Tranche B II and \$550 million Tranche B III Term Loans under the existing credit agreement maturing in September 2018.

In September 2012, the Company fully repaid the outstanding principal of its Commercial Mortgage due 2015 along with accrued interest which was approximately \$63 million.

In August 2012, the Company completed the offering of \$300 million aggregate principal amount of its 8.875% Senior Notes due 2019 in a private offering. The net proceeds from the offering of the notes will be used for general corporate purposes, including the potential repurchase, redemption, repayment or refinancing of the Company's and its subsidiaries' existing indebtedness from time to time.

Also in August 2012, Level 3 Financing, Inc. completed the offering of \$775 million aggregate principal amount of its 7% Senior Notes due 2020 in a private offering. The net proceeds from the offering of the notes, along with cash on hand, were used to redeem all of the Company's outstanding 8.75% Senior Notes due 2017, including the payment of accrued interest and applicable premiums. The Company recognized a loss on extinguishment of debt of \$40 million in the third quarter of 2012 as a result of the redemption of the 8.75% Senior Notes due 2017.

Level 3 Financing, Inc. refinanced its existing \$1.4 billion Tranche A Term Loan under its existing senior secured credit facility through the creation of new term loans in the aggregate principal amount of \$1.415 billion in August 2012. The Company used the net proceeds from the New Term Loans, along with cash on hand, to repay Level 3 Financing, Inc.'s \$1.4 billion Tranche A Term Loan under the existing credit agreement maturing in March 2014 and used remaining net proceeds to repay \$15 million in principal amount plus premium for existing vendor financing obligations. The Company recognized a loss on the extinguishment of debt of \$9 million in the third quarter of 2012 as a result of refinancing the \$1.4 billion Tranche A Term Loan and repayment of existing vendor financing obligations. In addition, in connection with the refinancing of the Tranche A Term Loan, the Company recognized a \$60 million non-cash loss on two interest rate swaps that had previously hedged changes in the interest rate on a portion of the Tranche A Term Loan. See Note 7 - Derivative Financial Instruments of the Notes to Consolidated Financial Statements.

In March 2012, the Company entered into an exchange agreement for a portion of its 15% Convertible Senior Notes due 2013. Pursuant to the agreement, approximately \$100 million aggregate principal amount of Level 3's outstanding 15% Convertible Senior Notes due 2013 were exchanged for approximately 3.7 million shares of Level 3's common stock into which the notes were convertible plus an additional 1.7 million shares for a total of approximately 5.4 million shares. The consideration was based on the market price for these notes which included an inducement premium and included a payment for accrued and unpaid interest from January 15, 2012 through March 15, 2012 of approximately \$2 million. This transaction did not include the payment by the Company of any cash. The Company recognized a loss on extinguishment of \$39 million in the first quarter of 2012 as a result of this exchange of the 15% Convertible Senior Notes due 2013. The transaction will reduce cash interest expense by approximately \$15 million on an annual basis.

In January 2012, Level 3 Financing, Inc. issued \$900 million aggregate principal amount of its 8.625% Senior Notes due 2020 in a private transaction. A portion of the net proceeds from the offering were used to redeem all of Level 3 Financing's outstanding 9.25% Senior Notes due 2014 in aggregate principal amount of \$807 million. The Company recognized a loss on extinguishment of \$22 million in the first quarter of 2012 as a result of the redemption of the 9.25% Senior Notes due 2014. The remaining proceeds constitute purchase money indebtedness under the existing senior secured credit agreement and indentures of Level 3 and will be used solely to fund the cost of construction, installation, acquisition, lease, development or improvement of any Telecommunications/IS Assets (as defined in the existing senior secured credit agreement and indentures of Level 3), including the cash purchase price of any past, pending or future acquisitions.

For information related to financing activities that occurred during 2011, see Item 7 of the Company's Form 10-K, as amended, for the year ended December 31, 2011.

Level 3 had \$ 793 million of cash and cash equivalents on hand at September 30, 2012 . In addition, \$47 million of current and non-current restricted cash and securities are used to collateralize outstanding letters of credit, long-term debt, and certain operating obligations of the Company. Based on information available at this time, the Company believes that its current liquidity and anticipated future cash flows from operations will be sufficient to fund its business for at least the next twelve months.

The Company may need to refinance all or a portion of its indebtedness at or before maturity and cannot provide assurances that it will be able to refinance any such indebtedness on commercially reasonable terms or at all. In addition, the Company may elect to secure additional capital in the future, at acceptable terms, to improve its liquidity or fund acquisitions. In addition, in an effort to reduce future cash interest payments as well as future amounts due at maturity or to extend debt maturities, Level 3 or its affiliates may, from time to time, issue new debt, enter into debt for debt, debt for equity or cash transactions to purchase its outstanding debt securities in the open market or through privately negotiated transactions. Level 3 will evaluate any such transactions in light of the existing market conditions and the possible dilutive effect to stockholders. The amounts involved in any such transaction, individually or in the aggregate, may be material.

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

Consolidation of the communications industry may continue. Level 3 will continue to evaluate consolidation opportunities and could make additional acquisitions in the future.

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

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

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

#### *Interest Rate Risk*

Level 3 is subject to market risks arising from changes in interest rates. As of September 30, 2012 , the Company had borrowed a total of approximately \$ 2.9 billion primarily under a Senior Secured Term Loan (excluding discounts) and Floating Rate Senior Notes due 2015 that bear interest at LIBOR rates plus an applicable margin. As the LIBOR rates fluctuate, so too will the interest expense on amounts borrowed under the debt instruments, unless LIBOR rates are below the minimum LIBOR rate for a particular Senior Secured Term Loan. The weighted average interest rate on the variable rate instruments at September 30, 2012 , was approximately 5.3% .

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



Prior to August 6, 2012 and the refinancing of the \$1.4 billion Tranche A Term Loan, Level 3 had designated the interest rate swap agreements as cash flow hedges on the interest payments for \$1 billion of floating rate debt. However, as a result of the refinancing of the \$1.4 billion Tranche A Term Loan on August 6, 2012, the two interest rate swap agreements that had effectively hedged the interest rate on \$1 billion of floating rate debt were deemed "ineffective" under GAAP. See Note 8 - Long-Term Debt of the Notes to Consolidated Financial Statements for more details regarding the Company's interest rate swaps.

As indicate above, the weighted average interest rate on the \$ 2.9 billion of variable rate instruments at September 30, 2012 , was approximately 5.3% . A hypothetical increase in the weighted average rate by 1% point (i.e. a weighted average rate of 6.3% ) would increase the Company's annual interest expense by approximately \$ 29 million . Declines in LIBOR below the respective fixed minimum rate applicable to a term loan under the Company's senior secured credit facility will not benefit the Company with respect to the variable interest rate on that term loan.

At September 30, 2012 , the Company had \$ 5.9 billion (excluding fair value adjustments, discounts and premiums) of fixed rate debt bearing a weighted average interest rate of 8.9% . A decline in interest rates in the future will not generally benefit the Company with respect to the fixed rate debt due to the terms and conditions of the indentures relating to that debt that would require the Company to repurchase the debt at specified premiums if redeemed early.

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

#### *Foreign Currency Exchange Rate Risk*

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



## Item 4. Controls and Procedures

(a) *Disclosure controls and procedures.* The Company's Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the Company's disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as of September 30, 2012. Based upon such review, the Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective and are designed to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in reports it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

(b) *Internal controls.* The Company completed the amalgamation of Global Crossing on October 4, 2011. The Company is currently integrating policies, processes, people, technology, and operations of the combined Company. Management will continue to evaluate the Company's internal controls over financial reporting as it continues its integration of Global Crossing. There were no other changes in the Company's internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13a-15 or 15d-15 that occurred during the third quarter of 2012 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## Part II - Other Information

### Item 1. Legal Proceedings

For information regarding legal proceedings in which we are involved, see Note 11, "Commitments, Contingencies and Other Items," to our consolidated financial statements included in this quarterly report on Form 10-Q.

### Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. "Risk Factors" in Level 3's Form 10-K, as amended, for the year ended December 31, 2011, which could materially affect Level 3's business, financial condition or future results. The risks described in Level 3's Form 10-K are not the only risks facing the Company. Additional risks and uncertainties not currently known to Level 3 or that it currently deems to be immaterial also may materially adversely affect Level 3's business, financial condition and/or operating results. There has not been a material change from the risk factors included in the Company's Form 10-K, as amended, for the year ended December 31, 2011, except as supplemented by the Company's Quarterly Report on Form 10-Q for the three months ended March 31, 2012 and as stated below.

***If our security measures are breached, or if our services are subject to attacks that degrade or deny the ability of users to access our systems, products and services, we may experience significant legal and financial exposure, our products and services may be perceived as not being secure, users and customers may curtail or stop using our products and services, and our business may be disrupted.***

Network and information systems and other technologies are critical to our business activities. Network and information systems-related events such as computer hackings, cyber attacks, computer viruses, worms or other destructive or disruptive software, process breakdowns, denial of service attacks or other malicious activities, or any combination of the these items, could result in a degradation or disruption of our services or damage to our

properties, equipment and data. We experience cyber attacks against our network and information systems of varying degrees on a regular basis, and as a result, unauthorized parties may obtain access to our data or our customers' data. Our security measures may also be breached due to employee error, malfeasance, or otherwise. Additionally, outside parties may attempt to fraudulently induce our employees or customers to disclose sensitive information in order to gain access to our data or our customers' data. The risk of these systems-related events and security breaches occurring has intensified, in part because we maintain certain information necessary to conduct our businesses in digital form stored on servers connected to the Internet.

While we develop and maintain systems and processes designed to prevent systems-related events and security breaches from occurring, the development and maintenance of these systems and processes is costly and requires ongoing monitoring and updating as technologies change and efforts to overcome security measures become more sophisticated. Despite our efforts, there can be no assurance that unauthorized access and security breaches will not occur in the future. In addition, because the techniques used to obtain unauthorized access, disable or degrade service, or sabotage systems change frequently and often are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures.

Any security breach or unauthorized access could result in significant legal and financial exposure, and damage to our reputation and the market perception of the effectiveness of our security measures, which could cause us to lose customers and could potentially have a material adverse effect on our business and results of operations. Moreover, the amount and scope of insurance we maintain against losses resulting from unauthorized access or security breaches may not be sufficient to cover our losses or otherwise adequately compensate us for any disruptions to our businesses that may result.

**Item 6. Exhibits**

Exhibits incorporated by reference are indicated in parentheses.

- 4.1 Indenture, dated as of August 1, 2012, between Level 3 Communications, Inc. and The Bank of New York Mellon Trust Company, N.A., as trustee, relating to the 8.875% Senior Notes due 2019 of Level 3 Communications, Inc. (Incorporated by reference to Exhibit 4.1 to the Registrant's Form 8-K, filed with the Securities and Exchange Commission on August 6, 2012).
- 4.2 Registration Agreement, dated as of August 1, 2012, among Level 3 Communications, Inc. and Citigroup Global Markets Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated, Morgan Stanley & Co. LLC, Credit Suisse Securities (USA) LLC, Deutsche Bank Securities Inc., and J. P. Morgan Securities LLC, relating to Level 3 Communications, Inc.'s 8.875% Senior Notes due 2019 (Incorporated by reference to Exhibit 4.2 to the Registrant's Form 8-K, filed with the Securities and Exchange Commission on August 6, 2012).
- 4.3 Indenture, dated as of August 6, 2012, among Level 3 Communications, Inc., as Guarantor, Level 3 Financing, Inc., as Issuer, and The Bank of New York Mellon Trust Company, N.A., as Trustee, relating to the 7% Senior Notes due 2020 of Level 3 Financing, Inc. (Incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K, filed with the Securities and Exchange Commission on August 7, 2012).
- 4.4 Registration Agreement, dated as of August 6, 2012, among Level 3 Communications, Inc., Level 3 Financing, Inc. and Citigroup Global Markets Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated, Morgan Stanley & Co. LLC, Credit Suisse Securities (USA) LLC, Deutsche Bank Securities Inc., and J.P. Morgan Securities LLC, relating to Level 3 Financing, Inc.'s 7% Senior Notes due 2020. (Incorporated by reference to Exhibit 4.2 to the Registrant's Current Report on Form 8-K, filed with the Securities and Exchange Commission on August 7, 2012).
- 10.1 Fourth Amendment Agreement to Amended and Restated Credit Agreement, dated as of August 6, 2012, among Level 3 Communications, Inc., Level 3 Financing, Inc., the Lenders party thereto and Merrill Lynch Capital Corporation (Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K, filed with the Securities and Exchange Commission on August 9, 2012).
- 10.2 Amended and Restated Loan Proceeds Note, dated August 6, 2012, issued by Level 3 Communications, LLC to Level 3 Financing, Inc. (Incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K, filed with the Securities and Exchange Commission on August 9, 2012).
- 10.3 Amended and Restated Loan Proceeds Note, dated August 6, 2012, issued by Level 3 Communications, LLC to Level 3 Financing, Inc. (Incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K, filed with the Securities and Exchange Commission on August 9, 2012).
- 12 Statements Re Computation of Ratios.
- 31.1 Rule 13a-14(a)/15d-14(a) Certification of the Chief Executive Officer.
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of the Chief Financial Officer.
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes– Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes–Oxley Act of 2002.

101	The following materials from the Quarterly Report on Form 10-Q of Level 3 Communications, Inc. for the quarter ended September 30, 2012, formatted in XBRL (eXtensible Business Reporting Language); (i) Consolidated Statements of Operations, (ii) Consolidated Statements of Comprehensive Loss, (iii) Supplementary Stockholders' Equity Information, (iv) Consolidated Balance Sheets, (v) Consolidated Statements of Cash flows and (vi) Notes to Consolidated Financial Statements <sup>†</sup> .
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<sup>†</sup> Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

## **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: November 8, 2012

/s/ Eric J. Mortensen

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Eric J. Mortensen

Senior Vice President, Controller and Principal Accounting Officer

## STATEMENTS RE COMPUTATION OF RATIOS

## STATEMENT REGARDING COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES  
(unaudited)

(In millions)	Nine Months Ended September 30,		Fiscal Year Ended				
	2012	2011	2011	2010	2009	2008	2007
Loss from Continuing Operations Before Taxes	\$ (331)	\$ (556)	\$ (786)	\$ (712)	\$ (623)	\$ (312)	\$ (1,167)
Interest on Debt, Net of Capitalized Interest	558	495	716	586	595	570	609
Amortization of Capitalized Interest	—	—	—	—	—	48	68
Portion of rents deemed representative of the interest factor (1/3)	76	52	77	69	68	68	63
(Losses) Earnings Available for Fixed Charges	\$ 303	\$ (9)	\$ 7	\$ (57)	\$ 40	\$ 374	\$ (427)
Interest on Debt	558	495	716	586	595	570	609
Preferred Dividends	—	—	—	—	—	—	—
Interest Expense Portion of Rental Expense	76	52	77	69	68	68	63
Total Fixed Charges	\$ 634	\$ 547	\$ 793	\$ 655	\$ 663	\$ 638	\$ 672
Ratio of Earnings to Fixed Charges	—	—	—	—	—	—	—
Deficiency	\$ (331)	\$ (556)	\$ (786)	\$ (712)	\$ (623)	\$ (264)	\$ (1,099)

**CERTIFICATIONS\***

I, James Q. Crowe, certify that:

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

Date: November 8, 2012

/s/ James Q. Crowe

James Q. Crowe

Chief Executive Officer

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

**CERTIFICATIONS\***

I, Sunit S. Patel, certify that:

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

Date: November 8, 2012

/s/ Sunit S. Patel

Sunit S. Patel

Chief Financial Officer

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



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

In connection with the Form 10-Q of Level 3 Communications, Inc. (the “Company”) for the three and nine months ended September 30, 2012 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, James Q. Crowe, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

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

/s/ James Q. Crowe

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James Q. Crowe

Chief Executive Officer

November 8, 2012

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

In connection with the Form 10-Q of Level 3 Communications, Inc. (the “Company”) for the three and nine months ended September 30, 2012 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Sunit S. Patel, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

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

/s/ Sunit S. Patel

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Sunit S. Patel

Chief Financial Officer

November 8, 2012